ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook — Fourth Quarter, 2011

INDEX	4th Qtr, 2011	Full Yr. - 2011
US STOCKS		
S&P 500 Index (large-cap stocks)	11.82	2.11
S&P 500 Growth Idx (lrg-cap "growth" stocks)	10.81	4.66
S&P 500 Value Idx (lrg-cap "value" stocks)	12.98	(0.49)
Russell 2000 Index (small-cap stocks)	15.47	(4.18)
FOREIGN STOCKS		
MSCI EAFE Index (developed foreign markets)	3.33	(12.14)
MSCI EMU Index (European Monetary Union)	2.25	(17.64)
MSCI Emerging Markets Index	4.42	(18.42)
MSCI BRIC Index (Brazil, Russia, India, China)	4.22	(18.44)
PRECIOUS METALS		
London Gold PM Fix	(5.49)	8.93
London Silver Fix Price	(7.45)	(8.00)
BONDS		
BarCap US Aggregate Bond Index (investment-grade bonds)	1.12	7.84
BarCap US 20+ Yr Treas Bond Idx (long-term US treasuries)	1.83	33.84
S&P Nat-l AMT-Free Muni Bond Index (municipal bonds)	2.10	11.22
iBoxx Liquid High Yield Index (high-yield/"junk" bonds)	7.98	5.94
iBoxx Liquid Investment Grade Idx (inv.-grade corp. bonds)	2.58	9.15
S&P/Citi Intern'l Treas Bond Index Ex-US (foreign bonds)	(3.00)	(0.06)

Source: iShares.com

In early 2011, after two years of strong stock market gains, we noted that:

> *While there is historical precedent for three consecutive years of post-recession gains, large first- and second-year returns have tended to be associated with lower third-year returns.*

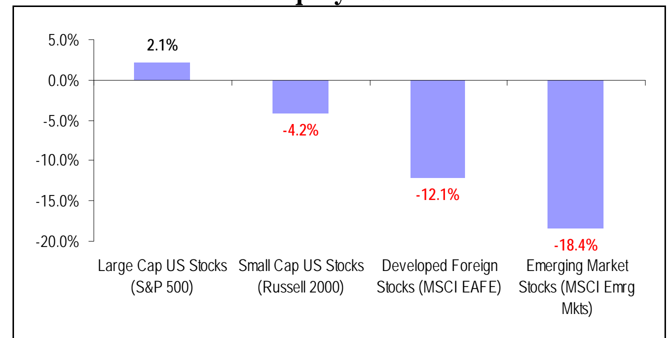
After doubling off the March 2009 low, the cyclical rally in US stocks did, indeed, stall in mid-2011, buffeted by the intensifying debt crisis in Europe and slowing growth in emerging economies. The "flattish" return for the S&P 500 (+2.1% for 2011) masked what was one of the more volatile years in its history (Exhibit 1).

Exhibit 1: S&P 500 During 2011

Source: eSignal

US large-company stocks were, however, a case of the best house in a bad neighborhood. As shown in Exhibit 2, despite a relatively flat absolute return, the large-cap US equity sector was nonetheless the lone bright spot in an otherwise dismal year for global equity markets.

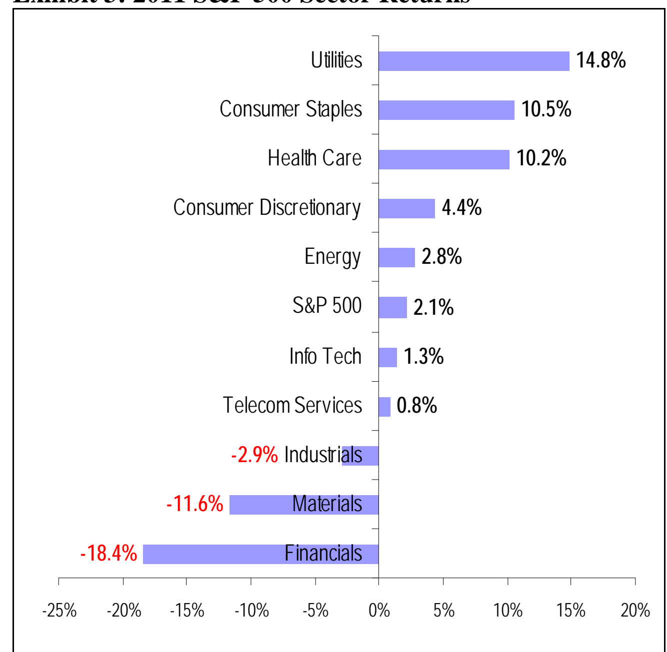
Exhibit 2: 2011 Broad Equity Market Performance



