10300 SW Greenburg Road
Suite 115
Portland, OR 97223

Client Newsletter

Quarter Ending December 31, 2012

Market continues rise from March 2009 lows.

Calendar year 2012 was a difficult year for the markets by nearly every measure but the one that counts. Globally economic and political problems in Asia, Europe and the U.S. dominated the news. Investors were force fed a diet of bad news and troubles.

During the year, European sovereign debt was a major worry. Political leaders in Europe and the U.S. seemed unable to deal with their respective problems. Central bankers throughout the world were forced to do the heavy lifting as politicians failed, but their toolbox was nearly empty. For many it seemed as though the central bankers were "pushing on a string". Bond defaults, the "fiscal cliff", the elections, all become common points in conversations. Nevertheless, the markets rose above the scary thoughts and turned in a surprisingly strong year. The markets continued their rise into the New Year with a post fiscal cliff, now fiscal slope, rally. The rally took the U.S. markets to a five year high. Investors who weathered the storm from 2009 to the present were rewarded for their patience, as the Dow Jones Industrial averages and Transport averages notched new five-year highs.

Furthermore, the market's so called "fear gauge" continued to decline. It has now fallen to its lowest level since June 20, 2007. The reading is down 43% this year.

In Europe, Mario Draghi, chair of the ECB pledged to do all that could be done to save the Euro and the Eurozone and his comments turned the tide. Greek, Italian and Spanish bonds found a bid. Interest rates fell. It seemed possible that Europe might muddle though. Asia meanwhile, followed the lead of China that for the time being, avoided a hard landing. The handover of the Chinese government, which happens every ten years, went smoothly.

The best performing U.S. industry sector was financial stocks. As you know, we have avoided most banks for the very reason of the uncertain nature of housing, bank finances, and the large penalties and litigation hanging over them. The cover story in **Atlantic Magazine** this month was about bank financial statements as a "black box", something I have been saying for some time. On the other hand, our other financial stocks did well.

Phone: 503/ 452-1210 • Fax: 503/ 452-0120 • WWW.RUTHERFORDINVESTMENT.COM

Consumer discretionary stocks also did well, and we were strongly represented in this area, with a weighting twice that of the S&P. Real estate, buoyed by a housing recovery, also was up. We were represented in this sector by REITS, which also have a strong yield.

We strive for a well-diversified portfolio to reduce risk and volatility. Managers who concentrate risk may have better (or worse) returns.

With the volatility index low and going lower, and the threat of interest rate increases looming, there is an increased interest in equities. For nine straight months, there have been inflows into equity funds, and out of bonds, in a reversal of past trends. With interest yields miniscule, investors are looking for higher returns. Fixed income generally will be under pressure going forward, but municipal bonds will still hold some yield and tax benefit attraction. High Yield bonds, with greater risk, should benefit from a recovering economy.

The U.S. economy slowed in the fourth quarter of 2012, but should strengthen as this year progresses. Equities should benefit from this trend. We see a good, but not great year for investors.

An interesting report by the N.Y. Times of an interview with Harvard economist Benjamin Friedman suggests that the absence of growth in the economy may be causing the political paralysis that we are experiencing. The Times refers to a "ball park" estimate, that if the GDP growth in the U.S. were 1% per year more, each year, over the next ten years, the deficit would shrink by $3 trillion. That would be more than enough to set our debt ratios on a comforting downward trajectory, without touching any of the "sacred cows" like Medicare or food stamps, and without a single dollar of additional tax revenue. Even one tenth of one percent would make the debt burden and work of Congress much less difficult. If this is true, and there is no reason to doubt it, Washington should be setting its sights on economic growth. However, our President in his inaugural speech January 21, 2013, scarcely mentioned jobs or economic growth.

William D. Rutherford

Rutherford Investment Management LLC.