



Quarterly Investment Commentary

Date: January 17, 2012

To: All Clients

From: Burt Wealth Advisors

Re: Q4 Investment Commentary & Portfolio Positioning

Focus remains on Europe

Following a dismal third quarter, the domestic equity markets provided investor's with a strong close to the year, as many equity indices posted double digit gains. Despite this, concerns about Europe's debt woes continue to plague the financial markets. Of specific concern is fear that the contagion is spreading to the healthier and more fiscally sound European economies. Thus far, policy initiatives aimed at ending the crisis have been insufficient to alleviate investor concerns, and more drastic measures will likely be needed in 2012.

Market Performance

Remarkably, after all of the volatility witnessed throughout 2011, the S&P 500 index ended the year exactly where it started, with its 2% return coming from dividends. Smaller- and mid-cap stocks closed the year down 4.18% and 1.55%, respectively, despite posting double-digit fourth-quarter gains.

The turmoil in Europe dragged foreign stocks down 12.14%, based on the MSCI EAFE Index. Continued concern over global growth along with periodic flights to quality drove emerging-markets equities sharply lower; they ended 2011 down 18.42%.

Total Returns for Select Indexes for the fourth quarter 2011 and year end

U.S. Stock Indexes	4Q	YTD	Non-U.S. Stock Indexes	4Q	YTD
S&P 500	11.82	2.11	MSCI EAFE	3.33	-12.14
S&P MidCap 400	12.98	-1.73	MSCI Europe	5.39	-11.06
S&P SmallCap 600	17.17	1.02	MSCI Japan	-3.86	-14.33
Russell 3000	12.12	1.03	MSCI EM	4.42	-18.42
Russell 3000 Growth	10.94	2.18			
Russell 3000 Value	13.33	-0.10			
Russell 2000	15.47	-4.18			
Russell 2000 Growth	14.99	-2.91			
Russell 2000 Value	15.97	-5.50			
Russell 1000	11.84	1.50			
Russell 1000 Growth	10.61	2.64			
Russell 1000 Value	13.11	0.39			
Russell Mid Cap	12.31	-1.55			
Russell Mid Cap Growth	11.24	-1.65			
Russell Mid Cap Value	13.37	-1.38			
			U.S. Bond Indexes	4Q	YTD
			Barclays Capital US Agg Bond	1.12	7.84
			Barclays Capital GNMA	1.25	7.90
			Barclays Capital US Govt 1-3 Yr	0.21	1.56
			Barclays Capital US Treasury Long	1.86	29.93
			Barclays Capital US Treas. Bill 1-3 Mo	0.00	0.07
			Other Indexes	4Q	YTD
			DJ UBS Commodity	0.35	-13.32
			DJ US Select REIT	15.36	9.37

Source: Morningstar (total return in US \$)

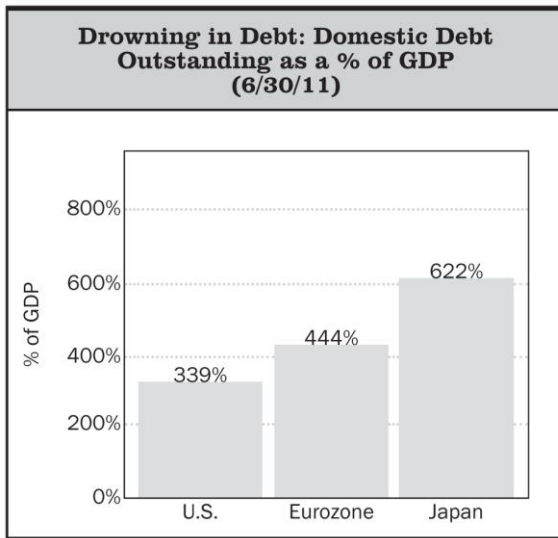
High-quality bonds were on the other side of the risk-on/risk-off volatility, with sharp flight-to-safety rallies that helped net the Barclays Capital U.S. Treasury Long a 29.93% full-year gain. Intermediate term bonds performed well, as the Barclays Capital U.S. Aggregate Bond Index closed up 7.84%. Short term rates remain artificially low as short Treasuries and Treasury Bills posted returns of 1.56% and 0.07% for the year.