Source: iShares.com

Even after the fourth-quarter stock market rebound, several indexes closed the year more than 20% below their 2011 highs. This made it very difficult for a globally diversified equity portfolio to generate positive returns for the year. Even hedge funds – as measured by HFRX Global Hedge Fund Indices – posted negative returns for the year (between -3.6% and -19.1% depending on the category). The best spin we can put on the broad-based equity market weakness is that it has served to reestablish better value.

Exhibit 3: 2011 S&P 500 Sector Returns

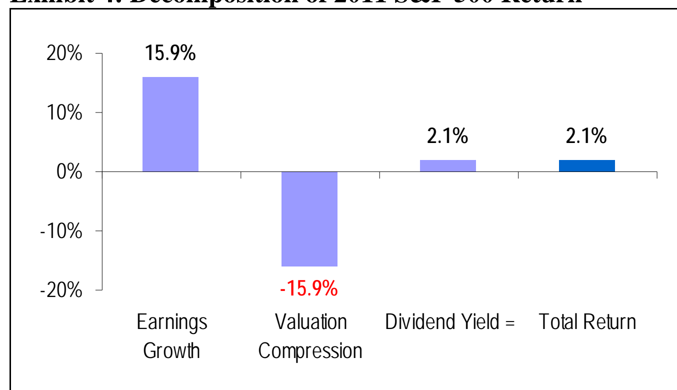


Source: Standard and Poors

Within the US market, defensive sectors (utilities, staples and health care) generated the strongest returns by a wide margin (Exhibit 3). These three best performing sectors represent only 27% of the index. In other words, even the S&P 500 traded much more bearishly than its slightly positive return for the year would suggest. This is further evidenced by the fact that among the 4,100 or so mutual funds that invest in large-cap stocks, only 17% outperformed the S&P 500 for the year – the least since 1997.

At the root of the US large-cap stock market resilience was the persistence of strong US corporate profitability. All told, S&P 500 operating earnings grew roughly 17% in 2011, setting a new all-time high in the process. In contrast, valuation multiples moved in the opposite direction as investors worried about the durability of earnings in the face of countless headwinds. This tug of war between resilient earnings on the one hand, and uncertainty over the macro environment on the other resulted in a total return for the S&P 500 equivalent to its dividend yield (Exhibit 4).

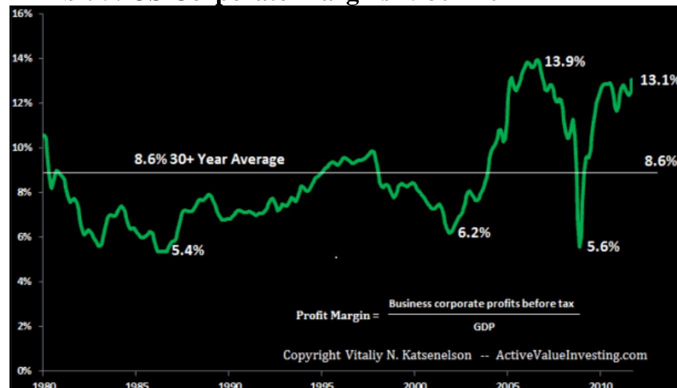
Exhibit 4: Decomposition of 2011 S&P 500 Return



Source: Goldman Sachs

The improvement in valuations should help support stocks as profit margins – which are at very high levels and are historically mean reverting (Exhibit 5) – grow at a slower rate going forward as the scope for additional productivity-enhancing, cost-cutting exercises is now more limited and earnings performance will be dictated more by sales growth.

