

January 25, 2011

Enclosed are your 4th quarter statements for your review. The equity markets had a strong finish for the year, with the broad US market gaining over 11% and other US asset classes also delivering double digit returns. The international markets continued their advance, but at a slower pace of slightly over 7%.

For the year the S&P 500 gained 15%, recouping all of its losses since the collapse of Lehman Brothers on September 15, 2008. The broad international developed markets gained 9% and the emerging markets gained over 20%. The past year was clearly the year of small cap stocks as they significantly outperformed large cap stocks in all markets. In the US and emerging markets, small cap returns were in excess of 30% while the returns in the developed international markets ranged from 18% for small value to 24% for small growth.

These returns came despite a host of troubling news and pessimistic market predictions. Even eight months into the year the S&P 500 Index was down 5.9%. Throughout 2010 negative news continued to dominate the landscape. Every day it was something new: the sovereign debt crisis of a few European countries, the Gulf of Mexico oil spill, the high rate of foreclosures, hundreds of bank failures, weak housing market, high unemployment and the list goes on. The positives that don't make the news are that corporate earnings, cash flows, dividends and productivity are on the rise. In fact cash as a percentage of corporate assets is at the highest level since 1959.

Even though 2010 was a year of recovery gathering momentum, it was also a year that the lemmings migrated to bond funds. The last two years has seen a staggering flow of funds away from equities and into bonds, despite the fact that fixed income returns are next to nothing. This is why the vast majority of investors earn returns way below the market.

We are pleased you have embraced our investment philosophy which has allowed you to stay the course in such turbulent times. You have and will continue to benefit from the resulting discipline. Continue to tune out the negative news reports and remember that "optimism is the only realism." As always, if you know of anyone whom you think could benefit from our philosophy, please have them give us a call.

Best Regards,

Pacific Asset Management Team