EXECUTIVE SUMMARY

First Quarter 2013…

- The equity markets in the US have staged a significant rally through the end of March\(^1\), however, earnings concerns have begun to weigh on the averages through the first month of the second quarter
- Advances were most significant in the defensive sectors of the S&P 500 (i.e., consumer staples, health care and utilities)
- US economic conditions appear to still be improving by several measures, but recent data suggests a pause in rate of improvement
- Earnings for the first quarter have started to come in a bit weaker than in the previous year or two, as cost cutting and consolidation play a smaller role in bottom line increases
- Gold has had a significant pullback, dipping to nearly $1,300/oz. in mid-April\(^2\)
- The bombing in Boston, while seemingly tied to anti-American ideology, seems to have left financial markets unfazed

Our outlook for 2013…

- The remaining part of the first half of 2013 for equity markets looks a bit shaky as we enter the impact stages of the fiscal cliff deal(s) and further reduced earnings expectations
- We expect significant sector rotation towards the end of the year – into more economically sensitive sectors
- Emerging markets may yet re-emerge in 2013
- MLPs may continue their uptrend\(^3\)

Also Inside:

Gold

Investing with Impact

"Some cause happiness wherever they go; others, whenever they go."

- Oscar Wilde
Tactical Ideas for Consideration
for the Appropriate Investor

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**Notes**

1 - Lowest, 5 - Highest [Increasing number of top hats indicates increasing conviction to the idea]

If you are interested in exploring any of the ideas mentioned above, please call. We will discuss if it is appropriate for your specific situation as well as the different investment choices available to gain exposure.
2013 First Quarter

It appears the markets weathered the fiscal cliff as we suspected it would. General economic numbers both in the US and in Emerging Markets (notably China) have been reported progress, albeit gradual. The world’s concern about the evolving EU crisis took center stage for a brief period, but gave way to greater optimism. The result of the depositor-cum-creditor in the Cyprus banking crisis was admittedly alarming, but further effects are yet to be seen.

As anticipated, first quarter earnings growth is coming in at a pace slower than in recent years. The market’s reaction is holding in stall but not sell mode, at least so far. US GDP for Q1 came in at 2.5%, slower than the 3.0% predicted by economists.

The S&P 500 moved higher in the first quarter of 2013 seemingly in spite of itself. Investors wondered aloud how long such a rally could persist and whether we deserved to be at historic highs given the current tepid economic recovery and so much uncertainty. But as many savvy investors have come to know, this is precisely the environment in which equity prices drift higher, seemingly climbing a wall of worry.

S&P 500
First Quarter 2013

It is notable that consumer staples and health care were among the leading sectors, while technology and materials were decidedly in the underachiever camp. Signs of an unconvincing investor?
Investment dollars appear to be flowing back into the dividend and stable growth names. Ironically, this may be the development of a mini defensive sector bubble as we move through the year and economic cycle. Expectations of real growth in the global economy may be reflected in allocations to capital goods (industrial sector), materials and technology.

The performance of the world equity index was considerably behind that of the US markets\(^5\), as emerging markets and other developed economy markets lagged. One other bright spot was Japan\(^6\).
Outlook for 2013

If I had to map out the rest of the year, I’d guess we’ll see a bit of a slowdown in equity priced through the summer and see us end 2013 on a positive note, hitting new highs in the equity averages. This is contingent on real earnings advances in particularly important sectors: technology, industrials and cyclicals.

I have come to dislike the term emerging markets as a basket of countries that somehow are interconnected in ways other than their level of industrial and financial development. China, India and Brazil couldn’t be more different countries economically and financially. Having said that, as portfolio managers continue to use vehicles that interlock the returns of these entities by allocation of money to each through one or several vehicles, as a group they did poorly in the first quarter of 2013. I suspect that Brazil and China will likely see an upturn in equity prices before year end and that Mexico may continue its rally.