The risk-on/risk-off trading mentality seems to have largely driven stock prices this year rather than individual company fundamentals. In the fixed income markets, this was also apparent as the rising risk within the

Eurozone helped boost returns for intermediate and long dated Treasuries. The many macro risks and ongoing headwinds from a global deleveraging suggest the potential for below average returns with periods of elevated volatility. We expect the volatility to provide our active managers the opportunity to find attractive investments at discounted valuations, resulting in better longer-term returns.

Trying Times

Almost the entire developed world is struggling to dig out from under a mountain of debt. The problem is that there is no easy or quick solution to doing so, and all options involve economic pain that is compounded by political uncertainty. The spotlight is on Europe, but the U.S. and Japan also face debt-related challenges. The following table quantifies all debt, public and private, in the majority of the developed world.



Sources: U.S. Federal Reserve, Bank of Japan, and Eurostat.

Having hit debt levels that are unsustainable, deleveraging (debt reduction relative to GDP) is necessary. Ideally this comes from economic growth—increasing the denominator in the debt/GDP equation. But when debt is so high it becomes a headwind to growth, as households spend less due to high debt service levels, are out of work, and/or need to rebuild savings due to the negative wealth effect from housing and financial asset losses. Governments try to use fiscal stimulus to counterbalance the private sector's retrenchment, but this can only continue for so long because the increased government spending/stimulus adds to the growing burden of public debt. Eventually, growth in government spending must contract, adding to the headwind. So, growth as a near-term option for deleveraging is not realistic. That leaves spending reductions and tax increases as solutions at the government level (austerity), or some degree of debt default. Default can happen in two ways: (1) not repaying debt, or (2)

creating inflation by “printing” money which devalues the currency. Both of these options create other problems. Most of the developed world will be forced to spend less and pay higher taxes in coming years. Some governments will default. Others will attempt to create inflation to reduce the debt burden. Governments can also attempt to force what is referred to as “financial repression,” where they use all possible tools to keep interest rates low. This serves several purposes including keeping their borrowing rates low so that the debt-service burden does not explode to impossible levels. For investors, this means lower yields on fixed-income investments.

The analysis outlining these challenges is not controversial. The lesson from economic history is that, without exception, a debt-induced financial and banking crisis results in a lengthy period of subpar economic growth. This is exactly what has been happening throughout the developed world economies since the 2008 financial crisis. Weak economic growth leads to periodic recession fears and unacceptably high unemployment. Moreover, high debt levels mean that we will likely be living with huge macro-level risks for a few more years at least. It is likely that we will continue to experience high market volatility and investor risk aversion, meaning lower prices for risk assets like stocks and high-yield bonds than would otherwise be the case.

