ACCESS FINANCIAL SERVICES, INC.

Quarterly Review and Outlook — Fourth Quarter, 2012

Politics dominated the headlines in the fourth quarter, with the biggest news being the presidential election. Despite some pre-election polls predicting a tight race, the results were largely one-sided as President Obama had little trouble retaining the White House. While this triggered a short-term sell-off in US stocks, the decline was short-lived. Obama's victory brought greater clarity on certain issues, such as Obamacare, but brought up uncertainty on other issues, such as the fiscal cliff.

As expected[1], the so-called "fiscal cliff" (self-inflicted) was avoided, but the really tough decisions were punted for another two months. The "deal" resulted in taxes increasing on individuals and couples earning over $400,000 and $450,000, respectively. Capital gains taxes and estate tax rates will also increase for "high income" individuals, and the value of personal exemptions will also be limited for the better off. The elimination of a 2% payroll tax cut will impact all income earners and will likely take a toll on economic growth this year. The longer-term impact of the deal is questionable at best and the issue of spending cuts was deferred.

Exhibit 1

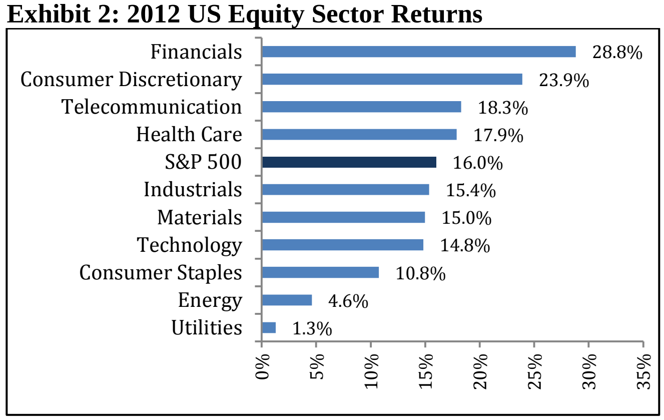
INDEX	4th Qtr, 2012	Full Year 2012	Last 3 years	Last 5 years
US STOCKS				
S&P 500 Index (large-cap stocks)	(0.38)	16.00	10.87	1.66
S&P 500 Growth Idx (lrg-cap "growth" stocks)	(2.04)	14.61	11.33	3.39
S&P 500 Value Idx (lrg-cap "value" stocks)	1.64	17.68	10.47	(0.15)
Russell 2000 Index (small-cap stocks)	1.85	16.35	12.25	3.56
FOREIGN STOCKS				
MSCI EAFE Index (developed foreign markets)	5.59	17.33	3.56	(3.69)
MSCI EMU Index (European Monetary Union)	7.42	21.17	(1.51)	(8.02)
MSCI Emerging Markets Index	5.36	18.29	4.68	(0.91)
MSCI BRIC Index (Brazil, Russia, India, China)	6.07	14.69	(1.03)	(5.34)
COMMODITIES				
London Gold PM Fix	(7.25)	8.26	15.08	14.73
London Silver Fix Price	(12.81)	6.28	20.80	15.20
GSCI Commodity Total Return Index	(3.28)	0.08	2.54	(8.12)
BONDS				
BarCap US Aggregate Bond (investment-grade bonds)	0.22	4.22	6.19	5.95
BarCap US 20+ Yr Treas Bd Idx (long-term US treas)	(0.94)	3.36	14.81	9.72
S&P Nat'l AMT-Free Muni Bond Index (municipal bonds)	0.25	6.52	6.51	5.67
iBoxx Liquid Inv Grade Idx (inv.-grade corp. bonds)	1.14	11.85	10.11	8.74
iBoxx Liquid High Yield Index (high-yield/"junk" bonds)	3.28	14.15	10.83	8.41
S&P/Citi Intern'l Treas Bond Ex-US (foreign bonds)	1.06	7.96	3.20	

Source: iShares.com

Equity markets celebrated the news as stocks rallied on December 31st and January 2nd. While US stocks finished the fourth-quarter essentially flat, foreign stocks delivered solid gains for the quarter with stocks in the euro zone generating particularly strong returns. For the year, most equity markets posted solid gains as shown in Exhibit 1.

At the sector level, financial stocks turned in the strongest performance during 2012 after under-performing the overall stock market for five-years (Exhibit 2).

