

Global Economic and Financial Markets Summary

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US and international equities started 2012 with strong gains. In the first few weeks of January, stock markets around the world advanced on positive US economic data, constructive developments in Europe, and hopes that China would continue easing monetary policy. We are especially pleased by the robust rally in international equities and US small- and mid-cap stocks, as these market segments had negative returns in 2011. In many portfolios, the strong start to 2012 offset some, if not most, of last year's negative performance.

2011 was an exceptionally volatile year in the global economy and financial markets. Political protests across the Middle East and North Africa, known as the "Arab Spring," sent oil prices above \$100 a barrel. Japan suffered a devastating earthquake and tsunami that led to a nuclear disaster. Economic growth slowed in China, and the US economy narrowly escaped a potential Congress-initiated debt crisis and hit a soft patch over the summer. Europe's sovereign debt crisis escalated, and the credit rating of the US government was downgraded. The manner in which US and European authorities responded to their countries' debt problems undermined investor confidence, as well as the confidence of the general public.

In this volatile environment, the performance of the financial markets was

mixed. The fixed-income markets generated positive returns as risk appetites declined. Despite a strong rally in the fourth quarter, US large-cap stocks ended the year close to where they started, while small and mid caps posted single-digit declines. International equities and commodities were not as resilient and finished 2011 with substantial losses; see Exhibit 1.

Correlations among stocks were well above average, which made equity investing even more challenging. *The Wall Street Journal* noted that there were 69 days in 2011 in which 90% of the stocks in the S&P 500 Index moved in the same direction. This was more than the combined total for 2008 and 2009, two other volatile years. The high correlations caused many active mutual fund managers to significantly underperform their benchmarks. According to Morningstar, active managers were able to beat their benchmarks in just two of nine equity asset classes, with "beat" being defined as more than 50% of the managers outperforming.

As we enter the new year, conditions in the financial markets are more favorable, and equity markets are rising. The issues in Europe will take time to resolve, but progress is being made. Many emerging economies remain strong, and the US economy continues to grow, quarter after quarter, as it has since mid-

(Continued on page 2)

2009. In fact, the United States has now recovered all of the output that was lost in the 18-month recession. (See attached Appendix A.)

Volatile years like 2011 keep the financial markets on edge, but they also create opportunities for long-term investors. At SOL Capital Management, we believe that today

is one of those opportunities. Whether investing in the United States or overseas, an investor can buy a diversified portfolio of very high-quality stocks at reasonable-to-low valuations. Yes, there are risks, and prices can go lower. However at today's valuations, we think owning equities is a prudent way to invest long-term assets as part of a diversified portfolio.

“Volatile years like 2011 keep the financial markets on edge, but they also create opportunities for long-term investors.”

Exhibit 1
Total Return* for Selected Equity, Fixed Income, and Hedge Fund Indices

| | 4Q 2011 (9/30/11 to 12/31/11) | Year to Date (12/31/10 to 12/31/11) |
|---|-------------------------------------|---|
| Major Equity Indices | % | % |
| S&P 500 Index | 11.8 | 2.1 |
| Russell 3000 Index (Total US Market) | 12.1 | 1.0 |
| Russell 2000 Index | 15.5 | -4.2 |
| MSCI All Country Ex-US Index (Net) | 3.7 | -13.7 |
| MSCI EAFE International Index (Net) | 3.3 | -12.1 |
| MSCI Emerging Markets (Net) | 4.4 | -18.4 |
| <i>Source: Bloomberg, MSCI</i> | | |
| Major Fixed Income and Hedge Fund Indices | % | % |
| Merrill Lynch 0-3 Year T-Bill | 0.2 | 1.2 |
| Barclays Capital US Aggregate Bond Index | 1.1 | 7.8 |
| Barclays Capital US Credit Index | 1.7 | 8.4 |
| Merrill Lynch US High Yield BB-B Bond Index | 5.9 | 5.4 |
| JPMorgan GBI Global ex-US Index Hedged in USD | 0.8 | 4.5 |
| JP Morgan EMBI Global Index in USD (Emerging Markets) | 5.1 | 8.5 |
| Dow Jones UBS Commodity | 0.3 | -13.3 |
| HFRI Equal Weighted Strategies Index (Hedge Funds) | -0.2 | -6.3 |
| <i>Source: Bloomberg, PIMCO, HFRI</i> | | |

* Includes price appreciation plus dividends and/or interest.