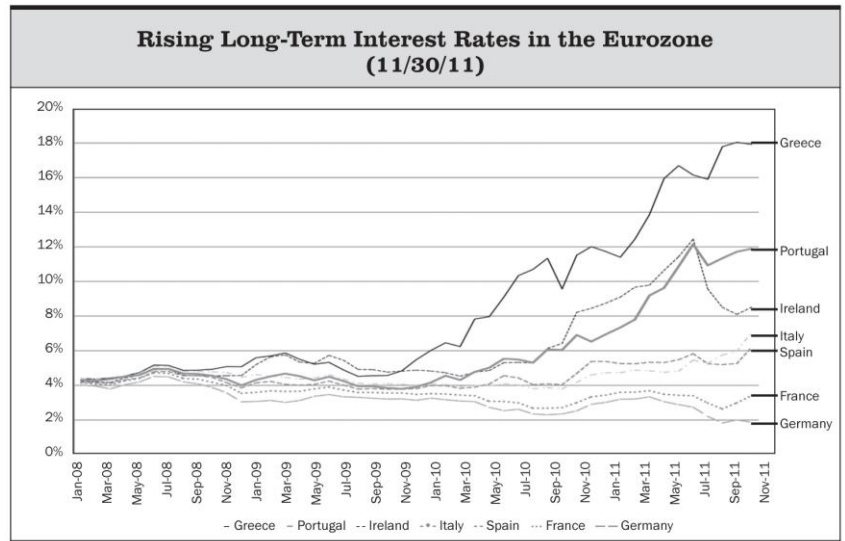
The European Issue

There are many debt-related risks in the world today. Europe is an obvious big risk in the near term. What we see in Europe is an adverse feedback loop where high government debt levels and uncompetitive economies create the following problems:

- Investors in certain troubled governments debt fear that they will not be paid back in full.
- Interest rates rise to account for this increased credit risk making debt refinancing difficult.
- Concern about European bank solvency grows because they hold most of the government debt.
- This leads to a banking crisis, as banks cannot refinance debt and asset values decline.
- Banks cut lending and sell assets to fund operations, resulting in a lack of available credit.

- A reduction in lending and credit strains government as (1) it stifles economic growth, (2) increases the risk of default, and (3) leads to increased government funding to support struggling institutions.
- Stronger economies are forced to help weaker economies.
- Economically weak countries are expected to implement austerity measures (lower spending and higher taxes) that risk further weakening their financial position and growth prospects.

Most economists now view recession in Europe in 2012 as almost certain. European authorities have been trying to contain the crisis through incremental steps, which have not materially addressed the issues or placated investors. The worsening of the crisis actually increases the likelihood that the European Central Bank will finally step in more decisively and provide major support for the sovereign debt market and the banking system via “quantitative easing” (much as the Federal Reserve has done with Treasuries). The hope is that this would bring down interest rates, restore some confidence, and break the debt-contagion cycle. But, this is not



Source: Eurostat.

certain and the question of whether they will do it in time to avoid a serious and potentially devastating economic downturn remains to be seen. The costs of a European Union break-up are high so there should be strong motivation to avoid it, but the political and practical realities are highly complex.

The global ramifications of a disorderly EU breakup would likely be severe. The banking system would be a primary way to transmit the crisis globally and trade would be a secondary transmission mechanism. The likely result of this scenario would be at the very least a developed world recession, as credit could temporarily freeze and trade levels would drop. This would also result in a slowdown in some emerging economies and outright recession in others. Heightened risk triggered by concerns about sovereign risk could also trigger a funding crisis. According to the Organization for Economic Co-operation and Development, developed countries will need almost \$11 trillion in funding in 2012—primarily for maturing loans needing to be rolled over. Normally this would not be a problem. But a European meltdown could conceivably trigger market pressure on the heavily indebted U.S. and Japanese economies (though capital has to go somewhere and U.S. Treasuries remain the asset of choice in times of heightened risk aversion). Policy tools would likely be more limited than in 2008 and 2009 because we’ve already used up some of our “bullets,” contributing to government debt levels that are very high and that could reduce the political will to allow them to expand further.

The Rest of the World

While Europe is the imminent risk there are other worries. The U.S. economy, though still weak, has performed somewhat better recently and appears to have moved back above stall speed. If a European meltdown can be avoided it is expected that the United States will continue its slow expansion, but our own maddening political dysfunction, severe debt problems, and continued housing weakness makes the United States susceptible to economic shocks and policy errors. Japan is one of the most indebted developed countries and highly susceptible to rising interest rates. China’s economy is slowing and the authorities are now moving to stimulate growth. The impact of a contracting real estate sector and slowing export growth to the developed world, remain serious risk factors. It is difficult to predict whether China will be able to avoid a sizable slowdown in growth, often referred to as a hard landing. A hard landing for China would be a significant blow to the developed world economies. And, yet another risk to the global economy as we move into 2012 is the possibility of rising Middle East tensions (with Iran specifically) driving up the price of oil.

On the Bright Side...Examining the Bullish Arguments

The weight of the evidence suggests to us that it is right to be cautious, but there are bullish arguments worth examining.