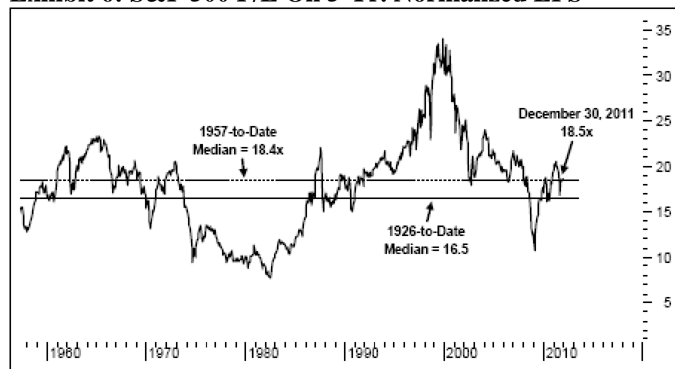
Exhibit 5: US Corporate Margins 1980 - 2011



Source: ActiveValueInvesting.com

There are countless methods of measuring the overall attractiveness of stocks. Currently, many such measures point to neutral- to attractive-valuation. For example, the Price/Earnings (P/E) ratio on a five-year normalized basis for the S&P 500 is 18.5, just above its 1957-to-date median of 18.4 (Exhibit 6).

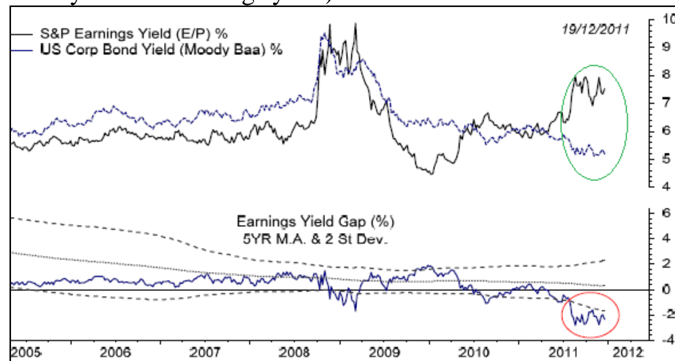
Exhibit 6: S&P 500 P/E On 5-Yr. Normalized EPS



Source: The Leuthold Group

Relative to very low bond yields (interest rates) and inflation expectations, valuations look even more compelling. Exhibit 7 below illustrates the US corporate bond yield (Moody's Baa) and the S&P 500's earnings yield (earnings/price). The gap between the two is significant and argues strongly in favor of stocks. While no single indicator is worth betting the farm, this one has historically provided good signals for market entry points.

Exhibit 7: S&P Earnings Yield Gap (difference between bond yield and earnings yield)



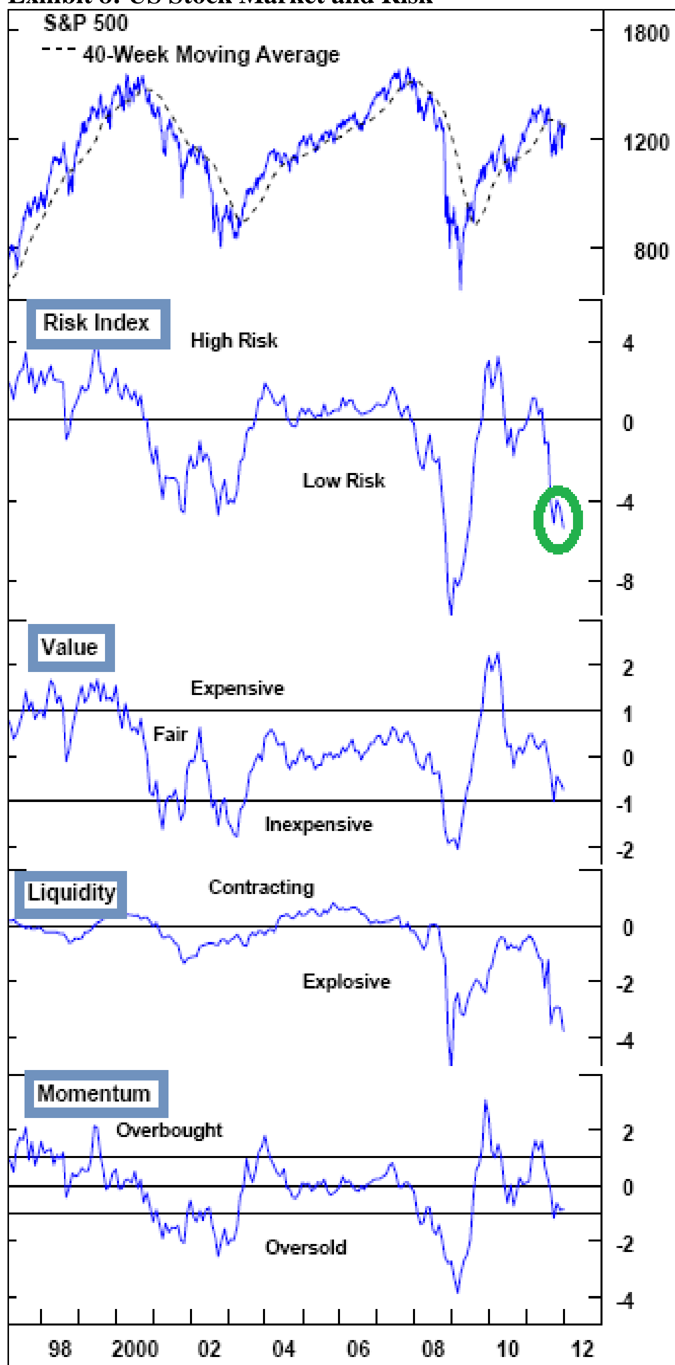
Source: Thomson Reuters Datastream/Boeckh Investment Letter