Financial Markets Performance

Equities

In the United States, a strong fourth quarter helped the broad stock market finish 2011 essentially flat. Small- and mid-cap equities outperformed large caps during the quarter, while value stocks led growth stocks. The reverse was true for the year, with large caps delivering the best performance among the capitalization segments and growth beating value.

Stock markets outside the United States also rallied in the fourth quarter; however, it was a case of “too little, too late.” The MSCI EAFE and MSCI Emerging Markets indices gained 3.3% and 4.4%, respectively, but lost 12.1% and 18.4% during the year. UK stocks, down 2.6% in 2011, escaped much of the pullback, since the pound largely insulated the local economy from the euro-zone turmoil. In contrast, German equities lost 18.1% of their value. The “BRIC” markets of Brazil, Russia, India, and China did even worse, as fears of a global economic slowdown encouraged investors to drain liquidity from the riskiest assets in their portfolios. India was down more than 37% for the year, while Brazil, Russia, and China each lost about 20%.

Fixed Income

US bond yields moved sideways to lower in the fourth quarter after experiencing much sharper declines earlier in the year. For all of 2011, the Merrill Lynch 0-3 Year T-Bill Index gained 1.2% and the broad-market Barclays Capital US Aggregate Bond Index gained 7.8%.

The events taking place around the world pushed US Treasury yields from historic lows to new historic lows. Municipals had solid gains, with supply remaining constrained and default risk dissipating in spite of earlier dire predictions. Investment-grade corporate bonds also advanced, supported by a strengthening in corporate balance sheets. Within the corporate bond market, financial issues suffered due to concerns about European banks, while industrials and utilities fared well. High-yield bonds had a volatile year. The high-yield bond market was down in the third quarter amid worries about the global economy. It subsequently recouped all of its third-quarter loss on upbeat US economic data, adding to gains from the first half of the year.

Overseas, government bond markets in most developed and emerging countries delivered respectable annual returns, except for Greece, Portugal, and Italy. The positive results were driven by investors' preference for the relative safety of bonds over stocks rather than conviction in the long-term potential of these markets.

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Global Economic Outlook

United States

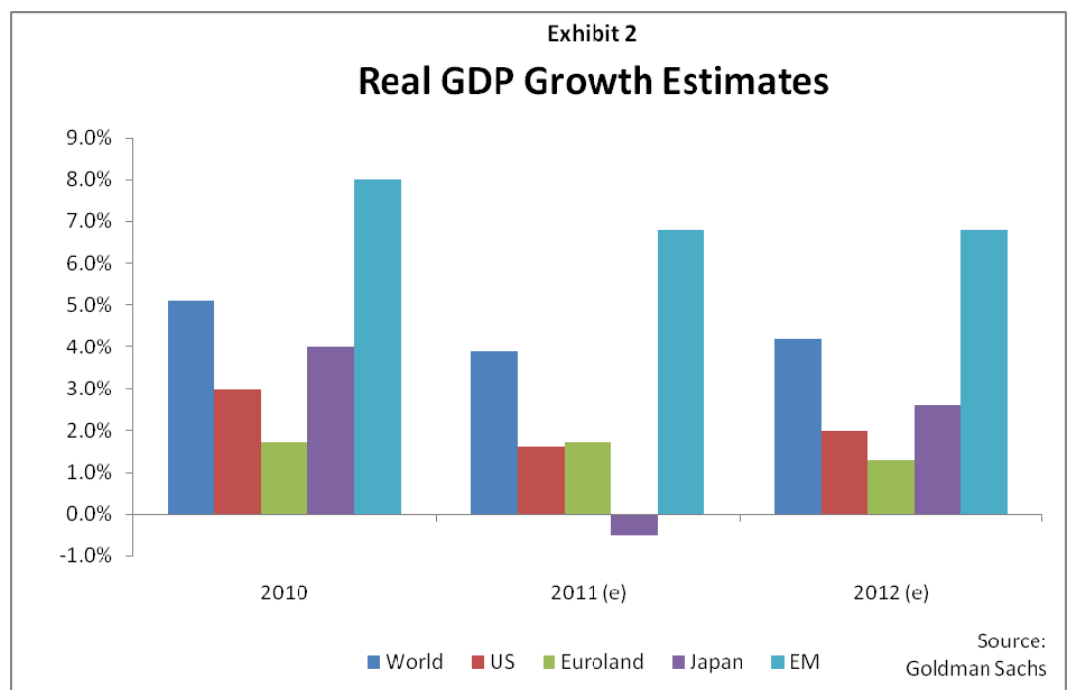
US economic indicators strengthened during the second half of 2011. Nonetheless, we continue to believe that the United States is on a path of relatively slow growth. The most recent official estimate for US real GDP growth was 2.8% annualized for the fourth quarter of 2011, which was encouraging given the slower growth earlier this year. Still, we expect 2012 growth to be around 2%; see Exhibit 2.

