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ETF Select Highlights:

1. **BUYS:** Real Estate, Emerging Market Debt
2. **SELLS:** China (tax loss harvest)

Good Riddance 2011

After a tumultuous year filled with record volatility, the S&P 500 ended near where it began the year — falling 0.003% (including dividends it gained 2.1%). At its October low of 1074, the S&P 500 had lost 21.6% from its May high before advancing back to essentially break-even following strong economic data that suggested a double-dip recession was unlikely. For December, the S&P 500 gained 1% on light trading, but failed to deliver the strong “Santa Claus” rally that many investors had hoped for.

Investors flocked to U.S. Treasuries looking for safety to escape global volatility and the European sovereign debt crisis.

U.S. Economic News Mostly Positive

Political headlines once again dominated the news for December as gridlock in Washington nearly prevented an extension of the payroll tax cuts and unemployment benefits. With modest economic growth of 2%-3% projected by most economists for the U.S. economy in 2012, the failure to extend these benefits could have impacted markets, as several estimates suggest the

extension of these benefits accounts for as much as 1% of next year’s anticipated growth. After a short period of political posturing, Congress eventually passed a two-month extension. All sides view a one-year extension as a priority and will get back to negotiating a longer term extension once Congress returns from break.

U.S. December economic news was led by improvement in housing data and strengthening employment statistics. Residential construction reached its highest levels in 19 months during November, with housing starts

reported at a seasonally adjusted annual rate of 685,000 units, 9.3% ahead of October. The gains in residential construction are promising, but are still far below the more than 1 million annual units associated with a healthy real estate market. November existing-home sales were also positive, rising 4% from the previous month, which was well ahead of expectations for a 1.6% increase. The annual pace of 4.42 million units sold for November was the highest level in 10 months. Several analysts are predicting a housing bottom will finally be reached by the end of 2012.

January 2012 started off with better-than-expected job additions for the previous month as the U.S. Department of Labor reported 200,000 non-farm payroll additions, which dropped the unemployment rate to 8.6%. The U.S. jobs picture is clearly improving as the economy added an average of 136,667 jobs per month in 2011 compared to only 78,333 jobs in 2010. As we have mentioned in previous newsletters, there is no precedent for a recession without job losses. The weekly U.S. initial jobless claims figures, a key indicator we carefully watch, also improved throughout December. Initial jobless claims fell to 366,000 for the week ending December 17, its lowest level since April 2008. The Conference Board’s index of Leading Economic Indicators

Asset Class Performance

	Dec.	4Q	2011
Real Estate – DJ-Wilshire REIT	4.6%	15.1%	9.0%
Bonds – Barclays U.S. Aggregate Bond Index	1.1%	1.1%	7.8%
U.S. Equities – S&P 500 Index	1.0%	11.8%	2.1%
U.S. Dollar – DXY Index	2.3%	2.1%	1.5%
Global Equities – MSCI All World Index	0.0%	7.7%	(5.0)%
Commodities – RJ Commodities Price Index	(2.7)%	2.4%	(8.2)%
Developed Foreign Equities – MSCI EAFE Index	(0.9)%	3.4%	(11.7)%
Emerging Market Equity Index – MSCI Emerging Mkt Index	(1.2)%	4.5%	(18.2)%

The S&P 500’s total return for 2011 was far from representative of global equity returns. The MSCI All World Equity Index lost 5% in 2011, while the MSCI EAFE Index fell 11.7% and the MSCI Emerging Market Equity Index declined 18.2% in the same time period. Despite resilient economic data from the United States, the gloom of Europe’s sovereign debt crisis hung over markets all year. Positively, several 2011 concerns, such as the fallout from the Japanese earthquake, unusual U.S. tornado activity and floods in Thailand that impacted technology supply chains, are likely to prove transitory as we move into 2012. The S&P 500 has started 2012 on a positive note, gaining 1.6% in the first week of trading. Interestingly, according to the Stock Trader’s Almanac, the last 37 times that stocks advanced the first five days of a new year, it resulted in gains 31 times or 84% of the time.