Authorities determined to avoid a crisis. By far the strongest bullish argument, in the short run, is that authorities will do whatever it takes to avoid financial catastrophe, and therefore there will be much stronger steps taken in Europe. For example, if the ECB undertakes major quantitative easing as discussed above, global stock markets could experience a massive rally. If this coincides with continued improvement in the U.S. economy, 2012 could turn out to be a very good year for the stock market. That could happen because a second bullish factor is that companies have piles of cash and are ready to spend it if uncertainty declines or demand increases. So, if policies are pushed forward that reduce some of the scariest risks, we could see companies loosening up their purse strings. This could be a positive double play for the economy and markets—as we'd have both policies that reduce uncertainty and a business sector that is poised to expand.

Global equity correlations should fall. Another bullish argument is that 2011 marked an unusually high period of equity correlation. This is seemingly driven by a risk on/risk off environment where investors obsess about macro risks rather than focus on individual company fundamentals. Should this decrease, it will likely benefit active equity managers as their portfolios may be priced at larger than normal discounts.

Stocks are attractively valued. This is dependent on the valuation measurement. Relative to bonds, stocks appear cheap. Comparing the “earnings yield” – the inverse of the price/earnings ratio- stocks are cheap relative to interest rates, or the yield on Treasury bonds. Stocks appear fairly valued based on price-to-earnings ratios compared to long-term historical averages. Fair value is based on how close the current measure is to the average. Stocks are now trading in a fair-value range based on various (but not all) P/E data series covering the post-WW II era. Therefore, one could conclude that returns could be average (around 10%) going forward. However, this type of valuation analysis does not factor in any forward-looking analysis of economic fundamentals. Considering that all-time-high profit margins are likely to decline, this could be a headwind to continued earnings growth. Moreover, a deleveraging world is a higher-risk world, which leads to higher volatility. If risk is higher, as we expect, investors won't be willing to pay as much for stocks, which shows up in the form of depressed multiples and reduced stock returns.

Negatives are well understood so they must already be reflected in prices. With respect to what is already reflected in prices, using the U.S. stock market as a proxy for risk assets, it appears to us that stocks in the United States reflect the expectation that we will see earnings return to their long-term-trend level over the next few years. However, this is entirely dependent on the macro environment.

The economy is improving. Yes, the economy is slowly improving. If additional crises are avoided the economy is still likely to continue to struggle with slow growth as the United States deleverages. Household deleveraging is progressing—aided by low interest rates, government transfer payments, and defaults—but it has further to go. Shrinkage at the state and local government level continues. Federal government deleveraging has not started yet but fiscal policy will tighten in 2012 and economists forecast this will result in a drag on U.S. GDP growth of approximately one percentage point. Looking further out, some fiscal austerity is coming to the United States. While occasional good news could trigger temporary optimism and market surges, the weight of the evidence suggests that it is quite unlikely that the economy can sustain a strong bull market.

Portfolio Positioning – Tactical Risk Reduction

During the fourth quarter, we continued to reduce the risk in our model portfolios. Both domestic and international equity allocations were reduced, while cash and hedged equity positions increased. We continue to have a cautious outlook, believing that the market may not be adequately discounting the significant risks to the global economy. We expect ongoing volatility within the equity markets to continue as a result of the Eurozone sovereign debt crisis, slow economic growth in the U.S., and the perceived political gridlock on

Capitol Hill. Any and all policy decision, both globally and domestically, are likely to produce significant swings in the global equity markets.

U.S. Equities: We tactically reduced our domestic large cap equity allocation in the beginning of November. Fortunately, most of the gains in the equity markets were seen in the first month of the quarter, and the S&P 500 only advanced 0.80% in the months of November and December. We benefitted by reallocating these assets within our hedged equity allocation, which outperformed over this period. Nonetheless, we continue to maintain a broadly diversified equity allocation. During 2011, we consolidated and reallocated some of our large cap investments. We now maintain a large percentage of assets in two distinct passive strategies that provide unique benefits and opportunities. In addition, one of our active large cap managers pursues a high quality dividend focused strategy, while the other maintains a relatively concentrated valuation driven portfolio. We made no changes during the year to our mid and small cap allocations. These positions, in general, have equaled or exceeded their primary benchmarks and investment peer groups.

