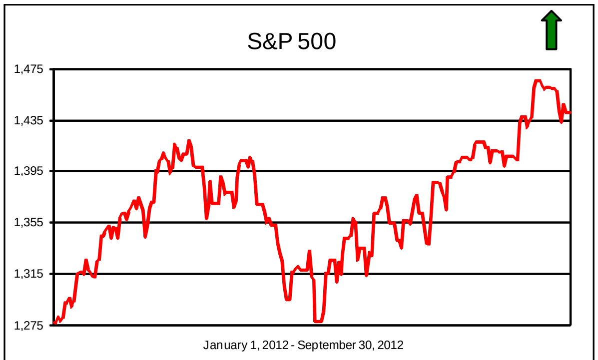
Wallington ASSET MANAGEMENT
INDEPENDENT INVESTMENT COUNSEL

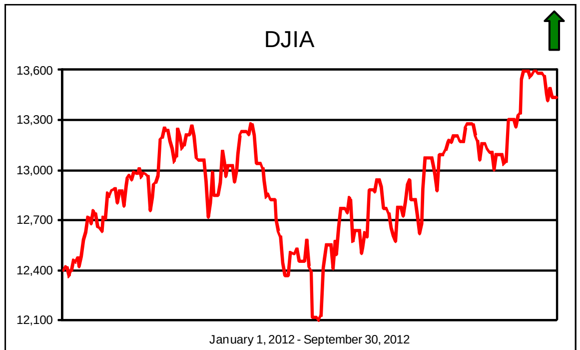
QUARTERLY REVIEW *95th Edition* *2012: Third Quarter*

CAPITAL MARKETS SCOREBOARD

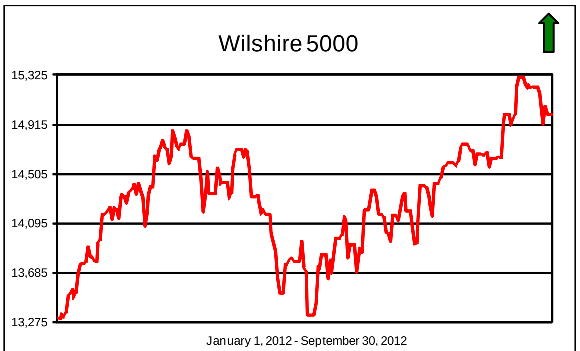
January 1, 2012 – September 30, 2012



3rd Qtr 6.4% YTD 16.4%

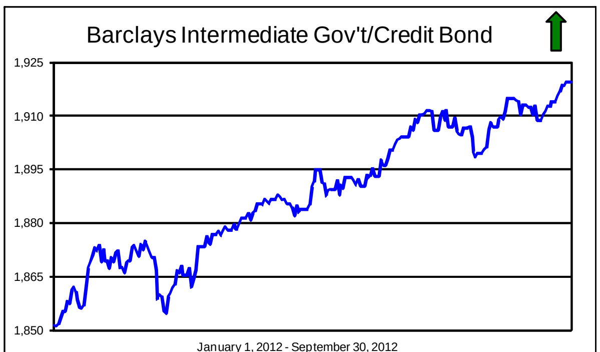


3rd Qtr 5.0% YTD 12.2%

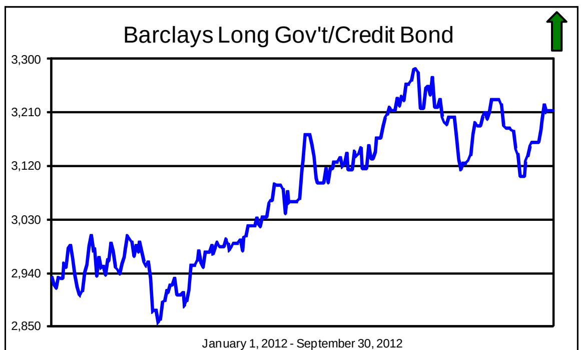


3rd Qtr 6.1% YTD 15.8%

3rd Qtr 6.5% YTD 20.7%



3rd Qtr 1.4% YTD 3.5%



3rd Qtr 3.1% YTD 8.3%

Performance Numbers Reflect Total Returns

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EQUITIES

Equity Market Performance

After a dismal second quarter, the S&P 500 bounced back sharply in the third quarter posting a return of 5.8% excluding dividends. Global market sentiment turned positive after the European Central Bank pledged to provide additional monetary support to the troubled countries of Europe. Sentiment was further boosted when the Federal Reserve (the Fed) announced in September that it would expand the size of its existing quantitative easing program. The economically sensitive sectors of the market, such as Energy, Consumer Discretion, and Information Technology, responded particularly well to this news. One notable cyclical sector that lagged was the Industrial sector, which only returned 3%. The transportation industry is an important sub-component of this sector, and these companies continue to be challenged by high fuel prices and lackluster volume trends.