Among other asset classes, the Reuters Jefferies Commodities price index fell 8.2% in 2011, with gold and crude oil’s gains of 10.2% and 8.2% among the few commodities to post positive returns. U.S. Treasury bonds gained in 2011 despite Standard & Poor’s cutting the U.S. credit rating below AAA. Ten-year U.S. Treasury bond prices rose 8.9% and finished the year offering a yield of only 1.88% — the first time on record below 2%.

(LEI) rose for its seventh consecutive month, providing further optimism for the U.S. economy strengthening in 2012. In early January, the Institute of Supply Management's (ISM) Manufacturing Index for December rose to 53.9 from 52.7 in November, above the 50 level that denotes an expanding U.S. manufacturing sector. This key economic indicator has remained above 50 since August of 2009.

Lack of Definitive Solution Means Eurozone Woes Continue

The other big news of the past month focused on the European December Summit meeting, which was supposed to restore confidence in the future of the Eurozone. While the summit resulted in several steps in the right direction, it failed to deliver a comprehensive agreement that included the European Central Bank's (ECB) commitment to purchase unlimited quantities of troubled countries' debt plus a common "euro-bond" issuance. Positively, the ECB did announce new measures to support European banks by making low interest loans more readily available that the banks can then presumably use to buy troubled sovereign debt. In effect, this is a back-door commitment by the ECB to buy weak country debt and most likely takes the worst case scenarios off the table, at least for the next several quarters. However, the ECB made it clear that it does not plan to engage in broad-scale debt purchases of countries like Spain and Italy and it sees the responsibility of dealing with the debt crisis as lying with the individual governments of the Eurozone. In other words, the ECB does not wish to act as lender of last resort - the absence of which is one of the underlying causes of the continuing weakness of the combined response. According to a study by the Boston Consulting Group, any true solution to the crisis must, at a minimum, accomplish four things: 1) buy time for fundamental reforms by introducing interest relief from the weaker countries of the Euro zone; 2) improve relative unit-labor-cost competitiveness; and, 3) restructure excess debt, and 4) establish a fiscal union.

Overall, European leaders did not go far enough at the December summit. The market's lukewarm response to the summit's conclusion reflected its ongoing concern, as did Italian 10-year bond yields drifting back above 7% — the threshold level which preceded Greece and Portugal's bailouts. We believe the Eurozone sovereign debt crisis will continue to see its ups and downs in 2012, with European officials doing the minimum to keep the Eurozone from disintegrating. To regain market confidence, there still needs to be a sufficient back-stop in place, such as more ECB bond buying, International Monetary Fund (IMF) loans (including the latest IMF proposal for €200 billion), and a larger and more robust European Financial Stability Fund/ European Stability Mechanism. These are not solutions to the sovereign debt crisis but will buy the Eurozone time, as its move to fiscal union through austerity and debt reductions will take several years.

It appears increasingly likely that Europe will enter a recession in the first half of 2012, if it is not there already. The best-case scenario is for a normal recession in the region, which accounts for approximately 19% of global GDP. Germany has essentially been holding up the region's economy, but with nearly half of its exports going to other Eurozone countries, it's difficult to see how much longer Germany's economy can avoid a contraction. The length and depth of Europe's recession will be a key risk factor to monitor in 2012.

What's In Store for 2012?

