RETURN ON TRUST

April 23, 2013

Dear Clients, Colleagues, and Friends,

Thank you for your support and interest in Clark Dodge Asset Management. We are pleased to present updates on our initiatives and commentaries on some of the key financial issues.

**"**Never leave to chance what you can achieve through calculation**"**

- Cardinal de Richelieu

**Macroeconomic Update on the United States**

The Federal Government is operating under the "sequester", but it is still too soon to detect its broad effects on the economy. Discretionary spending areas – defense, education, child care, justice, food inspections, air traffic control and border security – bear the deepest cuts while the perennial and challenging burdens on the economy and on Washington – social security, Medicare and Medicaid – proceed without much intervention. The recently approved "continuing resolution" keeps the government open through September. The good news is that there are more reports of agencies responding intelligently to the fiscal challenges by developing long-term strategies for cutting costs and creative funding and staffing solutions. Head Start in Baltimore, for example, plans to engage more volunteers and philanthropic organizations to meet staffing and financial needs, respectively. In spite of the sequester, government layoffs were not too dramatic this quarter. Challenger, Gray & Christmas, a consultant in human resources, reported that the government laid off 3,721 people in the first quarter. The post office, as reported by the Bureau of Labor Statistics, shed 12,000 jobs. Challenger also noted that aerospace and defense lost 9,766, the first likely casualty of the sequester.

It is our hope that the White House's recently proposed budget will catalyze some constructive discussion between the two chambers of Congress.

The entities not waiting idly by for Congress to decide on a budget are the states in the union. State governments are vigorously trying to improve local competitiveness by reducing red tape, taxes and needless regulatory burden. Kansas governor Sam Brownback has even created the Office of the Repealer to identify and eradicate needless burdens on the government and businesses. Some states, such as Nebraska and Louisiana, are studying the elimination of corporate and personal income taxes. According to *The Economist*, some states have offices whose sole purpose is to poach companies from other states. It is an encouraging sign that at least some of our public officials are taking the matter of addressing economic growth seriously.

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## Economic Tailwinds

Goldman Sachs researchers have forecasted 2.1% growth in GDP in the United States for 2013, a moderate rate. The number of variables required to assemble an estimate, such as currency values, levels of exports, energy prices, and geopolitical factors, make an accurate or precise assessment of GDP growth virtually impossible. It is best to view them as an economist's best guess. As we mentioned in the last letter, GDP growth and the return of the stock market are not always correlated events.

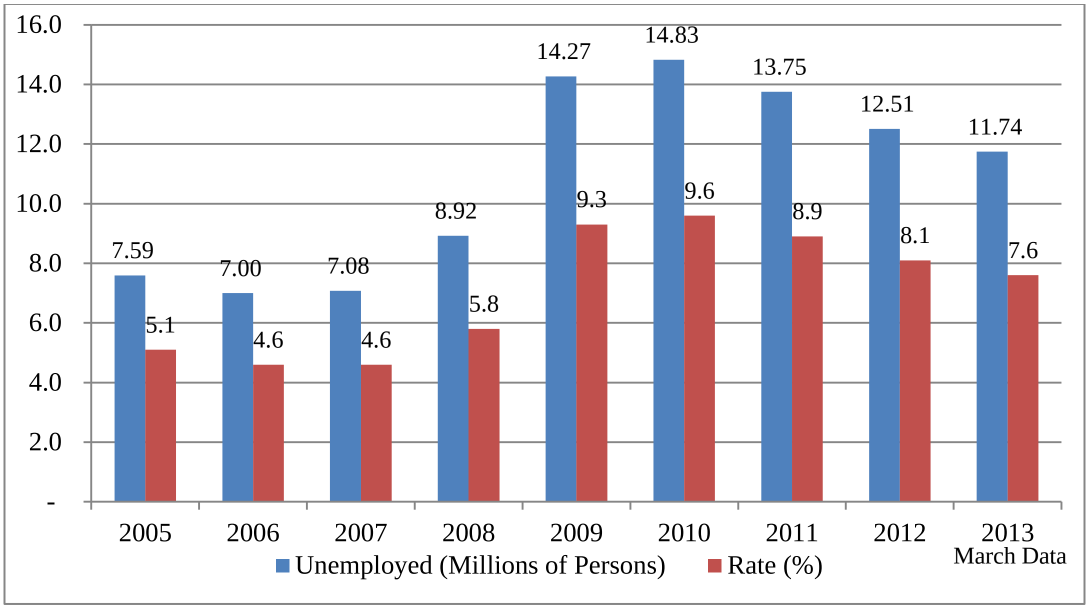
The so-called "shale gale" continues to unfold in the United States. According to IHS, an economic consultancy, unconventional oil and gas generated $238 billion in economic activity in 2012 and was responsible for 1.7 million jobs. Locally, New York State consumers benefited by paying less for electric power. 2012 offered the lowest electrical prices to New Yorkers since the deregulation of the wholesale power market. Investments in shale and the production of shale hydrocarbons are expected to add 0.5% of GDP growth to the economy each year from 2015 to 2020, which should support healthy GDP growth in the future. While no observer is certain how the abundance of cheap energy shall ultimately affect the domestic economy, we are seeing more announcements of investments in plants that either require a great deal of energy, such as direct reduced (sponge) iron creation, or use a great deal of natural gas, such as derivatives from natural gas liquids or the manufacture of methanol. Some economists believe that our newly abundant energy shall usher in a new age of manufacturing in the United States. The larger opportunity is achieving "energy independence," which not only grants the United States better fuel choices but also has the potential to insulate our economy from energy shocks caused by hostile foreign powers.