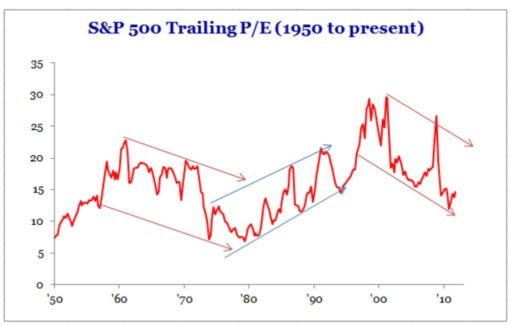
S&P 500 by GICS Sector	Price Return (%)	
	3Q12	**YTD**
Energy	9.5	5.8
Consumer Discretion	7.1	20.0
Information Technology	7.0	20.6
Telecommunications	6.8	21.0
Financials	6.4	19.9
Health Care	5.6	15.8
Materials	4.5	10.0
Consumer Staples	3.1	10.3
Industrials	3.0	9.2
Utilities	-1.5	1.0
S&P 500 Index	**5.8**	**14.6**

Earnings Outlook

Wall Street analysts are currently projecting earnings growth of 1.6% year-over-year for the third quarter and then an acceleration to a 6.9% year-over-year growth rate in the fourth quarter of 2012. However, one consideration for the economy in the fourth quarter may be the return of normal weather. According to the National Oceanic and Atmospheric Administration, there were approximately 10% fewer heating degree days in the fourth quarter of 2011 than normal, so consumers and businesses were able to redirect part of their income away from heating bills into other areas of the economy. Another tailwind during this period was the expiration of the accelerated depreciation rules on December 31, 2011, which may have moved 2012 capital spending into 2011. Overall, the economy grew at a 4.1% annualized clip in the fourth quarter of 2011, which was the highest growth rate since the recession ended in 2009. Analysts who have not adjusted for these anomalies may have set the bar too high for earnings growth in the fourth quarter of 2012. A further consideration is the uncertainty regarding economic policy post the U.S. election. Many companies may be reluctant to hire and spend for the balance of the year until they have clarity as to who will win the November elections and what the regulatory/tax environment will look like in 2013.

Peeling the P/E Onion

There are some Wall Street pundits who like to claim that the market is currently cheap because it is trading at a trailing four quarter price-to-earnings (P/E) multiple of 14.6 which is a 15% discount to the 10-year average. Their analysis may be overly simplistic in two respects. First, it ignores the relationship between earnings growth and economic cycles. Economies typically go through four phases: recovery, expansion, slowdown and recession. The outlook for earnings can vary greatly through these phases. Cyclical companies such as autos barely make money, if at all, during a recession and, thus can sport a very high P/E ratio during this period. At the top of the economic cycle, the very same company might generate record earnings, so the P/E could be deceptively attractive (low). In contrast, a food manufacturer generally has fairly consistent earnings growth throughout an economic cycle, so its P/E typically will not vary much. The S&P 500 is a blend of both of these types of companies, so simply valuing the market without adjusting for this factor is likely to lead to the wrong conclusions. Second, the range of P/E's has shifted dramatically throughout the decades. During the 60s and the 70s, the range of P/Es steadily fell, while the range expanded throughout the 80s and the 90s. More recently, the 10-year average of 17.1 incorporates the sky high valuations of the early 2000s, whereas the 60-year median P/E of 16 is more representative of a long-term market P/E.