As a third example, an overall Risk Index (Exhibit 8) that incorporates measures of valuation, liquidity and momentum is illustrated on the next page. Its message is that stocks are cheap, liquidity is plentiful and momentum is stabilizing at oversold levels.

Overall, many of the measures traditionally used in forecasting market returns argue in favor of a bullish outlook. This, combined with the market's recent strength is serving to rebuild investor confidence from the depths of despair just a quarter ago. Indeed, the consensus outlook by

Wall Street strategists is for a year-end S&P 500 value of 1,348 (a gain of around 9% including dividends for 2012).

Exhibit 8: US Stock Market and Risk



Source: BCA Research

That being said, we can't help but wonder if investors are ignoring the fact that none of these measures or models account for or recognize that:

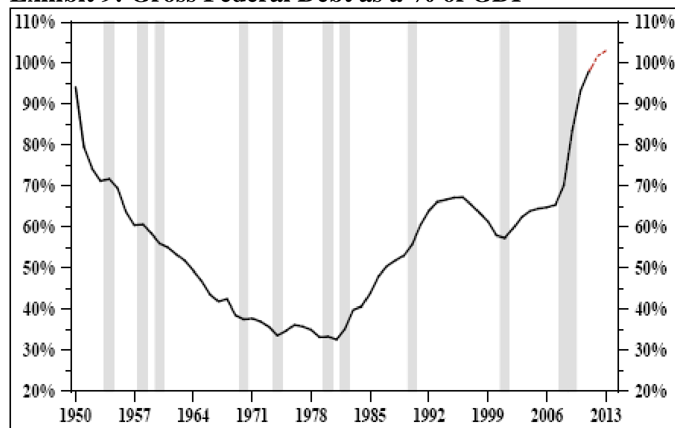
1. The euro zone is engulfed in a severe debt crisis; and
2. Interest rates are being held artificially low through central bank manipulation.

We remain skeptical about the outlook given the current environment, but acknowledge that an ultimate period of reckoning is unlikely for the time being as the authorities strive to avoid even the smallest of downward adjustments in their effort to get something for nothing and to shift the costs laterally in geography and demography via fiscal policy, and forward in time via monetary policy.