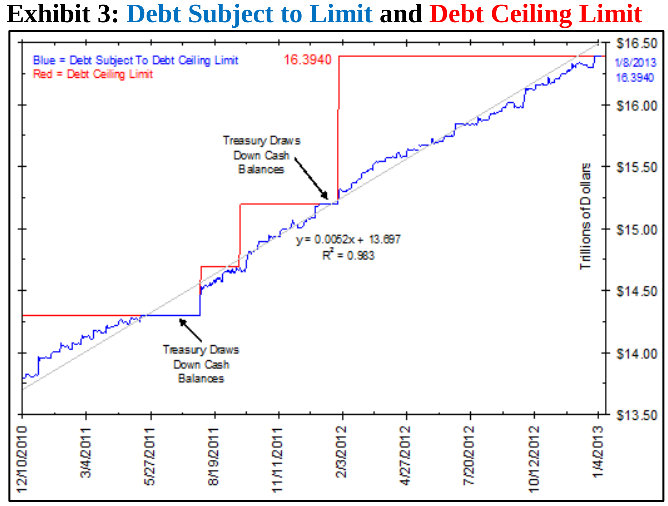
Exhibit 2: 2012 US Equity Sector Returns



Source: Morningstar

Although Congress and the Administration made a deal to postpone the fiscal cliff, December 31st was still notable. The total public debt subject to the limit reached the statutory debt limit of $16.394 trillion on that day according to the daily Treasury statement (Exhibit 3). Treasury must now take "extraordinary measures" in order to bring total debt down enough to allow the government to continue borrowing.

Exhibit 3: Debt Subject to Limit and Debt Ceiling Limit



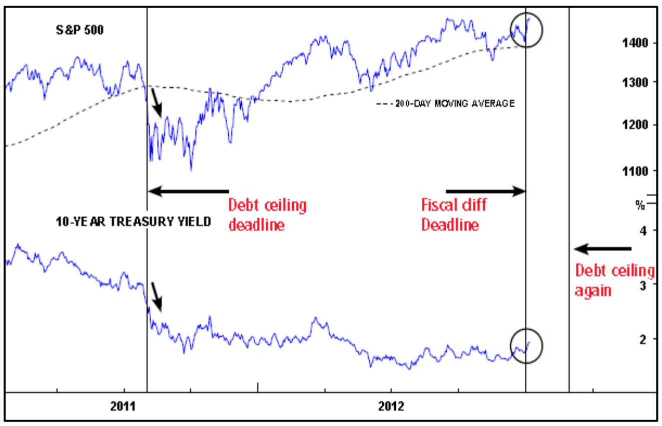
Source: Bianco Research, LLC

---

[1] From our Third-Quarter Quarterly Review and Outlook: "We believe the most likely scenario is that Congress agrees – at the last minute – to temporarily extend the Bush-era tax cuts and delay the sequestering to provide more time for debate. Therefore, the final showdown is likely sometime in February – April, 2013, when the debt ceiling again becomes binding and a compromise can no longer be delayed."

Treasury Secretary Timothy Geithner confirmed this fact when he notified Congress that a "debt issuance suspension period" (DISP) began on December 31. Declaration of a DISP means that the Treasury can suspend additional investments in, and redeem Treasury securities held by, the Civil Service Retirement and Disability Fund as well as the Postal Service Retiree Health Benefits Fund. This creates an additional $12 billion in debt room over the next two months. Other measures the Secretary is likely to invoke include: suspending issuance of State and Local government securities; suspend daily reinvestment of Treasury securities held by the federal employees' G-fund and the Exchange Stabilization Fund. In total, these extraordinary measures "free up" about $200 billion and should buy enough time to make it to the end of February. After that, more severe action would be required.

Exhibit 4



Source: BCA Research

This next phase of the debate in Washington (over the next 2 months) will have to deal with the much more contentious issue of additional spending cuts and the need to increase the debt ceiling. We expect a renewed fight that will prove tougher to resolve than the deal that was achieved with respect to the fiscal cliff at year-end. We expect financial markets to react negatively during this period as investors face a replay of the summer of 2011 when an acrimonious fight over the debt ceiling contributed to a significant decline in risk assets (Exhibit 4). The Republicans will demand cuts to entitlement programs and threaten to force the Treasury into a position where it might have to temporarily suspend payments. The Democrats will not accept cuts to entitlement spending without greater tax revenues. Obama may use his Presidential decree powers to unilaterally extend the debt ceiling. The focus would then shift to the possibility of a government shutdown, which the GOP could trigger at the end of March when the current appropriations bills expire. A "grand bargain" seems unlikely without significant pressure being applied by the financial markets (unless, of course, our elected "leaders" will figure out some way to kick the can once again) [2].