As we do in each December newsletter, we provide some thoughts on the upcoming year. For 2012, we foresee the following outlook, themes and risks:

Outlook

- **A significant low was reached in October** — we intend to maintain slightly above-average equity exposures into the first quarter of 2012. Among other considerations, there were fewer new 52-week lows registered at the October low, a sign of reduced downside participation often seen at waterfall bottoms.
- **Volatility persists** — The following concerns are all likely to cause above-average volatility in 2012: 1) Europe's looming recession and sovereign debt crisis; 2) the sustainability of the U.S. economy's resilience; and, 3) the re-acceleration of several key emerging market economies. China's economy will be critical to monitor in 2012 although March is the probably the earliest to expect improvement, as the Chinese economy must first pass through the Chinese New Year - the equivalent of a business dead zone.
- **Range-bound market requires tactical moves** — should the S&P 500 trade at 11 to 14 times projected 2012 earnings of \$102.63 per share (a P/E range similar to 2011), it implies a range of 1130 to 1440. We expect to reduce equity exposure at the upper end of this valuation range and add back exposure at the lower-end, provided our indicators support these adjustments.
- **Presidential cycle implies a positive year with a summer low** — 80% of post-WW II election years have had positive returns that averaged 9% growth, with the year's low typically reached during the summer. However, the election-year trading pattern is only an average and we intend to remain flexible. In 1980 - an election year that resulted in the installment of Ronald Reagan's pro-business administration - the low for the year came earlier than usual in March and the S&P 500 rose steadily thereafter, putting in its high for the year in late November.
- **U.S. economic resilience** — improving economic data implies 2012 U.S. GDP growth of 2%-3%. S&P 500 earnings are expected to reach another all-time, record high of \$102.63 in 2012.

Themes

- **"Paid to wait"** — maintain bond and high-quality dividend-paying stock exposures.
- **Large-cap** — large cap equities remains attractively valued vs. small cap equities.
- **Energy** — a recovering global economy (on balance) should benefit the energy sector; OPEC spare capacity is limited.
- **Technology** — mobile 3G is likely to surpass all prior technology evolutions in terms of subscriber usage.
- **Emerging markets** — several emerging market economies surpassed their 2007 pre-crisis levels in 2011 despite sagging stock markets. Last year was negatively impacted by restrictive monetary policies that have recently turned expansionary. We will look to add to emerging market exposures should global equity markets bottom at mid-year. Valuations appear reasonable.
- **Commodities** — 2012 should be a better year for commodities. Like 2011, most commodities will take their cue from the emerging markets (and China in particular).

Risks

- **Europe** — risks from Europe are two-fold: 1) debt contagion appears unstoppable, with Italian and Spanish 10-year bond yields spiking above 7%; 2) its looming recession proves much deeper and longer than expected, threatening anticipated 2012 global GDP growth of 3%-4%.
- **Emerging market growth** — the world will be dependent on continued emerging market growth of 6% to 7% in 2012, as Europe will be in a recession and the U.S. economy is likely to provide modest growth of 2%-3%. A soft landing from China's economy will be critical. Its economy is estimated to have grown at 9.5% in 2011 and is expected to only ease slightly to 9% growth in 2012, according to the IMF.
- **Oil** — oil prices of \$140-\$150 a barrel (vs. the current \$101 a barrel) would likely prove recessionary.
- **Geopolitical** — just as the 2011 Arab uprisings in Tunisia, Egypt, Libya, Yemen and Syria proved unsettling to global markets last year, an escalation of tensions with Iran may come to the forefront in 2012.
- **Natural Disasters** — 2011 was negatively impacted by the coincidence of unpredictable natural disasters, including the Japanese earthquake, U.S. tornados and Thailand floods. Over time, these events tend to be temporary, or cyclical, in nature but another raft of natural disasters could derail our outlook.

December ETF Select Positioning

ETF Select accounts posted mixed returns in December, with more equity-oriented accounts finishing negative while more conservative accounts closed in positive territory. Performance