There are certainly headwinds facing the United States, including the need for deficit reduction and the economic slowdown in Europe. Furthermore, the tense political environment and November elections make the direction of the economy less certain in the minds of businesses and consumers. However, the fact that 2012 is an elec-

tion year means that the current administration has a major incentive to create new jobs. The unemployment rate has already dropped to 8.5%, and initial jobless claims are moving in the right direction.

The economy is also showing clear improvement in other areas. Critical sectors (e.g., Light Vehicle Sales, Manufacturing and Trade Inventories, Housing Starts, and Real Capital Goods Orders) performed well in the fourth quarter. (See attached Appendix B). Holiday sales and consumer spending were positive and higher than expected at the end of the year. In addition, consumer balance sheets are solid, personal savings are on an upward trend, and the ratio of household debt payments to disposable income is at its lowest level in years. (See attached Appendix C.)

“...the fact that 2012 is an election year means that the current administration has a major incentive to create new jobs.”



Global Economic Outlook Cont.

The corporate sector is also on solid ground. The earnings-per-share of S&P 500 companies is higher than it was in 2007, and profits relative to GDP are far above the historical average. (See attached Appendix D). Balance sheets are strong, and companies are looking for ways to put excess cash to work, either through acquisitions or dividend increases. With a bit more certainty on the economy, corporate cash could fuel additional investment and hiring.

Europe

The latest data suggest that the European economy is expanding at a moderate-to-slow pace. However, continued uncertainty surrounding the debt crisis could dim the outlook for growth. Austerity measures have already driven Greece and Portugal into recession, and growth is slowing in Germany and France, the region's two largest economies. In January 2012, Standard & Poor's downgraded the debt ratings of nine European countries, including France. The downgrades could diminish the euro zone's ability to help its most troubled members. We continue to hope for a slow growth environment in the euro zone, and the probability of a recession has gone down since the summer, but it still remains higher than a year ago. If the ECB is unsuccessful in controlling the sovereign debt crisis, or if the stronger countries continue to demand further austerity measures, or if there are concerns over a banking crisis we could certainly see a further economic downturn in Europe. Likewise, since coun-

tries like Germany and France have benefited from their exporting sector, a slowdown in other parts of the world would affect them.

Nonetheless, officials in Europe—especially in the core countries of Germany and France—are starting to take serious steps to address the debt problems, including securing balanced-budget commitments and making fiscal transfers to peripheral nations. Furthermore, monetary authorities are injecting massive amounts of liquidity into the financial system. These and other policies being developed, such as a plan to recapitalize European banks, could bring stability to the region within the next few years.

Japan

The supply-chain disruptions resulting from Japan's natural disasters were largely mended in the second half of 2011. Following two quarters of contraction, the Japanese economy rebounded in the third quarter, growing at an annual rate of 5.6%. As reconstruction spending fades, future growth will be more dependent on demand for the country's exports. The strength in the yen is currently a drag on exports and may prompt the Bank of Japan to intervene in the currency markets as it did last fall.

Emerging Markets

Emerging markets continue to be the major growth engine of the

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“We continue to hope for a slow growth environment in the euro zone, and the probability of a recession has gone down since the summer, but it still remains higher than a year ago.”

Global Economic Outlook Cont.