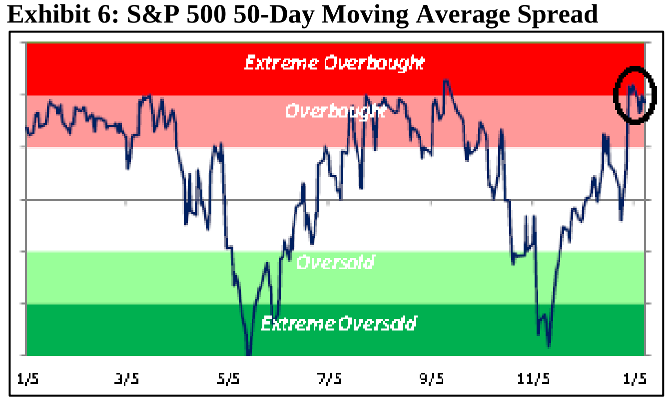
It seems almost assured that an eventual compromise will only be reached at the last minute (yet again). Thus, the cloud hanging over investors and business leaders will remain in place for at least another couple of months, continuing to impede growth for a while longer. There is a non-trivial risk that the government will have to delay outlays such as social security checks or federal employment wages for a few days once the debt ceiling can no longer be avoided.

A key question for investors is: how will financial markets behave as the debt ceiling deadline approaches? The S&P 500 fell by about 16% in the summer of 2011, although there were other factors weighing on risk tolerance besides the debt ceiling (Europe, China and questions regarding the strength of the U.S. economy). Investors may have learned from that episode and could be more reluctant to sell risk assets in fear of missing the rally once a deal is struck. The fact that the stock market correction in the closing weeks of the fiscal cliff debate in 2012 was not particularly significant suggests that investors have become more tolerant of Washington infighting. Nonetheless, this is far from assured.

Exhibit 5: S&P 500 Index

Source: eSignal

Exhibit 6: S&P 500 50-Day Moving Average Spread



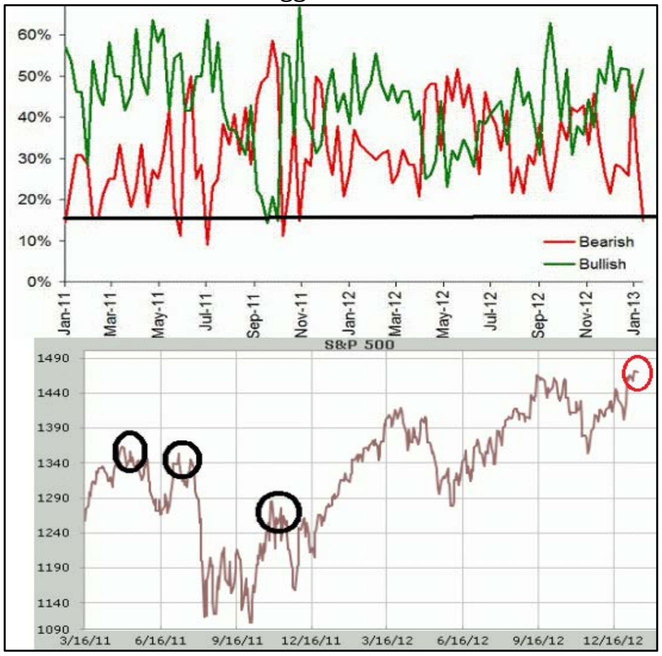
Source: Bespoke Investment Group

In the near-term, we are concerned that a modest set-back in stocks is likely given the upcoming debate and the somewhat extended nature of the recent rally off of the mid-November

[2] As an aside, it's interesting to note that congress is now less popular than cockroaches, lice, traffic jams, Donald Trump, France, Genghis Khan, and used car dealers according to a survey by the Public Policy Polling which surveyed 830 Americans from January 3-6. The poll found just 9% of those surveyed had a favorable opinion of Congress.

lows. The result is that measures of momentum have become technically over-bought (Exhibits 5 and 6) and sentiment has become increasingly complacent (Exhibit 7).