Longer term, there is some basic math related to the sustainability of sovereign debt that will eventually exert itself:

- Once sovereign interest rates climb above the likely GDP growth rate, the debt burden sooner or later overwhelms the state. By this measure, the so-called PIIGS (or GIPSIs) are already above the danger zone.
- As the US enters 2012, the gross government debt-to-GDP ratio stands near 100% (Exhibit 9). It has been shown that when a country's gross government debt raises above 90% of GDP "the median growth rates fall by one percent, and average growth falls considerably more" (National Bureau of Economic Research Working Paper No. 15639 of January, 2010, *Growth in the Time of Debt).*
- When a nation's debts become many multiples of its government revenues, a non-linear relationship develops that becomes insurmountable because expenses grow faster than revenues even in inflationary or growth environments.
- Since 2002, total global credit market debt (public debt securities + private debt securities + bank assets) has grown at more than an 11% compound annual growth rate from $80 trillion to around $200 trillion. Over the same time, global real GDP has grown by around 4% annualized.

Exhibit 9: Gross Federal Debt as a % of GDP



Source: Congressional Budget Office and Hoisington Investment Mgmt Co

It seems that we – as a society – have been programmed to believe we will always be saved from default. Investors in today's sovereign debt markets actually seem to believe hard

defaults cannot occur because it is against the interest of too many powerful parties.

Ultimately though, our view is that lending schemes designed to lend more into an intractable debt problem are destined to fail and government intervention is only delaying the inevitable. When these events actually transpire, investors will be forced to accept enormous losses.

For now we expect more of the same: the investment environment will continue shifting from one extreme to another. Consider for example that in one month investors were willing to lend money to Italy for ten years at interest rates below 5%; the next month 7.25% is insufficient. We go from one state to another with almost nothing in between.

During the second-half of 2011, European bank dependency on the European Central Bank increased massively. During this period, French and German bank stocks declined around 40% and there were mass downgrades of European bank debt. Ultimately, there will likely be some form of climax – possibly the rollover of European debt over the next year-or-so as there is more than 457 billion euros of euro zone government debt due to be repaid in the first quarter of 2012 alone. Italy has to repay almost 113 billion euros in the next three months at a time when its funding costs remain at near unsustainable levels. Confidence is fading as European authorities dither through endless summits, deadlines and "senior consultations".

STRATEGY

As usual, the outlook is incredibly uncertain. Many traditional measures imply an environment conducive to strength in "risky" assets. These measures don't, however, recognize factors like stress in the European banking system, below trend economic growth in most of the developed world as a result of austerity and deleveraging, a worsening fiscal picture and the central bank intervention currently at play.

Against this backdrop, volatility is likely to remain historically high. Our strategy in this environment is to:

- invest relatively conservatively from an overall asset allocation perspective
- underweight sectors and asset classes we believe have poor risk/reward profiles
- overweight sectors and asset classes we believe have strong risk/reward profiles
- use market weakness to add to our favored areas
- use market strength to tactically reduce appreciated positions

Within US equities, we have gotten increasingly underweight small-cap stocks and are focusing on US large-caps instead. Within this asset class, we are emphasizing quality, yield and value.

Exhibit 10 summarizes some earnings and valuation measures for the ten sectors of the S&P 500. Our current emphasis is on the three highlighted sectors (health care, energy and technology) as these appear to be selling at significant discounts and have depressed earnings growth outlooks (a contrary indicator as earnings are more likely to surprise to the upside when expectations are low).

Exhibit 10

Sector	12 Month Forward Earnings Growth Expectations (%)	Forward P/E Ratio		
		Current	Historical Mean	Ratio
Financials	23.8	10.0	12.8	78.1%
Industrials	13.0	12.6	16.6	75.9%
Cons Discretionary	12.2	14.0	18.2	76.9%
Materials	10.4	11.7	15.7	74.5%
S&P Total	**9.8**	**12.0**	**15.0**	**80.0%**
Technology	9.0	11.9	22.7	52.4%
Telecom	8.7	16.6	17.1	97.1%
Cons Staples	8.1	14.5	17.7	81.9%
Health Care	4.5	11.5	18.8	61.2%
Energy	2.4	10.4	15.3	68.0%
Utilities	(2.1)	14.3	13.3	107.5%

Source: Thomson Reuters / IBES and BCA Research

Health Care – This sector is cheap by most valuation yardsticks as well as by non-conventional metrics such as market capitalization relative to health care outlays as a share of GDP. Further, consumer spending on health care is climbing relative to total overall consumption and improvement in the labor market points to more gains ahead.

