RUTHERFORD
INVESTMENT MANAGEMENT, LLC.

10300 SW Greenburg Road
Suite 115
Portland, OR 97223

Calendar Year 2011

Client Newsletter
Quarter Ending December 31, 2011

This past year severely tested investors' patience. The year started well, with economic optimism emerging. The first quarter of the year the S&P index finished up 5% in spite of enormous headwinds. However, even more unpredictable events appeared which dashed optimism. A severe earthquake and resultant Tsunami rocked Japan, disrupting supply chains and economies throughout the world, showing once again how exogenous events seemingly faraway can impact our markets.

The "Arab Spring" erupted in North Africa, spreading political uncertainty. The ongoing government debt crisis in Europe continued, with no resolution in sight. European headlines overshadowed the small progress being made in the U.S. economy. From August on, the Dow experienced 32 trading days in which the Dow averages moved by more that 2% in a single day. That equaled 41 % of trading days. On several consecutive days the Dow moved by more than 4%. 2011 was the most volatile year on record for stocks. Investors were rattled; some panicked. A few withdrew from the market. Mindful of our client's risk aversion, we raised cash to dampen the volatility. However the cash proved an impediment as the market staged a dynamic recovery. Still, with all the volatility, we could not be convinced of a recovery in the averages. This stance caused us to underperform the markets in the fourth quarter, even as we were experiencing positive returns. What this demonstrated is the need to be fully invested in the market at all times, but not all have the stomach for it.

Of the 8000 funds tracked by Lipper, 92% lost money in 2011

At home our own political problems caused great uncertainty. Three policy errors in six months, debt ceiling, super committee and payroll tax shook confidence in government. Globally faith in government plummeted. Uncertainty caused Banks and Corporations to hoard cash and defer capital spending further retarding growth. When we needed political leadership the most, on both sides of the Atlantic, politicians failed us.

Housing problems remained unsolved. Foreclosures continue apace. As I have written before, we need stability in housing to mount a strong recovery.

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Unemployment remains stubbornly high. While the private sector has been adding jobs since February, since August of 2008, state and local governments have cut 650,000 jobs. A trend predicted by Rutherford Investment some time ago. At the current rate of job growth, it will take until 2016 to recover the jobs lost in this recession.

Europe is heading into a recession, but only 18% of S&P earnings come from Europe so the U.S. can weather that recession. Our equity markets appear to have decoupled from the European debt crisis, for now.

Equities appear attractively priced. 2011 saw record S&P profits, but they will be surpassed in 2012 (barring surprises); however the market index is 20% below its 2007 peak. Average Price Earnings ratios are attractive. Interest rates remain low, and will for some time. Equities are under owned as record amounts of cash have been held in fixed income and cash accounts setting the stage for a recovery in the averages. Fixed income yields continue to decline and fixed income presents serious investment risk. The case for owning equities is compelling.

We expect continued volatility in the markets. We expect further slow growth and some recovery in employment. Currently President Obama appears poised to win a second term in spite of leadership failures.

We continue to remain substantially fully invested in equities. In those accounts which allow, we have some exposure to fixed income, and some international equities. We have begun to reinvest in Europe. We continue with our policy of diversification to reduce risk. We also favor dividend paying stocks to aid the portfolio.

If you have any questions, please do not hesitate to contact us.

Best personal regards,

William D. Rutherford, President
Rutherford Investment Management LLC.