International Equities: The ongoing sovereign debt crisis in Europe proved detrimental again for developed market international equities. Considering the risks, we believed it was prudent to lower our international allocation during the quarter. We continue to analyze investment opportunities to deploy these proceeds, but given the heightened global economic uncertainty, we are currently comfortable with an increased cash allocation. As a result of this reduction, our international allocation has a lower exposure to developed Europe and higher allocations to developed Asia and diversified emerging markets. While emerging markets suffered from investors' risk aversion in 2011, we continue to believe that attractive valuation levels and growth prospects present an attractive long term investment opportunity. Overall, our international equity allocation represents investments in 35 countries, including a broad mix of developed and emerging economies.

Fixed Income: The risk on/risk off trade proved to be difficult for many active fixed income managers in 2011. Many intermediate term bond fund managers maintained significant underweights to Treasury bonds, as their long term return potential and valuations seemed unattractive. Surprisingly, intermediate and long Treasuries were among of the best performing fixed income sectors and a significant allocation in the benchmark Barclays Capital U.S. Aggregate Bond Index. Our primary intermediate term fixed income position was indeed underweight Treasuries and short duration, which both factored into its below average performance for the year. Nonetheless, we remain confident in the manager's ability and his stellar long term track record. We understood the fund's positioning and the rationale behind it, and realize that investment managers will be wrong from time to time. Additionally, our allocation includes investments in inflation protected, mortgage backed, short-term corporate, and multi-sector bonds. We are currently reviewing our fixed income positioning with the considerations of lengthening duration (interest rate risk), adding additional active managers, or indexing a portion of this allocation.

Alternative Investments: Our allocation to alternative investments provided significant support during a volatile 2011. Specifically, our hedged equity allocation helped to mute equity volatility throughout the year and provided strong relative risk adjusted returns. We added to our hedged equity allocation in early November as a tactical risk reduction strategy by decreasing our large cap domestic equity allocation. Our global macro position provided poor absolute returns for they year, but delivered reasonable relative performance given its significant allocation to emerging markets. The managers continue to allocate assets globally to companies they believe will benefit from the growing emerging market middle class. This leads to a diverse portfolio of global companies, with more emphasis on operations and less of a focus on the company's domicile. They have specifically noted the high correlation among global equities and believe they stand to benefit significantly when the market again focuses on company fundamentals.

What is Our Job?

This is an important question especially in times where economic and investment complexity is high. Our answer is that our job is to:

1. Understand each client's long-term investment goals and shorter-term risk tolerance
2. Understand each client's investor psychology and other factors that impact their investment experience
3. Manage a portfolio that is consistent with the above principals
4. Use discipline and diligence to make decisions that balance risk and return relative to the client's objectives
5. Educate our clients so that they understand the rationale behind our decisions and the risks and rewards of various courses of action
6. Help provide context to assess how we should be evaluated

We believe accountability based on relative performance is important and necessary, but more context is required. Absolute performance measurements are part of this context, as is the appropriate time horizon for evaluation and an understanding of the risks that are taken and avoided. Risks avoided are particularly important because even though some risks may not come to pass, no investment manager can forecast the future with certainty. Meeting clients' needs is also an important part of assessing an investment manager's decisions and performance. Some clients invest in more conservative strategies because capital preservation is an important goal. As investment advisors, however, we may give more weight to protecting capital in high-risk environments than we do to trying to beat a benchmark. At times, managing perceived risks may come at the cost of relative performance, but our job is to base decisions on what we believe is best for clients. Over the long term, what we expect in a world that is inherently uncertain is that a strong commitment to research, a disciplined process, and a focus on our clients' interests will continue to lead to our long-term success.