Corporate investment has picked up in the USA. Private equity activity in the first quarter advanced at the highest rate since the $4^{th}$ quarter of 2010 with more than $84.8 billion in buyouts. This acceleration in investment indicates that managers are generally feeling more optimistic about future economic conditions and a stable taxation regime. The United States led corporate merger and acquisitions activity globally due to several so-called "mega-mergers." In January, Comcast completed its acquisition of NBCUniversal for $16.7 billion, which created a vertically integrated media giant. Berkshire Hathaway and investment partner 3G Capital are pursuing the purchase of the H.J. Heinz Company for $28 billion (including assumed debt). It seems appropriate that the owners of Dairy Queen and Burger King shall own a company best known for its ketchup. Dish Network made a competitive bid for Sprint Nextel Corp, offering $25.2 billion for the firm, $5.2 billion more than Softbank's proposed investment into the mobile network operator. In the rarefied world of gene sequencing, Thermo Fisher Scientific won a bidding war for Life Technologies, paying $13.6 billion for the laboratory-equipment maker. It is our hope that the higher levels of corporate investment activity are a harbinger for the eventual economic expansion.

## Economic Headwinds

The slowly improving labor market in the United States remains the biggest challenge to economic expansion. The Federal Reserve is watching unemployment carefully because the central bank's current program of quantitative easing is meant to foster wider job creation. We are encouraged because more officers of the Federal Reserve are talking about potentially ending the program later this year, which may indicate that there is momentum behind the improving employment statistics.

**Unemployment in the United States: 2005 - 2013**




Source: Bureau of Labor Statistics

## Review of Financial Markets in the First Quarter 2013

**Asset Class Returns**

| **Global Equity Indices** | **1st Quarter 2013** | **2012** |
|---|---|---|
| S&P 500 Index | 10.61% | 15.99% |
| Russell 2000 Index | 11.99% | 16.71% |
| EAFE Index (International) | 4.13% | 18.76% |
| Emerging Markets Index | -5.10% | 19.06% |
| **Commodity Indices** | | |
| CRB Commodity Index | 0.47% | -3.37% |
| DJ-UBS Commodity Index | -1.13% | -1.06% |
| Gold | -4.74% | 6.60% |
| **Fixed Income Index** | | |
| Barclays Capital Treasury Bond 1-5 Index | 0.16% | 0.89% |
| **Real Estate Index** | | |
| MSCI REIT Index | 10.70% | 17.63% |

Source: Bloomberg, CRSP, SSgA Global Advisors, iShares Advisors. Results are total returns.

