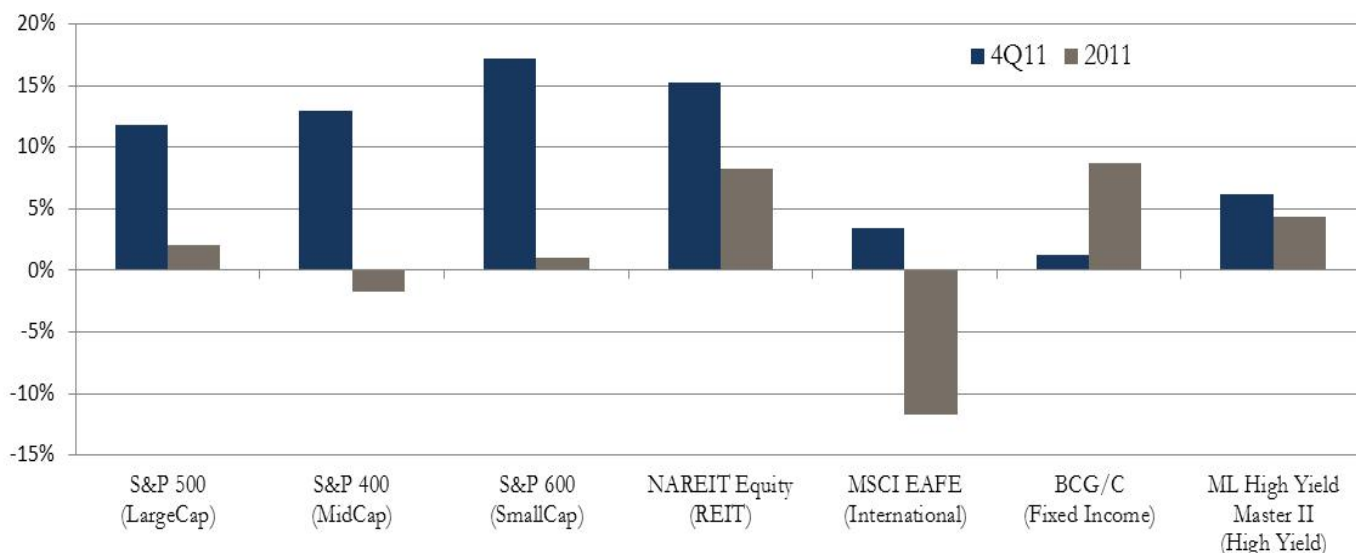




4th Quarter 2011 Review

Market Overview



Market Performance

The year 2011 will be remembered for many things, but investors will likely focus on the market's volatility. A lack of confidence in political leadership in the US and Europe created extreme levels of volatility, which was the key theme for the year. When coupled with fears about the macro-economic environment, asset prices became highly unpredictable. This crisis of confidence hindered business and consumer spending, and the S&P 500 traded in a volatile 21% range over the year while 10-year Treasury yields fell 200 basis points. Earnings growth, however, remained strong, as S&P 500 corporate profits rose at a consistent double digit rate. Interestingly, despite all the angst felt during the year, stock market indices effectively ended the year unchanged.

The market rebounded in the 4th quarter as strong earnings growth, improved US economic data, and optimism surrounding the European debt crisis encouraged investors. Better data on housing & employment, and stronger than expected consumer spending convinced investors that the US was not heading into a double dip recession, while S&P 500 earnings posted another double digit year-over-year growth rate during the 4th quarter, confirming a positive outlook for US corporations. European leaders continued to propose and debate plans to mitigate the risk of a financial crisis precipitated by default of sovereign debt, and although the details of their plans were largely met with skepticism, the consensus seemed to be that EU leaders were at least on a path that will prevent the situation from deteriorating further over the coming year. Importantly, despite the many concerns that persisted as the year ended, the improvement in sentiment over the final 3 months of the year was encouraging.

Economic data was fairly robust as the year came to a close, and had many believing that 2012 growth could surprise on the upside. Specifically, the four week average of weekly unemployment claims was anchored below the important 400,000 level, housing starts and pending house sales were in an uptrend, and holiday sales were better than expected. Also, home affordability was at an all-time high while the credit card delinquency rate had plunged to a record low.

As a result of moderation in the growth rates of emerging markets, commodity prices were generally well-contained during the quarter. Crude oil, however, was the notable exception as it rose to \$100/bbl. on fears of supply disruption. Gold prices fell below \$1600/oz. as investors began to question the sustainability of the rapid appreciation of the precious metal.