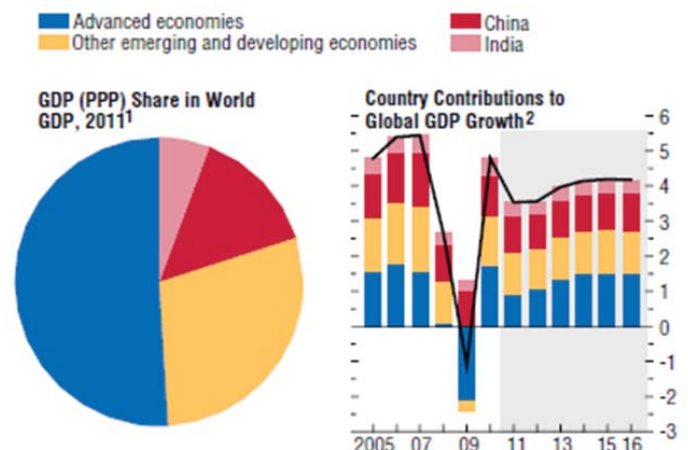
among ETF holdings was also mixed, as U.S. stocks saw a major dip in the middle of December but ended the month positive, while both foreign developed and emerging equities fell. Top performers for the month varied across asset classes as our REIT, high-yield bond and dividend stock positions led the way with strong positive returns. Our gold position, which was one of our top-performing positions for 2011, saw a sharp reversal in December as gold fell about 10% for the month.

We made three moves in December. Very early in the month, we added to our REIT exposure due to their attractive yield, diversification benefits and high risk-adjusted returns relative to stocks. Later in the month, we added to our emerging markets debt position as it had seen a considerable selloff in the previous three months and provided a favorable entry point as we continue to believe emerging debt will perform well in the long run. Finally, we sold our China position and rolled the proceeds into our broad emerging market position to realize a tax loss in 2011 and gain greater diversification from the emerging region beyond China.

As we begin a new year, we remain cautiously optimistic. We are positioned with a quality bias within our equity exposure and a credit bias within our fixed income exposure. Europe remains underweight across the board, and we continue to closely monitor the Eurozone for a lasting solution to its sovereign debt issues. We remain flexible to alter our portfolios as we see changes in the macro backdrop.

Longer-term Outlook

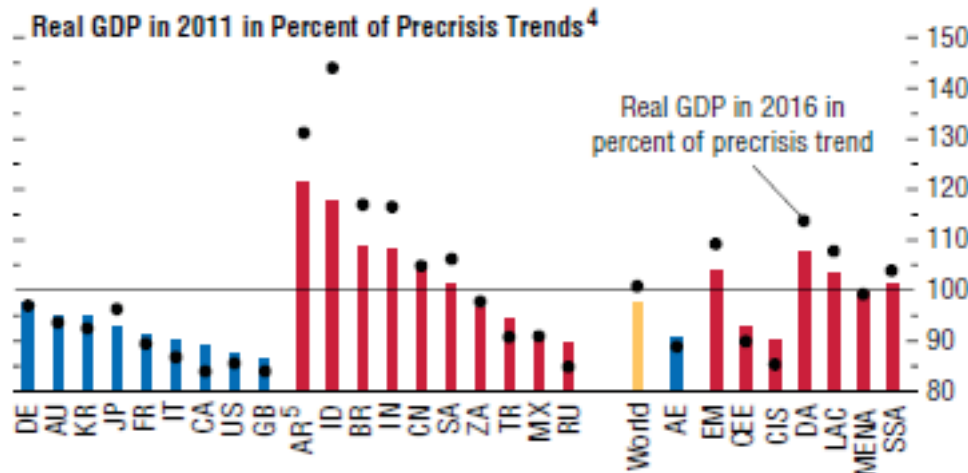
While emerging market equities fell in 2011, the longer-term investment thesis appears intact and this remains an important theme of ours for the intermediate term, as discussed previously. Emerging market economies are estimated to have grown by 6.4% in 2011, which is down slightly from 2010's growth of 7.3%. However, both years remained well in excess of estimated developed market growth of only 1.6% and 3.1% in 2011 and 2010, respectively. Emerging market economies now account for just under half of global GDP and 66% of projected global growth.



Source: International Monetary Fund, September 2011 World Economic Outlook

The red and pink sections in the pie chart on the previous page represent China and India's share of global GDP, respectively, while the gold section depicts other emerging market economies. The adjoining bar chart shows regional contributions to global growth.