*Equities*

The social context surrounding the equity market is puzzling. Sentiment is relatively negative in spite of good results, and the investing public is only gradually returning to equity markets. We suspect that the pain of 2008's severe declines is still fresh in the public's collective memory, a feeling reinforced by the weak labor market and the media's incessant focus on the negative aspect of just about anything. The media recognizes that doom sells papers and increases viewership. The US equity markets made strong returns in the first quarter with the S&P 500 Index (a broad indicator of large-capitalization stocks) returning 10.6% and the Russell 2000 Index (a broad indicator of small-capitalization stocks) producing 12.0% returns. The broad rise in value derives from the impressive growth in corporate earnings in 2012. We will carefully monitor this quarter's earnings season for continued strength. With stock market valuations at reasonable levels, further growth in profits may justify higher stock prices.

Even with good results, it is not uncommon for so-called "pull backs" or retractions to take place during bull markets. We examined the investment results of quarterly periods from January 2003 to March 2013 to observe the frequency of loss-producing periods. As the table below illustrates, losses between -2.5% and -15% in a quarter occur about 24% of the time during the 41 periods studied. Fortunately, quarterly periods have positive results about 63% of the time and big declining trends appear much less frequently (2.4% of the time). We mitigate such risks through our diversification strategies, rebalancing on a regular basis, and, most importantly, understanding our clients' near-term liquidity needs. The final component is key because it shields current funding requirements from the volatility of financial markets. We do take the view that price weakness may be an opportunity to add to holdings and stay prepared for any such eventuality.

**Quarterly Results S&P 500 Index Returns (in Price Terms)**
**Period: January 2003 - March 2013**

| | Number of Periods | Frequency |
|---|---|---|
| -5% to -2.5% | 5 | 12.2% |
| -10% to -5% | 2 | 4.9% |
| -15% to -10% | 3 | 7.3% |
| -20% to -15% | 0 | 0.0% |
| -30% to -20% | 1 | 2.4% |

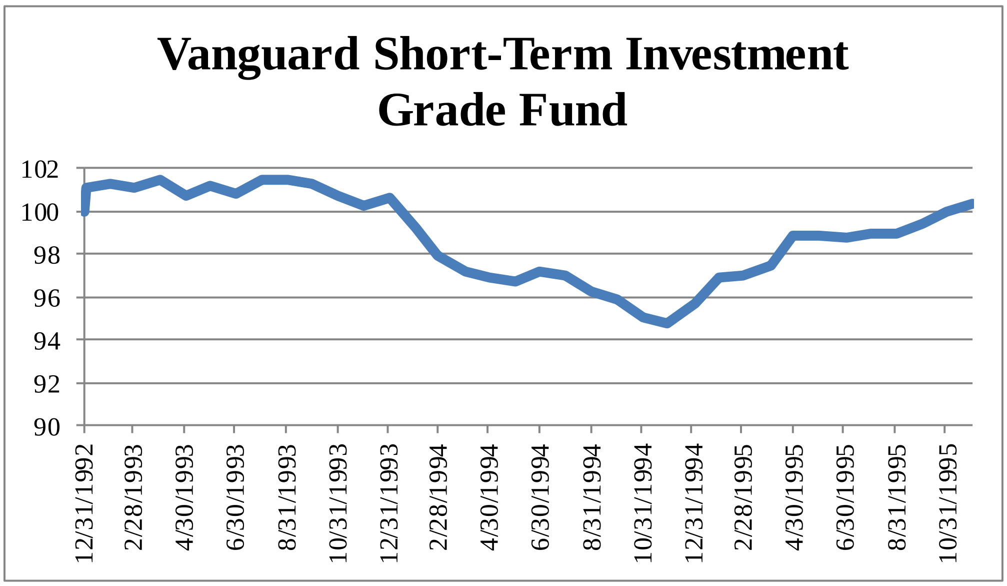
Source: Clark Dodge Asset Management Research

