CAUBLE & HARRE WEALTH MANAGEMENT

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It seems hard to believe, but with the end of 2012 now behind us, Cauble & Harre Wealth Management, Inc. has completed its 5th full calendar year of operation. We are very appreciative of our clients and the trust you place in us. Our growth as a firm has been steady through the years. Certainly one major milestone was the addition of Mary last year.

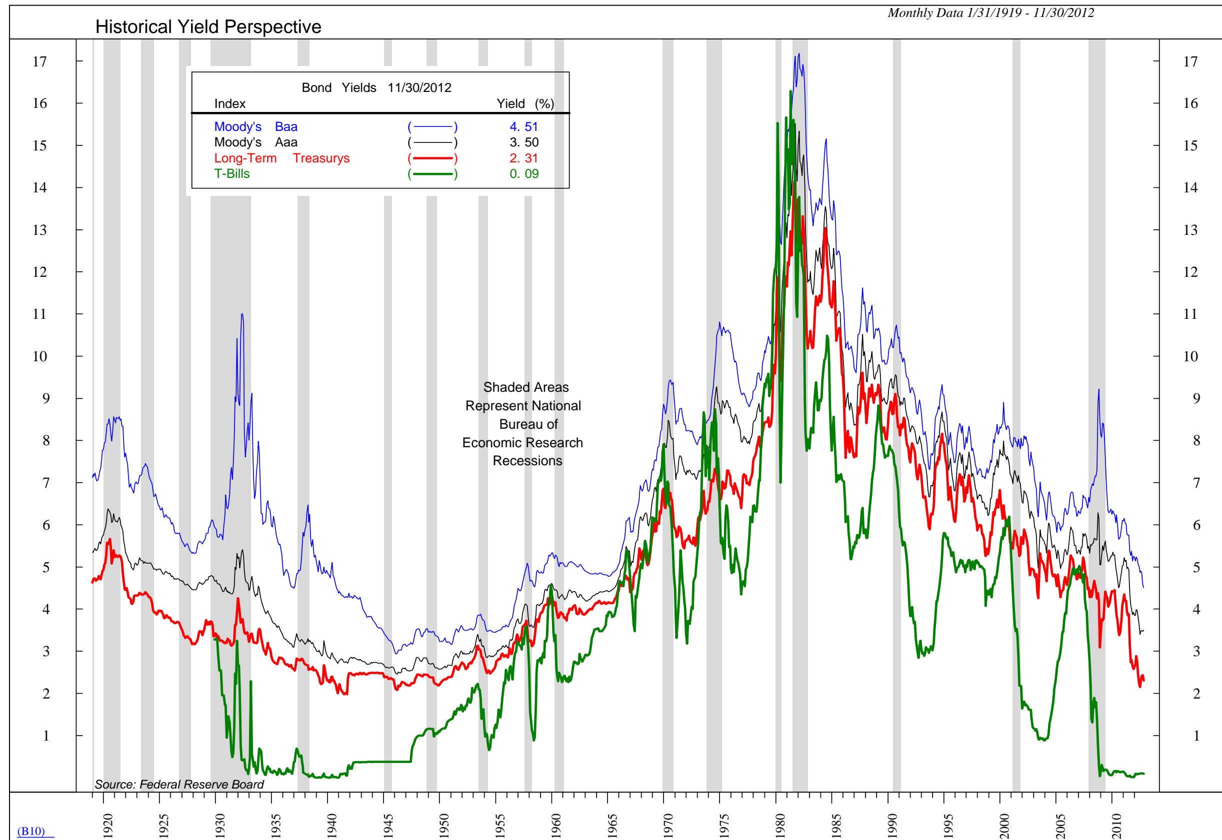
As a firm, growth is obviously important to us over time. Different firms have different opinions on how they should spend their time on their business. The choices are: delivering services to clients, spending time on operations, or marketing and growing the business. I know that some firms are essentially marketing firms that spend most of their time and energy gathering assets and putting them in cookie cutter investments. Liz and I have spent the vast majority of our time on delivering services to our clients and on our operations (certainly related areas). Despite our lack of attention to sales and marketing, our clients have found us over time, some through referrals from current clients, which we always appreciate. There is a rumor that you might see an advertisement this year from us. Rest assured that we remain committed to delivering our service to our clients.

When I decided to join Liz in starting CHWM, I knew I wanted to spend more of my time creating investment strategies and having the independence to do so. I had no idea what the market had in store for me. There have been plenty of opportunities to try to figure out what was going on and what to do about it. I remember in 1995, the market seemed to rise about 3% per month all year. I cannot remember what I worried about then.

Our goal for the investment portfolios we manage is to generate a certain real rate of return over time (this is the return left after inflation). The way we do this is to invest across different asset classes. The combination of investments selected is connected to certain risk profiles or expected volatility. This real return target is identified in the Investment Policy Statement, and for many of you, also connected to a financial plan.