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global economy. In fact, China alone accounted for approximately 25% of nominal global GDP in 2011. Many emerging countries that were tightening monetary policy to curb inflation have seen price pressures subside, especially China. They now have more room to adjust fiscal and monetary pol-

icy, and some have even started easing to combat moderating growth. We are also beginning to see higher levels of domestic consumption in some emerging countries where rising incomes are expanding the ranks of the middle class. This not only benefits local companies but European and US multinationals that sell into these markets.

Investment Strategy

Equities

In our view, the same themes that drove equity performance in 2011 are likely to drive performance in 2012. Chief among them are Europe's handling of its debt issues, the growth trajectory of the US economy, and China's ability to maintain robust growth while controlling inflation.

Having said that, there is always the potential for unpredictable events or already-emerging issues to disrupt the global economy and financial markets. For example, weather-related food shortages or rising tensions between the West and Iran over Iran's nuclear program could cause commodity prices to rise. This would have implications for both equities and bonds.

In the United States, large-cap growth stocks continue to look undervalued. We are seeing good opportunities in small- and mid-cap companies. Overseas, European equities generally appear undervalued, but we think the

markets will remain volatile due to the debt crisis. We thus continue to tilt (and our mutual fund managers continue to tilt) our European exposure toward large multinational companies with significant sources of revenue outside of Europe. We are finding more opportunities in emerging markets, where growth prospects and equity valuations are compelling.

Fixed Income

In 2011, expensive assets (US Treasuries) became more expensive, and inexpensive assets (stocks) became even more attractively valued. This was unexpected in a year when the US government's debt rating was downgraded, inflation was rising, and corporate profit growth was strong. We expect to see this trend reverse in 2012, mainly because we do not believe 30-year mortgage rates at 4% and 10-year Treasury yields below 2% are sustainable. We understand that the Federal Reserve is working to keep long-term interest rates low. However, we think

“We believe that the equity markets will remain volatile in 2012 and that fixed-income exposure, where appropriate, will continue to provide stability.”

Investment Strategy Cont.

longer rates could rise quickly if there is more positive news on the US economy.

As a result, we continue to tilt (and our mutual fund managers continue to tilt) our fixed-income exposure toward short-term bonds with lower duration and credit, which are less sensitive to changes in interest rates. This kind of allocation dampened the volatility caused by the equity portion

of many portfolios in 2011 (although an allocation to longer-term bonds would have had an even greater positive impact). We believe that the equity markets will remain volatile in 2012 and that fixed-income exposure, where appropriate, will continue to provide stability. However, we think overweighting shorter-term bonds relative to longer-term bonds makes sense given the extremely low level of interest rates.

In closing

SOL Capital Management believes the financial markets are highly efficient in the long term. But in the short term, investors have the tendency to become overly optimistic when markets are rapidly rising and overly pessimistic when markets are weak and volatile. These shifts in sentiment create both bubbles and opportunities. In our view, the challenging environment of 2011 has created an opportunity to invest in stocks of very strong companies at attractive valuations. If those companies, on average, can continue to be profitable—even if profits are less than last year—then investors should be able to weather short-term volatility to reach their long-term goals.

We also believe broad diversification remains one of the most prudent

strategies for dampening volatility and preserving capital. As a result, portfolios are broadly diversified by asset class, geographic market, asset size, and investment style.

We continue to thoughtfully rebalance portfolios, being mindful of the geopolitical and macroeconomic backdrop. And our focus—as always—remains on achieving your long-term investment goals, within your risk profile, and funding your future liquidity needs. We invite you to call us at 301.881.3727 with any questions or concerns about your portfolio.