Van Hoisington’s newsletter of Q1 2013 points out that the government may be able to supply money, but not apply money. “Printing money,” as we all too easily refer to the expansion of the monetary base, is really the increase of M2, which is a measure of the deposits and currency in the system, so states Mr. Hoisington. The point he makes (and this is not new for him) is that while the government may be making reserves available and expanding their balance sheet, they do not control the velocity of money. This points out why interest rates are not moving in the expected direction.

It is fairly clear that the liquidity in the system is not necessarily having the desired effect of re-igniting growth. Much of this liquidity seems to be reabsorbed in the continual deleveraging of the economy is experiencing. For these reasons, the bond market (particularly corporate credit markets) appears to offer some value out beyond 3-5 years. The right credit profile is important, with durations somewhere shy of 8 years that offer value, in our opinion.

MLPs

A note on the explosive rally in MLPs: it doesn’t appear near over. While we may go through one of several consolidation phases, the money flowing into this energy transportation and storage group appears in the early innings, historically. Notably institutional money is finding this a more attractive space than in the past.

There are several strong investment themes into which MLPs fit: America’s energy independence, energy cost reduction, economic stimulation to name a few.
The Alerian MLP index is a market weighted index of the energy MLPs traded in the US public markets.
Gold

Given the violent move in Gold this month (which, technically, is not a first quarter 2013 event, but I believe too important not to address), I thought it worth a brief review.

Gold is a commodity, used and traded for various purposes. The price of gold, like all commodities, moves according to the laws of supply and demand. Like many other commodities, its price is included in several indices tracking among other things, “commodities,” and “precious metals.” But, because of the history of gold and its place in the world of money, we consider gold to be a distinct asset class, subject to economic forces unlike other commodities and substances, including precious metals.

Aside from its application in industry and use in jewelry, gold is viewed, we believe, as a substitute for currency. Without the lesson in gold history and currency background, the basic premise is that there is a definable amount of gold in our economic system and thus its value can be determined with a different method than that of a sea of currency whose ultimate number or value change depending on issuance and issuer.

Gold in dollar terms has been on a long-term tear, with prices increasing generally over the last 11 years.

Gold Spot Price Jan 2000- Present, Monthly

However, over the last two years, gold has had a tougher time (see chart below).
Recent action in not only the gold market, but also alternative repositories of cash and investment, has colluded to undermine the short term outlook of gold’s price. The US Dollar has been stronger than other currencies, and the equity markets have been of more interest to investors and speculators for the last few months, as evidenced by the price action.

Gold’s precipitous decline in April seems to have been a combination of forces including specific market reaction to trades and a short term deteriorating environment for gold’s valuation\(^{10}\). In addition, several actors in the gold market seem to have come to view gold as either a “risk on” or a “risk off” trade. These misperceptions can wreak havoc with prices, as we know, in any market.

Looking at gold from the perspective of an alternate currency, we’ve provided the comparative chart below showing asset price inflation spikes or “bubbles” since we went off the gold standard. This may help paint the picture of what can happen in various asset classes as an unanchored money supply casts about.
This chart shows inflation adjusted performance of four asset classes (housing, gold, oil and the NASDAQ) since 1976, when the world financial system relinquished the gold-dollar standard (actually this happened in 1973, but it was October 1976 when the US Government officially changed the definition of the US Dollar – fiat money).

Our thesis for holding gold remains. Recent rebounding of prices suggests that large trades had an impact on the price action and may be a short term dislocation. Longer term, we estimate the amount of gold needed in a portfolio by the impact of other anticipated asset/currency movements. We favor the metal here, rather than the miners or ancillary metals (although long term correlations in price action have been high).
Investing With Impact

Sustainable and Responsible Investing (SRI) is one of the fastest growing segments of the investment world. It is having a profound impact on the decisions being made by corporate CEO’s, institutional managers, and everyday investors. In this segment, we will attempt to keep our friends and clients informed on recent developments, trends, and thought provoking commentary surrounding sustainable processes, responsibility and the investment world. Incorporating SRI into one’s investment approach not only has “green” benefits, but appears to make good long term business sense. As the focus on SRI strengthens, and more research and information becomes broadly available, we are fast approaching a time when the term SRI will become obsolete. It is likely to be viewed simply as a given in the investment analysis of any credible research firm or investment manager. We are proud to work with Morgan Stanley, one of the leaders in SRI amongst the major brokerage firms.

