CAUBLE & HARRE WEALTH MANAGEMENT

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I attended the Grand Ole Opry recently and was struck with a couple of things. The first was the apparent respect that the artists had for each other, even across generations. I was left with the impression that these musicians shared life together, young and old. I don't think that this was solely paying respect to your elders, because the musicians of the older generation were also gracious to the younger ones. This aspect of this sub-culture, if I can call it that, makes it very resilient and stable over time. There is something good happening here that should be studied.

The other thing I thought about was the determinants for success as an artist, songwriter or musician. The raw talent that occurs in people, talent that can be developed into something unique, seems to occur in people randomly. In other words, connections, family of origin or money won't help you. What is required is the gift, and it cannot be predicted where this talent might occur.

If we each have talents, and we all developed those talents to their fullest ability, I would think that our world would be a better place. To the extent that something kept us from fully developing our talents, the world as a whole would be less well off. Take this thought and consider the economic status of all the countries in the world, rich and poor, current and historical. Are there systems or practices that keep their people from developing their talents?

Can we look at our own country's amazing rise to prosperity over the last 70 years and ask if it was tied to our citizens' ability to develop their own talents fully? If you invest on the basis of something other than talent, does the investment work out well? Why are there so few companies that survive over multiple generations? Perhaps the next leader is selected based on the family name and not talent. Will a system that divides the spoils based on political affiliation, or worse yet, corruption be as successful over time as one that divides resources based on talent?

Any one system, whether a country, company, state, city or church probably has a mix of all of these allocation schemes (based on politics, payoffs or talent). The ones that flourish are those where the allocation of investment is based more on talent. Yes, all this came from a songwriter born into a family unconnected with the music industry that was gifted in their ability to communicate and born in a system where that could be developed.

2012 continued the rally that began in the fall of 2011, with the S&P500 appreciating about 12%. Earnings gains for companies were a part of this as was a rise in the market multiple. To some extent, I could repeat most of my January letter at this time. Europe is past the immediate crises and on to the next phase of restructuring. China weakness is a question. Iran is a question. These

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will likely keep Price Earnings ratios lower than in the past but we have seen a healthy increase so far this year.

We should enter a period of slower earnings growth. Expectations for the current quarter have declined over the last year. In April of 2011, analysts expected 2012 Q2 earnings to have increased 15% year over year. Their current expectation is for earnings to increase less than 1%. The current expectation is for there to be acceleration in earnings growth later this year. When markets release their Q1 earnings over the next few weeks, they will give guidance for the year. This will impact the analysts' thoughts. Given the lower growth currently, if future expectations are curtailed, it could cause some problems in the equity markets.

The challenging aspect of investing today is that I believe we are in unchartered waters. This means that the way the markets behaved or reacted in the past few decades may not help in figuring out what might happen today. The amount of government debt and the pace at which it is growing is the issue. Unless our government becomes fiscally responsible, the impact on returns could be devastating.

It is impossible to know the timing of any of this. Maybe something happens this year, maybe in five years. I don't think it is wise to assume that the worst will happen at any specific time. It is a risk factor that needs to be monitored. I just read an article that mentioned that the Federal Reserve purchased 61% of all Treasury issuance last year. In the past, they would buy near zero. What happens to interest rates if this buyer leaves the market? China and Hong Kong were net sellers of Treasuries at the end of last year and the beginning of this year. This trend bears watching.

Is a rise in interest rates bad for markets? Good question. After rates rise, we could buy bonds and get better returns. This would be good for all the savers out there that have been suffering from the financial repression being imposed by the Federal Reserve and other central banks around the world. If the rise in rates is moderate, it should have limited impact on the markets over time. Especially if it reflects a lesser need for government intervention due to a growing economy. If the rise is due to a falling confidence in Treasuries as a store of value, it would be bad for stock returns.

As always, we will try to keep abreast of these issues. Please call with any questions or concerns.

Sincerely,

Peter B. Harre, CFA.