From an external standpoint, deflationary economic undertones are good for this group, in relative performance terms, because health care costs are sticky. Moreover, health care stock valuations have a history of being lifted during periods of elevated broad market volatility. Dividend yields within the sector exceed yields on most competing investment alternatives which should provide support from income-oriented investors.

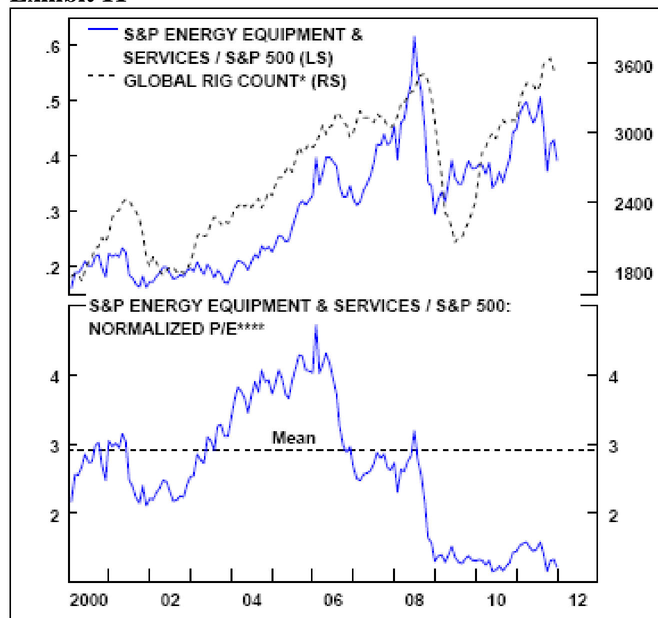
Energy – We view this group as having a clear path to long-term revenue growth given the developing world's price-inelastic demand for crude oil and a rising geopolitical risk premium. The increasing technical challenges of accessing tight reserves and deeper offshore wells are a strong long-term pricing power tailwind for energy service stocks in particular.

Exhibit 11 (top panel) illustrates that the global rig count has expanded in line with rising oil prices and has made new all-time highs. Energy service stocks have, however, not kept up with this growth in rig count. We believe this divergence is unsustainable. Further, we do not believe that currently depressed valuations will be sustained (Exhibit 11, bottom panel).

Technology – The technology sector has one of the most attractive valuation profiles among the ten S&P sectors. Based on 12-month forward earnings growth expectations, the sector's forward price/earnings ratio of 11.9 is around

half its historical mean of 22.7. Additionally, the sector has a strong overall balance sheet and cash flow profile. And unlike other cyclical sectors, the tech sector was much more cautious in terms of expanding over the past decade. Additionally, its cyclicality has been reduced.

Exhibit 11



Source: BCA Research
**Global Rig Count source: Baker Hughes, Inc.*
*****Normalized P/E based on 10-yr. moving average of earnings per share*

A word on gold – Gold corrected during the second half of 2011 and a number of analysts pronounced the gold bull market officially dead. We believe this is unlikely and used the pull-back to initiate/add the asset class to our clients' portfolios.

We view gold as more of a currency than a consumable commodity like oil and copper. In an environment where few currencies offer attractive fundamentals, and given the poor state of global monetary and fiscal affairs, we believe gold will be looked upon as the only sound currency as holding paper money is almost guaranteed to be a losing proposition.

We cannot rule out further weakness in gold in the near-term as it has advanced significantly over the last decade and will continue to be highly volatile. However, from a fundamental, medium-term perspective, we don't believe the main factors driving gold's bull market have changed.

Bond markets in 2012 will continue to be influenced by most of the same themes that we witnessed in the second-half of 2011. Sluggish economies, fiscal austerity and European risks remain the key drivers. Monetary policy will stay extremely stimulative in all of the developed markets to promote growth in the still weak post-crisis recovery.

So far, central bankers' hopes for credit channel improvements have been slow to develop. This has held back growth and reduces the risks that the monetary stimulus becomes inflationary.

We anticipate developed market monetary policy will stay stimulative throughout 2012. In fact, there is a good chance more intervention is coming because central planning intervention has become dependent on additional intervention in order to sustain itself. If this is the case, the near-term outlook for risk assets should be positive and we intend to use any near-term weakness to add to our favored areas.

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