It's clear from the second chart that the emerging market growth theme continued to play out in 2011 even though these countries' equity markets were hurt by the systematic risk factors impacting virtually all equities. Thus far, since the October 3 low, emerging markets have accounted for seven of the top nine gainers among 45 global markets.



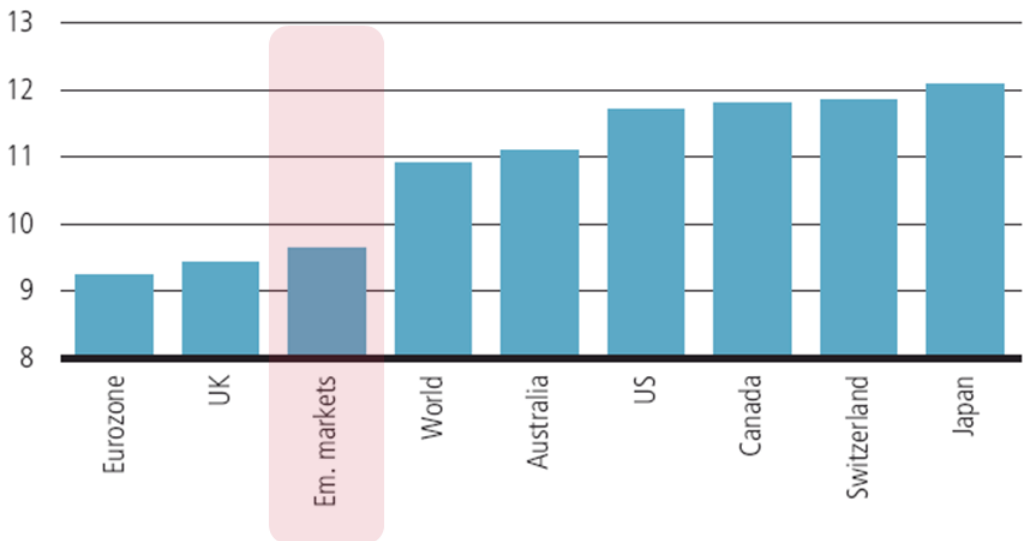
Source: International Monetary Fund, September 2011 World Economic Outlook. DE: Germany, AU: Australia, KR: Korea, JP: Japan, FR: France, IT: Italy, CA: Canada, US: United States, GB: Great Britain, AR: Argentina, ID: Indonesia, BR: Brazil, IN: India, CN: China, SA: Saudi Arabia, ZA: South Africa, TR: Turkey, MX: Mexico, RU: Russia, AE: Advanced Economies, EM: Emerging Markets, CEE: Central and Eastern Europe, CIS: Commonwealth of Independent States, DA: Developing Asia, LAC: Latin America and the Caribbean, MENA: Middle East and North Africa, SSA: Sub-Saharan.

Finally, emerging market valuations appear reasonably attractive, as shown in the chart below.

The potential for a 2012 mid-year bottom in the stock market may restrain the performance of emerging markets in the first half of 2012 but once investors gain confidence that a bottom is in, emerging markets will likely be strong performers. Following the past five cyclical bottoms, the relative strength of the MSCI Emerging Markets Index has been up by medians of 4% after three months, 11% after six months, and 34% after one year - in each case exceeding the median relative strength of the five other major regional indices (U.S., Pacific ex Japan, UK, Japan and Europe ex UK).

The above chart, also from the IMF, shows estimated 2011 GDP by country as a percentage of each country's pre-recession levels (black horizontal line). The red bars represent key 2011 emerging market economies and the blue bars depict advanced or developed economies. The key takeaway is that many emerging market economies exceeded their pre-crisis levels in 2011 and, as shown by the black dots, are expected to grow well beyond this level by 2016.

P/E ratio based on consensus estimates for 12-month forward earnings



Source: IBES, Datastream & UBS WMR 12/11

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