Global equity markets generally had a good start to the year with the exception of emerging markets, which offered a mixed bag. Emerging markets equities are a strategic allocation for our portfolios and, in our opinion, offer a nice current opportunity for long-term investors. We shall take advantage of the softer pricing among emerging markets equities as we rebalance portfolios in the current period. We are addressing emerging market equities via a value strategy that offers an attractive yield – 3.3% – taking in to account exposure to firms with good cash flow. Some emerging markets investors are concerned about slowing Chinese economic growth. They forget that the Chinese economy (any economy for that matter) cannot grow at 9% per year forever without becoming a global economy. They also do not recognize Chinese officials' concern about an overheating economy and a desire for more moderate growth. The groups that do stand to lose are companies delivering raw materials to China (the global iron ore miners, among others) who made large investments counting on everlasting Chinese growth. More broadly, commodity inputs in general may experience softer prices with a more slowly growing China, but we cannot state this with certainty. If consumption becomes a desired driver for the Chinese government, such demand may potentially boost materials prices.

*Bonds*

The bond market, in spite of low interest rates, is still attracting significant capital. The low rates are great news for issuers but are creating some challenges for long-term investors. A trend that we observe among some investors is a move to higher-yielding sub-classes (such as corporate high yield or emerging markets debt) that they may not fully understand from a risk-and-return perspective. For example, some Brazilian corporate debt may be a better credit risk than a "small cap" domestic oil company, but someone shopping by numbers may simply buy the high-yield corporate paper because of the higher yield without thinking about default risk. We are skeptical of such opportunistic strategies because, simply put, we believe that the low interest rate environment is unsustainable. Despite varied and powerful interests influencing current rates – the Federal Reserve, and domestic and foreign investors placing billions of dollars in "safe haven" assets – we are disposed to believe that market activity shall move interest rates to higher levels. The prime rate, the interest rate at which banks loan funds to the most credit worthy customers, stays at 3.25%, its level since January 2009. It is important to note that during this period banks sharply curtailed loans to businesses. Such inactivity is key because banks are not fulfilling their role as important assessors of risk in terms of interest rates. It is our belief that as banks continue to recover, they shall pursue new business and the interest rate mechanism shall reactivate. Of the larger American banks that have reported first quarter results, Wells Fargo has increased lending while Citibank and JP Morgan, while profitable, are still not increasing their loan books. Both managements explain the lack of loan growth by claiming that business owners do not need the investment capital because of a weak order environment. It is our opinion that the banks are instead quietly repairing their balance sheets after the effects of poor investment decisions.

When rates rise, instruments issued at lower coupon rates lose value, especially those with long maturities. As we can see from the graph, not even index funds are immune to price swings when rates change. When rates rose at the end of 1993, this portfolio fell 5.2% in value over the next 12 months. The portfolio recovered nicely as the Federal Reserve entered its next cycle of easing.



How does one navigate such a situation? By assembling a portfolio of securities that will come due within a 3-5 year period or so, which has been our strategy of the last several years. Short-term securities (which are not strictly cash securities – bonds in their final year of life also fit the description – carry substantially less interest rate risk). We frankly welcome the eventual return to higher rates as it shall be a sign of a healthier economy and better bond returns.

While bonds are a strategic holding for many of our portfolios, they serve the dual purpose of providing statistical diversification and corporate cash flow that is not related to earnings. We employ a "total return" approach to portfolio management, which enables us to meet investment and eventual spending needs without relying solely on income generating securities. In other words, the outcome of the whole portfolio is responsible for attaining any goal, not a single asset class. Many make the mistake of relying on bonds and higher yielding equity securities for current liquidity needs. Such a strategy robs a portfolio of earning power in future periods.

We thank you again for your support of Clark Dodge Asset Management. We strive to offer the best advice for retirement, educational plans and strategies for intergenerational assets and wealth management. Our clients are at the center of all we do.

I invite you to contact me to discuss the attached or any concerns or questions that you may have. Also, please do not hesitate to request a copy of our disclosure document (Form ADV Part II), which we are offering to you.

With kind regards,

Michael R. Sanders
*President*
Clark Dodge Asset Management

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Sources: *The Economist*, *The Guardian, The New York Times, Wall Street Journal,* Goldman Sachs research, Bloomberg News and company websites and news releases.