Exhibit 7: Historical Blogger Sentiment and S&P 500



Source: Helene Meisler | TheStreet.com

We spent most of the quarter positioned relatively conservatively versus our benchmarks due to caution about the fiscal cliff and ongoing weakness in Europe. While stocks and other risk assets performed much better than we expected in an environment that could easily have resulted in declining prices, we believe the next few months are equally likely to see financial assets struggle given the upcoming debates in Washington and extended nature of stocks.

Looking beyond the near-term, another important decision is the allocation between US and foreign stocks. As most investors are aware, diversification is a vital component of successful investing. The problem is that since 2008, being invested internationally has diminished performance (Exhibit 8). While the underperformance of foreign stocks has dampened enthusiasm for the asset class, we expect a reversal in relative performance.

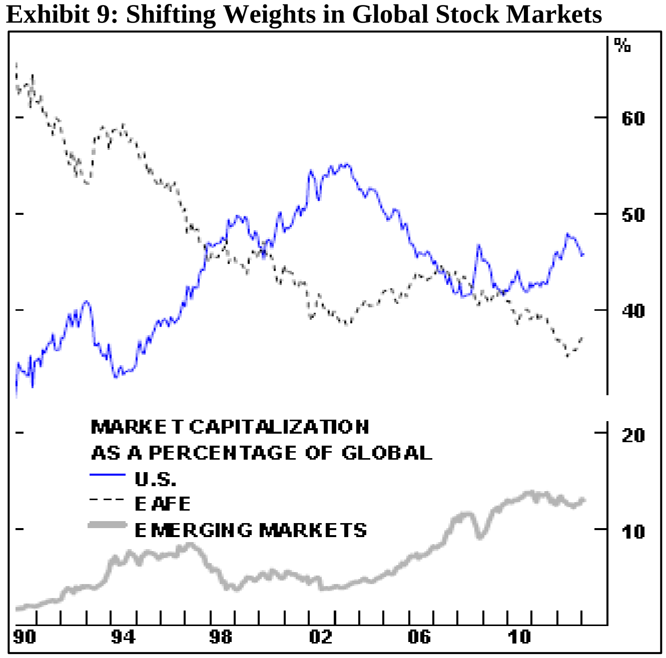
For some context, the MSCI All Country World Index breaks down as follows: 50% North America (45.8% US; 4.2% Canada), 36.9% EAFE (Europe, Asia and Far East) and 13.1% emerging markets. Exhibit 9 shows the shifts in the weights of these various sub-indexes over the last two decades.

We anticipate a reversal in the relative performance of foreign stocks versus US stocks for a number of reasons. The first is valuations. While the US stock market is not richly valued in our opinion, foreign stocks are much cheaper. On both a price-to-book value ratio basis and a forward price-to-earnings ratio basis, foreign stocks are less expensive than their US counterparts. For instance, the US equity market is selling at 2.2 times book value, while the Euro Area stock market is trading at 1.25 times. This represents a 42% discount. Exhibit 10 provides a valuation comparison among several key markets.

Exhibit 8: EAFE (Foreign Stocks) Relative to S&P 500

Source: eSignal

Exhibit 9: Shifting Weights in Global Stock Markets



Source: BCA Research

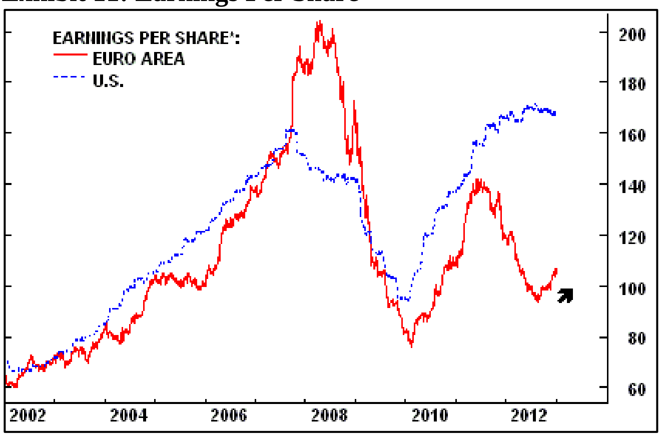
The second reason is cyclical. The US economy has passed its most dynamic phase of the profit recovery and earnings growth has flattened out. In other words, the best part of the US business cycle is most likely behind us, while the recovery in the rest of the world has just begun. The European economy has suffered repeated recessions, but the underlying earnings cycle has probably just reached a bottom and has less absolute risk than US earnings (Exhibit 11). From a cyclical viewpoint, European profit growth could accelerate, while it has already decelerated in the US. Additionally, as we pointed out last quarter: one of the greatest imbalances in the global equity markets is the underperformance of euro area stocks versus other major stock markets (Exhibit 12).