I recently gave a presentation discussing SRI and some of the most recent developments. It was on the evening of a snow storm, and yet we had an impressive turnout. This speaks to the desire people have to learn more about how one can “do good, while doing well.” Studies are showing numerous instances where companies are driving profits through sustainable and responsible business practices. Take the following data points from Mark Fulton, Global Head of the Climate Change Investment Research at Deutsche Bank (June 2012):

- 100% of the academic studies showed the highest-rated companies for environmental, social and governance (ESG) investing and corporate social responsibility (CSR), factors boasted a lower cost of capital for debt and equity.
- 89% of the studies indicated that companies with the highest ESG elements showed market outperformance, and 85% indicated accounting-based outperformance.

These results are helping to debunk the myth that social responsibility and profit maximization are mutually exclusive. One of the more recent developments which pairs social responsibility and profit maximization is the Benefit Corporation (B-Corp). This is a type of corporation required by law to create general benefit for society as well as for shareholders. Benefit corporations must create a material positive impact on society, and consider how their decisions affect their employees, community, and the environment. Moreover, they must publicly report on their social and environmental performances using established third-party standards. It is a form of for-profit charity. The B-Corp law was enacted in April 2010 in the state of Maryland. There are now a total of fourteen states that have passed legislation allowing benefit corporations. Time will tell if this trend stretches nationwide, and if companies begin en masse to convert to this new type of structure.

Our website contains further information on the Investing with Impact approach.
Notes

2 --- Yahoo Finance 4/13-16
3 — MLP performance as measured by the Alerian index for 2013 through March 31, 2013 was +18.1%, exclusive of dividends and distributions - Thompson Financial 4/22/13
5 — MSCI ACWI Q1 total return +6.0% - MSCI.com 4/3/13
6 — Japan Topix Q1 total return +10.8% (USD) - Morgan Stanley, - Morgan Stanley Capital Markets 4/11/13 “Market Recap and Outlook.”
7 – Safian Investment Research 4/7/13
8 – Morgan Stanley, Stephen Maresca, April 18 “Midstream Energy LPs 3.0”
9 – Alupka Asset Management, 3/13/13
10 – Thompson Financial 4/21/13

FIN

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Information contained herein has been obtained from sources considered to be reliable, but we do not guarantee their accuracy or completeness.

A word about the risks of the asset classes/sectors/securities discussed in this material...

International Investing:
International investing may not be suitable for every investor and is subject to additional risks, including currency fluctuations, political factors, withholding, lack of liquidity, the absence of adequate financial information, and exchange control restrictions impacting foreign issuers. These risks may be magnified in emerging markets.

Equities:
Investors should be willing and able to assume the risks of equity investing. The value of a client’s portfolio changes daily and can be affected by changes in interest rates, general market conditions and other political, social and economic developments, as well as specific matters relating to the companies in which securities the portfolio holds.

Sectors:
Portfolios that invest primarily in securities of companies in one industry or sector are subject to greater price fluctuation and volatility than portfolios that invest in a more broadly, diversified portfolio.

Fixed Income:
All fixed income securities are subject to market risk and interest rate risk. If fixed income securities are sold in the secondary market prior to maturity, an investor may experience a gain or loss depending on the level of interest rates, market conditions and the credit quality of the issuer.

