RUTHERFORD
INVESTMENT MANAGEMENT, LLC.
10300 SW Greenburg Road
Suite 115
Portland, OR 97223

Client Newsletter

Quarter Ending September 30, 2012

U.S. equity markets have staged a strong rally since their low point June 1, 2012. At that time investors feared a global recession, Europe was facing disaster and the general outlook was one of despondency. The market closed at 1278.04 on June 1, 2012. Since that time, in a stealth rally, the broad market has risen 12.7% through the end of third quarter 2012. The market closed at 1440.67 September 30, 2012. In September alone, usually the worst month for markets, the S&P rose 2.6% and the Nasdaq 1.6%. The Dow logged 2.75%.

At the conclusion of the quarter, the Dow had risen in 11 of the past 12 months, falling only in May. The last time this happened was in 1959. The Dow has had a remarkable one year run up, about 2500 points, or 23%. I have often mentioned in these letters that the market climbs a wall of worry. This year is a good example. The markets have overcome concerns over Europe and China, general pessimism, inconsistent economic numbers, and retail investors shunning equity markets. The investors who opted out of the equity markets missed this stunning rally. The Dow is now 6% away from its high in 2007. While we may not attain that 2007 high in 2012, it could easily happen in 2013.

Jim Paulsen, Chief investment strategist at Wells Capital Management notes that "a housing recovery is under way, bank lending is rising, consumer confidence is at a five year high, and unemployment rate is at a four year low."

Byron Wien, global strategist at Blackstone Advisory partners, says, "the economy is stronger than the numbers reveal. It is probably growing better than 5%...."

Both conclude that the market will be 5% higher by year end, with the S&P approaching 1500.

In spite of the run up this year, the market is priced more cheaply than in 2007. In October of 2007, the market current P/E was 17.7 with a forward P/E of 16.1. Now, the market current P/E is 12.6 with a forward P/E of 11.6. None of the Dow components trade at more than 20 times earnings. Furthermore, if retail investors returned to the market, or with a dose of optimism, the P/E ratio could expand. While an exogenous event could upset the market, in the meantime, an investor can earn 2% in dividends.

Recently, the market got a lift from the announcement by the Fed of another round of Quantitative Easing. Both the anticipation of QE3 and the implementation helped the market rise. Investors were reminded of the old saw "Don't fight the Fed", as the markets went up. At present, concern over upcoming profit reports has contributed to a drop in the Dow as the fourth quarter began.

We continue to invest prudently for our clients; this means a conservative portfolio, which has no doubt cost us some performance. This may be one of those infrequent years when we underperform the broad market. Still, it should be an up year, we just don't know how much.

The election will no doubt have an influence, but we don't know which way the election will go. It adds another big imponderable. The "fiscal cliff" is causing problems even now. Businesses do not know what to do, because they do not trust congress to solve the problem. My belief is that the failure to resolve the "cliff" issue, and the debt ceiling issue, will cause such headaches that even congress will be forced to act because they do not want to risk the outcome if they don't act. I think the "fiscal cliff" will become more of a "fiscal slope".

As always, we appreciate the opportunity to manage your account. We think it is a good time to invest, so if you have friends or relatives that you think could benefit by our management, please let us know.

Thank you,

William D. Rutherford, Managing Director

Rutherford Investment Management, LLC.