Sincerely,

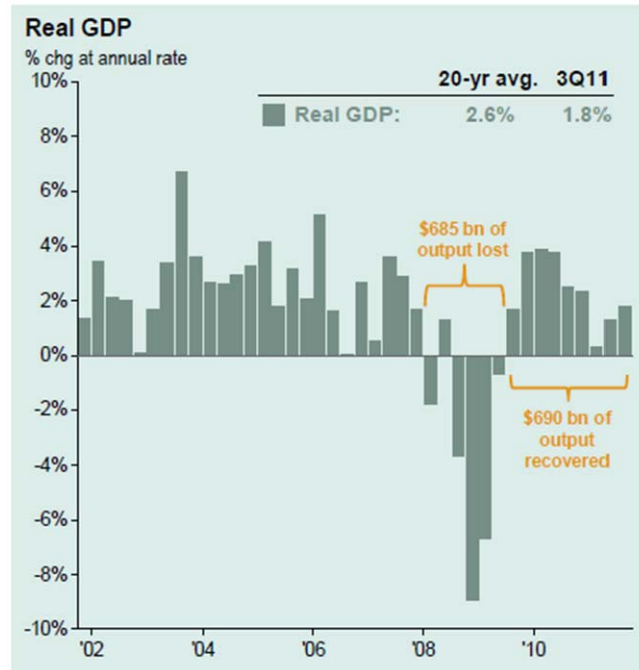
The SOL Capital Management Team

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Appendices

Appendix A

US Real GDP

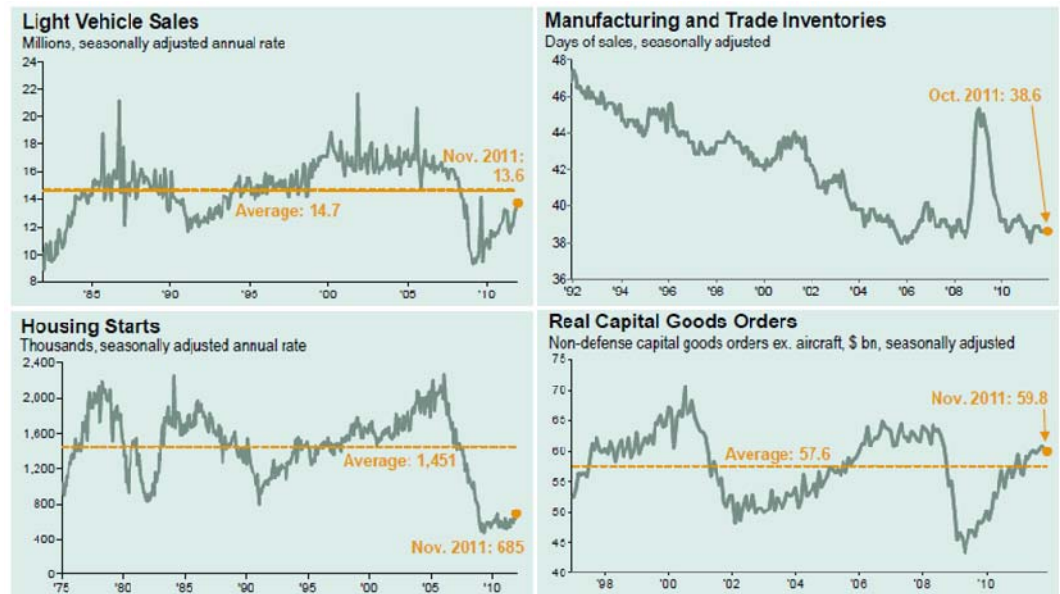


Source: BEA, FactSet, J.P. Morgan Asset Management. GDP values shown in legend are % change vs. prior quarter annualized and reflect revised 3Q11 GDP. Data reflect most recently available as of 12/31/11.

Source: "Real GDP," *Guide to the Markets 1Q 2012*, J.P. Morgan Asset Management, page 17