I would describe today's investment environment as quite challenging. There are opportunities and potentially great risks over the next five years. One example of this is shown in the following chart:

Historical Bond Yields



This chart shows the decline in bond yields over the last three decades. I do not know if yields will rise sharply over the next 12 months. They may stay at current low levels for some time. I do not think that rates will continue to fall over the next ten years. This is a quite different environment than we have experienced for the last 30 years. This change will flow through to a lot of other markets.

A trait that I think is important for an investment manager to have is flexibility. By this, I mean that due to the current environment, I question whether any historical 'model' or 'shortcut' will be helpful to us in attempting to manage uncertainty about the future. One quick example of this: A few years ago, an international bond fund had an investment restriction of only investing in foreign government bonds. It marketed this fact as a benefit to conservative investors. Unfortunately, during 2008 and 2009, these are the bonds that you did not want to own. This 'shortcut' of an investment restriction did you no favors.

Having a broad market mandate can be an attractive tool for a manager in today's climate, if they know what to do with it. As you know, portfolios that we put together can include mutual funds, exchange traded funds (or ETF's) and individual securities.

One mutual fund annual report I was reading recently (held in a majority of accounts) cited as beneficial to returns for the last year a lower exposure to Japanese bonds and a higher exposure to Mexican bonds. A lower relative exposure to the Euro currency was also mentioned as helpful. This same fund disclosed a combined exposure to Sweden and Poland of a little over 8% of assets.

I mention this to give you an idea on the type of decisions that are being made inside of your accounts. I make the decisions with regard to the individual securities and the allocation decisions on how to invest with the other managers of the mutual funds and ETFs. Together, the goal is to generate real returns, over time, using liquid investment securities representing exposure across the world.

The U.S. markets, being the home country for all of you, are typically pretty important. 2012 was a decent year for the U.S. The U.S. economy has been growing for a number of years now. Corporate earnings have been rising, and the P/E multiple has been stable to rising as well. The Commerce Department recently revised U.S. GDP for the third quarter from 2.7% to 3.1%. Personal Income has been growing. There are definite signs that the housing market has bottomed and is beginning to recover.

With any clarity provided to the markets from Washington regarding the rules/taxes/regulations that will be in effect, we could see more investment funds flowing into equity markets. Note that this fall, companies began holding back on investment. Companies that might have had 10 projects to invest in have been waiting to know what the rules of the road were going to be, or what the costs were going to be before investing.

Knowing the rules, even if they suggest higher costs and lower returns, could very well begin the process of funding some of these projects. This would generate more economic activity, and would support increasing levels in investment in equities. The case for some rotation from fixed income into stocks does make sense to me in 2013.

At the same time, there are economic statistics that suggest that this is a materially substandard recovery in terms of employment gains and production gains. Employment improvements can happen with business investment. Perhaps clarity from Washington can help with this area as well.

My primary concern for the domestic markets will likely take some time to play out. I believe that the government of this country has a spending problem. One does not need to listen to rhetoric to determine this. They only need to look at what the government spends versus how much revenue it collects, and the amount of debt relative to the economy. It doesn't add up.

When Bear Stearns collapsed in 2008, it was following all the rules and regulations put into place by the rule makers. If fact, it had $2.0 billion of extra capital based on the standards in place at the time. That did not stop it from collapsing. It didn't matter what

the leaders said was okay. The market determined that it wasn't and acted. Bear Stearns put itself into a position where it lost control of its destiny.

Current estimates suggest that the U.S. Government will borrow an additional $7 trillion over the next 10 years. Current estimates do not say who will buy all these Treasuries or at what price. At some point, it won't matter what our leaders in Washington want or demand. They will no longer be in control. The market will decide. If we cannot deal with our problem, we will put ourselves in a position where we lose control and the markets will force us to make harsher decisions. The U.S. is different than all other countries. We can get away with more fiscal irresponsibly than other countries before we are held to account. When will that be? I don't know. It is difficult to act today on something that might happen in 2015. It is appropriate to look for signs of trouble, and to consider what courses of action make sense at that time.

As someone trying to earn real returns across asset classes, I suppose it is frustrating to me because of the difference between what I believe is possible in this country and where I think we are headed. I do believe that there will be opportunities in this country and across the globe to generate returns. Our job is to find those opportunities.

Assuming our lenders remain comfortable with us as a creditor, we have a good chance to see positive returns for this year. Any rotation from fixed income to equities will support this move. There is not a lot of enthusiasm in stocks these days. I see this as a bullish condition for additional gains.

As always, we will keep our eyes open for risks and opportunities. For those of you that like to be prepared, you might look into that asteroid (40 meters in diameter I think) that is supposed to pass within 20,000 miles of earth on Feb 15. Apparently, this is the orbital distance of quite a few communication satellites. Hopefully, they can adjust their orbits if necessary. If you are a satellite TV customer, you might take note.

Sincerely,

Peter