Domestic Equities

In the equity market, fear and volatility led investors to favor sectors with defensive characteristics, specifically Utilities, Consumer Staples, and Health Care during 2011. The best performing sectors during the fourth quarter included Energy, Producer Durables, and Materials & Processing, as economically sensitive stocks with global exposure rebounded nicely due to the renewed optimism about the global economy. Financial Services stocks also performed well, as the announcement of a new stress test for US banks and recapitalization/funding plans for European banks produced hope that a financial crisis will be averted. The worst performing sectors were those that led the market during the previous quarter, specifically the defensive Consumer Staples and Utilities sectors. In addition, although macro fears continued to impact stock price performance, earnings and company fundamentals were much more important factors for investors than during the 3rd quarter.

International

International equity markets were volatile during the fourth quarter, ultimately ending slightly positive for the period. A mix of positive and negative factors buffeted markets. Corporate earnings in 2011 generally met or exceeded expectations, highlighting corporate resilience despite macroeconomic headwinds. Concerns over slowing world growth and sovereign debt problems in Europe were prevalent during the quarter, although the mid-December announcement of a European Central Bank (ECB) plan to provide liquidity to banks heartened markets as it signaled ECB readiness to backstop the banking system. Emerging markets performed well in the quarter due to lessening fears related to Europe's debt crisis and on China easing monetarily to avoid a hard landing.

During the quarter, sector leadership was mixed as two traditionally defensive sectors, Consumer Staples and Health Care, outperformed as investors sought safety amid market volatility. Among cyclical sectors, Energy was the best performer as it benefitted from the rising price of oil, and Industrials also outperformed. Among the worst performing sectors were Utilities and Financials. In currency markets, the euro declined against the U.S. dollar as investors remained concerned about the sovereign debt crisis. However, the Australian dollar and the Canadian dollar strengthened relative to the U.S. dollar due to the improved outlook for these resource-based economies.

Fixed Income

During 2011, fixed income investors were not immune to the stock market's gyrations, and benefitted from a flight to safety trade. Treasuries surged as investors fled the stock market in search of the perceived safety of fixed income securities and as the Federal Reserve maintained its commitment to low interest rates via "Operation Twist" and a continuation of a zero Fed Funds rate. As a result, the 10-year US Treasury produced a 15% return and the 30-year Treasury gained over 35%. The Federal Reserve maintained its commitment to a zero Fed Funds rate at least until mid 2013, but did not embark on a third quantitative easing program, as many had hoped for. However, the turnover on the FOMC in 2012 is likely to result in a membership that is more willing to provide monetary accommodation to the economy if they deem it necessary. Globally, there have been roughly 50 central bank easings since August, including many by governments in emerging market nations. This is a sign that liquidity will not be a problem as we continue to work through the aftermath of the 2008 recession.

In a dramatic change from the extreme volatility experienced over the first three quarters of 2011, interest rates ended the fourth quarter largely unchanged. Events in Europe were once again a constant source of anxiety, but a series of better than expected economic reports, especially on the U.S. labor front, provided a modest source of relief for investors. At both their November 2nd and December 13th meetings, the Federal Reserve once again reiterated their commitment to keeping short interest rates at 0% for the foreseeable future, and signaled that additional policy responses would be considered as needed. In response, investors sought out duration and once again embraced risk, causing credit spreads to tighten over the final three months of the year.

While more modest than in the third quarter, positive returns were once again the norm in the fourth quarter. After being the star performer all year, Treasury securities took a back seat to corporate bonds in the fourth quarter as investors sought an alternative to the record low yields offered by government securities. However, with a gain of approximately 2% in the final period and over 35% for the year, the 30-year U.S. Treasury bond easily remained the top performer for all of 2011. Commercial mortgage backed securities, along with long duration corporate bonds from the Industrial and Utility sectors generated the highest returns in the fourth quarter, gaining almost 4%. Floating rate mortgage bonds and short duration Treasuries provided the bottom performers for the period.

**For more information, please contact Randy Root at 214.756.6980 or rroot@westwoodgroup.com or Art Burtscher at 402.393.1300 or aburtscher@westwoodgroup.com
Previous newsletters can be found by visiting www.westwoodgroup.com under Newsletters & Commentary.**