Exhibit 10: Equity Valuation Matrix

Stock Market	Price-to-Book Value Ratio	Price/Book Relative to US	Forward Price-to-Earnings Ratio	Forward P/E Relative to US
Japan	1.09	50.2%	12.82	98.6%
Euro Area	1.25	57.6%	11.04	84.9%
Emerging Markets	1.65	76.0%	10.55	81.2%
China	1.70	78.3%	9.92	76.3%
United Kingdom	1.74	80.2%	10.89	83.8%
United States	2.17	100.0%	13.00	100.0%

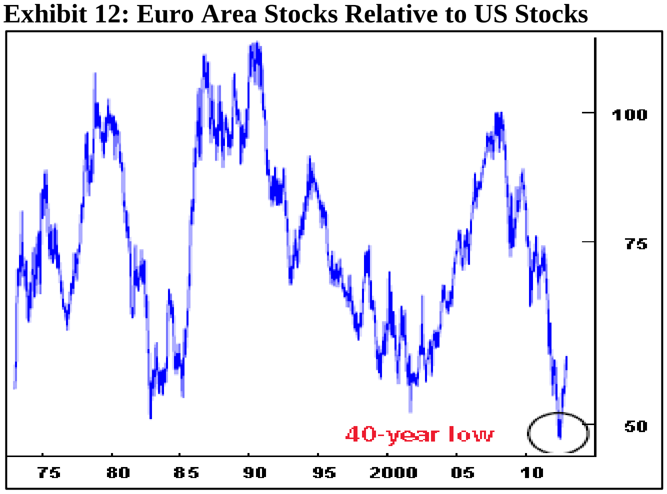
Sources: BCA Research, MSCI Inc., Thomson Reuters/IBES

Exhibit 11: Earnings Per Share



Source: BCA Research and Thomson Reuters/IBES

Exhibit 12: Euro Area Stocks Relative to US Stocks



Source: BCA Research

In China, a change in both economic policy and political leadership has opened the door for strength in stock prices. China's monetary policy was not in synch with G7 nations for the last three years and the slowdown in the Chinese economy and underperformance of the Chinese stock market is primarily attributed to monetary tightening. This policy has ended. The Chinese authorities have already shifted their focus away from containing inflation to promoting growth. Infrastructure spending has been ramped up to counter the fallout in export growth as a result of the euro zone crisis.

The third reason is fiscal policy. The fiscal drag from the US federal government in 2013 could be significant. For Europe, however, severe fiscal austerity appears to have crested as fiscal deficits are being closed and most crisis-stricken countries are adopting much softer targets or measures to regain their fiscal balance.

In short, a de-synchronization in fiscal policy among the major world economies seems under way: the US is getting tighter while much of the rest of the world is getting looser.

All of this seems to point to a continuation of the recent outperformance of foreign stocks relative to those in the US. We have begun increasing our clients' allocation for foreign equities (Europe in particular) and anticipate continuing to do so in the months ahead.

The bottom line with regard to investment strategy is that the risk of a "market riot" in the near-term is substantial as the inability to compromise in Washington comes to a head. We do not, however, believe it will be the beginning of a sustained decline *at this point.* (By 2016, the federal deficit will be pushing $20 trillion. The current fiscal path of the US is clearly unsustainable and will at some point trigger a major crisis.) Therefore, we anticipate using a pullback as an opportunity to add exposure to stocks. Our outlook for bonds over the near-term is benign as easy monetary policy remains in place. Longer-term, interest rates should rise as the Fed's eventual lift-off date approaches.

-Brant Kairies
952-885-2732