Interest in municipal bonds is generally exempt from federal income tax. However, some bonds may be subject to the alternative minimum tax (AMT). Typically, state tax-exemption applies if securities are issued within one’s state of residence and, local tax-exemption typically applies if securities are issued within one’s city of residence.
Bonds are affected by a number of risks, including fluctuations in interest rates, credit risk and prepayment risk. In general, as prevailing interest rates rise, fixed income securities prices will fall. Bonds face credit risk if a decline in an issuer's credit rating, or creditworthiness, causes a bond's price to decline. Finally, bonds can be subject to prepayment risk. When interest rates fall, an issuer may choose to borrow money at a lower interest rate, while paying off its previously issued bonds. As a consequence, underlying bonds will lose the interest payments from the investment and will be forced to reinvest in a market where prevailing interest rates are lower than when the initial investment was made. **NOTE:** High yield bonds are subject to additional risks such as increased risk of default and greater volatility because of the lower credit quality of the issues.

Bonds rated below investment grade may have speculative characteristics and present significant risks beyond those of other securities, including greater credit risk and price volatility in the secondary market. Investors should be careful to consider these risks alongside their individual circumstances, objectives and risk tolerance before investing in high-yield bonds. High yield bonds should comprise only a limited portion of a balanced portfolio.

S&P 500 Index is an unmanaged, market value-weighted index of 500 stocks generally representative of the broad stock market. In investment cannot be made directly in a market index.

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Physical precious metals are non-regulated products. Precious metals are speculative investments, which may experience short-term and long-term price volatility. The value of precious metals investments may fluctuate and may appreciate or decline, depending on market conditions. If sold in a declining market, the price you receive may be less than your original investment. Unlike bonds and stocks, precious metals do not make interest or dividend payments. Therefore, precious metals may not be suitable for investors who require current income. Precious metals are commodities that should be safely stored, which may impose additional costs on the investor. The Securities Investor Protection Corporation (“SIPC”) provides certain protection for customers’ cash and securities in the event of a brokerage firm’s bankruptcy, other financial difficulties, or if customers’ assets are missing. SIPC insurance does not apply to precious metals or other commodities.

Investing in commodities entails significant risks. Commodity prices may be affected by a variety of factors at any time, including but not limited to, (i) changes in supply and demand relationships, (ii) governmental programs and policies, (iii) national and international political and economic events, war and terrorist events, (iv) changes in interest and exchange rates, (v) trading activities in commodities and related contracts, (vi) pestilence, technological change and weather, and (vii) the price volatility of a commodity. In addition, the commodities markets are subject to temporary distortions or other disruptions due to various factors, including lack of liquidity, participation of speculators and government intervention.

Portfolio Management is an advisory program in which the client's Financial Advisor invests the client's assets on a discretionary basis in a wide range of securities.

The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada. As of May 30, 2011, the MSCI EAFE Index consists of the following 22 developed market country indices: Australia, Austria, Belgium, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden, Switzerland and the United Kingdom. An investment cannot be made directly in a market index.

The MSCI World Index is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets. As of May 30, 2011, the MSCI EAFE Index consists of the following 24 developed market country indices: Australia, Austria, Belgium, Canada, Denmark, Finland, France, Germany, Greece, Hong Kong, Ireland, Israel, Italy, Japan, the Netherlands, New Zealand, Norway, Portugal, Singapore, Spain, Sweden,
Switzerland, the United Kingdom, and the United States. An investment cannot be made directly in a market index.

Master Limited Partnerships (MLPs) are (rolled-up) limited partnerships of limited liability companies that are taxed as partnerships and whose interests (limited partnership units or limited liability company units) are traded on securities exchanges like shares of common stock. Currently, most MLPs operate in the energy, natural resources or real estate sectors. Investments in MLP interests are subject to the risks generally applicable to companies in the energy and natural resources sectors, including commodity pricing risk, supply and demand risk, depletion risk and exploration risk. Because of their narrow focus, MLPs maintain exposure to price volatility of commodities and/or underlying assets and tend to be more volatile than investments that diversify across many sectors and companies. MLPs are also subject to additional risks including: investors having limited control and rights to vote on matters affecting the MLP, limited access to capital, cash flow risk, lack of liquidity, dilution risk, conflict of interests and limited call rights related to acquisitions.

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