Appendix B

US Cyclical Sectors



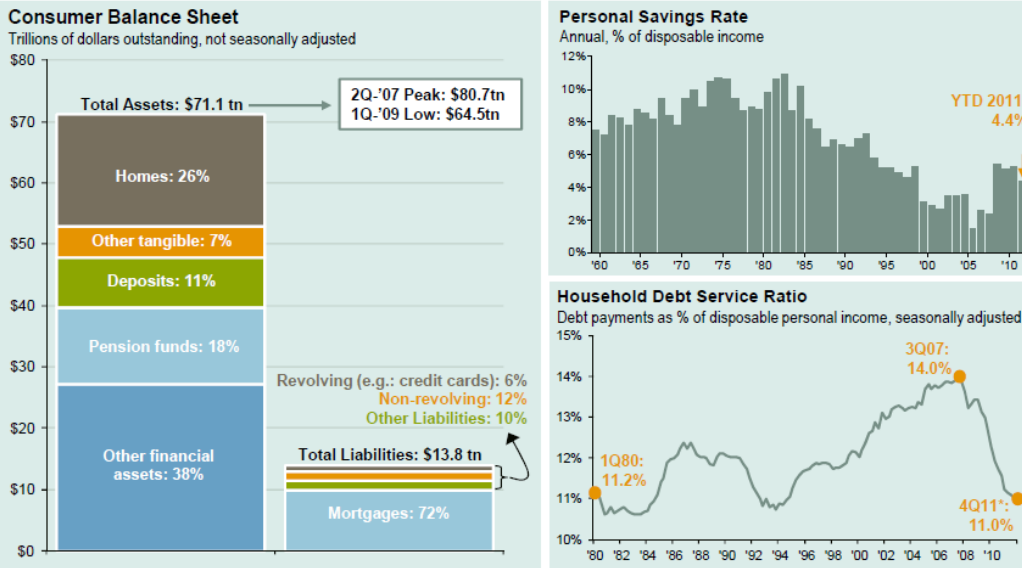
Source: (Top left) BEA, FactSet, J.P. Morgan Asset Management. (Top right) Census Bureau, FactSet, J.P. Morgan Asset Management. (Bottom left) Census Bureau, FactSet, J.P. Morgan Asset Management. (Bottom right) Census Bureau, FactSet, J.P. Morgan Asset Management. Capital goods orders deflated using the producer price index for capital goods.

Data reflect most recently available as of 12/31/11.

Source: "Cyclical Sectors," *Guide to the Markets 1Q 2012*, J.P. Morgan Asset Management, page 18

Appendix C

US Consumer Finances

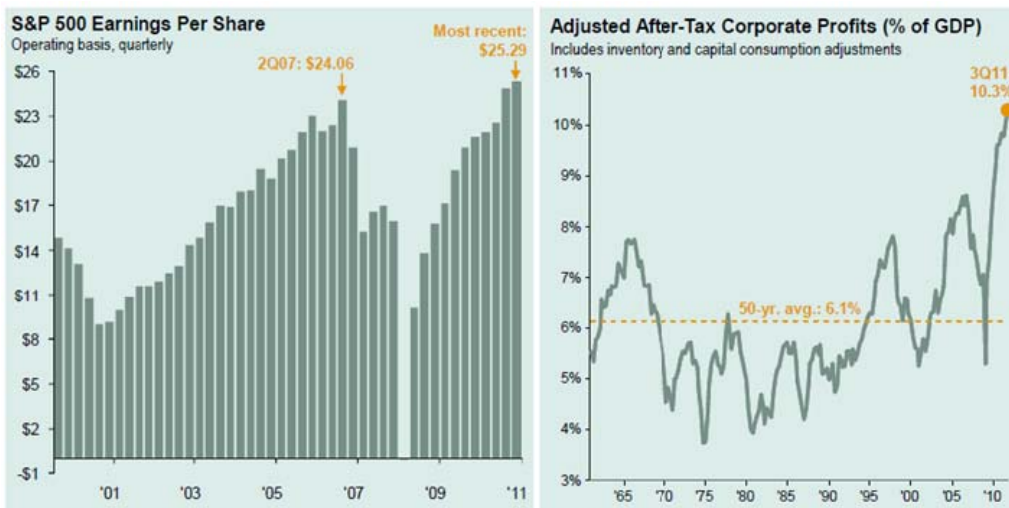


Source: (Left) FRB, J.P. Morgan Asset Management. Data includes households and nonprofit organizations. (Right) BEA, FRB, J.P. Morgan Asset Management. Personal savings rate is calculated as personal savings (after-tax income – personal outlays) divided by after-tax income. Employer and employee contributions to retirement funds are included in after-tax income but not in personal outlays, and thus are implicitly included in personal savings. Savings rate data as of November 2011. *4Q11 Household Debt Service Ratio is J.P. Morgan Asset Management estimate. All other data are as of 3Q11.

Source: "Consumer Finances," *Guide to the Markets 1Q 2012*, J.P. Morgan Asset Management, page 19

Appendix D

US Corporate Profits



Source: Standard & Poor's, J.P. Morgan Asset Management. EPS levels are based on operating earnings per share. Most recently available is a 3Q11 99% complete estimate. Data reflect most recently available as of 12/31/11.

Source: BEA, FactSet, J.P. Morgan Asset Management.

Source: "Corporate Profits," *Guide to the Markets 1Q 2012*, J.P. Morgan Asset Management, page 25

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