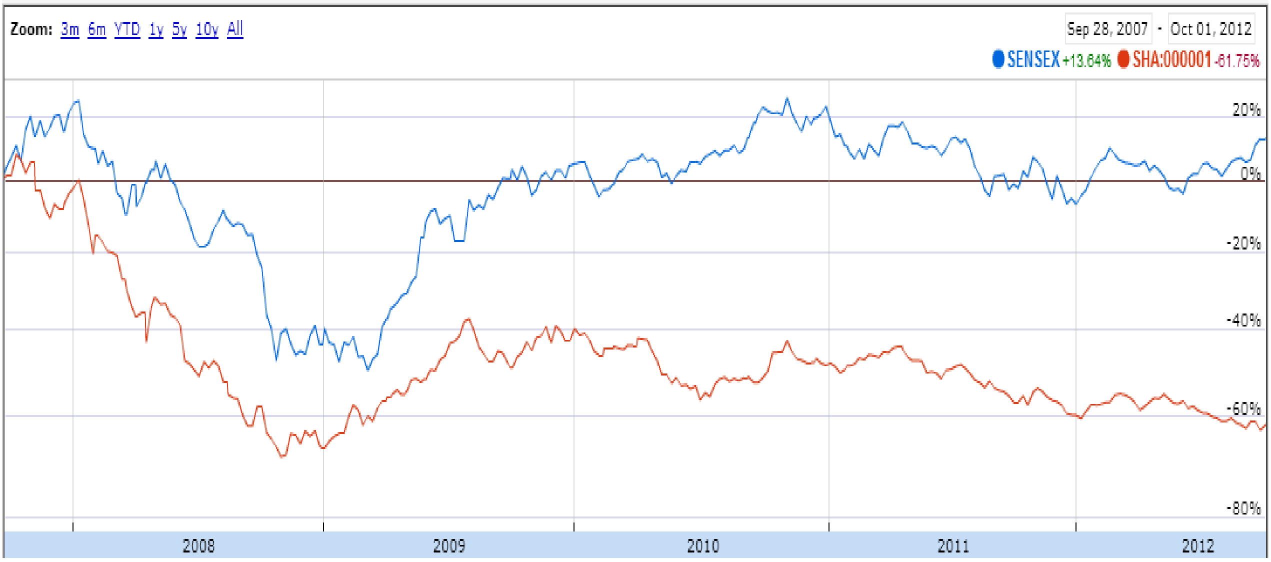
Source: Wallington Asset Management, Strategas Research Partners

The Predictive Power of a 15 VIX Reading

The financial press and other commentators often spotlight the VIX, which is the Chicago Board of Options Exchange's measure of expected volatility for the S&P 500. It is popularly referred to as the market's "fear gauge" or "fear index". A VIX reading of greater than 30 is often associated with high amounts of fear (expected volatility), although the true meaning is that investors expect significant price movements either upward or downward. A reading below 20 indicates that investors believe prices will not move significantly in one direction or another over the next 30 days. The VIX drew attention in August because its value had fallen through, and remained below, 15 for several days. For many market participants, this implied many investors had become complacent about the prospects of a major market move. Such complacency is often viewed as a contrarian indicator. For instance, since the Great Recession, a sustained reading near 15 preceded some declines in the broad market. Using the "VIX @ 15" rule as a sell signal has not always proven prescient as there have been many times in history when stock prices have provided positive returns after the VIX had declined to that level.

India takes the spotlight from China

China has been in the news on a regular basis with reports of disappointing economic growth, growing tensions with their neighbor Japan, and the exile of a high-profile member of the Communist Party, Bo Xilai. Their neighbor (and rival) to the



Source: Google Finance

west, India, has also had its share of bad press. Numerous bribery scandals have plagued the Indian government. The country suffered a major blackout over the summer, highlighting the antiquated state of the country's infrastructure. Food and energy prices have spiraled higher despite aggressive tightening action by the central bank. While both countries have had their share of setbacks, the stock market performance of the two is remarkably different. Over the last five years, the Chinese Shanghai Composite Index is down 61.8% while the Indian Sensex Index is actually up 13.6%. Valuations are one possible explanation for this disparity, as the Chinese stock market experienced a significant bubble during the latter half of 2007. Another plausible explanation is transparency. A number of Chinese companies have recently come under scrutiny regarding the accuracy of their financial statements, whereas Indian companies must follow much more stringent accounting rules. Perhaps the most important factor is the policy changes that India recently introduced to attract foreign capital into the country. Global investors are now watching China to see what policy changes, if any, they will implement after the new President, Xi Jinping, assumes office later this year.

Hedge Fund Returns

According to Hedge Fund Research, hedge funds that invest primarily in equities have posted year-to-date returns of 3.35% compared to the S&P 500 total return of 16.4%. While high hedge fund fees partially explain the significant difference in returns, the comparison may not be apples-to-apples. Investors are lured to long/short equity hedge funds because these funds typically try to achieve steady, positive returns irrespective of the direction of the market. Hedge funds typically manage the volatility of returns by shorting (selling without owning) $100 of a basket of stocks for every $100 of equities that they are long (own), thus effectively creating a "hedge" against a decline in the market. While their long portfolio will do well when the market is trending up, the negative returns in the short portfolio will offset some (but hopefully not all) of the returns from the long portfolio. Likewise, the short portfolio should outperform the long portfolio during market corrections. Still, hedge fund investors continue to be frustrated by lackluster performance. From 2009-2011, the average equity hedge returned -0.2% per year.

Hunt for Yield (Equities)

Since the Fed has committed to keeping rates "low for long", also known as "financial repression", media articles highlighting the benefits of income-producing securities and strategies have proliferated. Most of the articles remind readers that dividends provided 40% - 45% of the broad market's total return since 1926; the latest Ibbotson SBBI Classic Yearbook indicates 41.8%. Equity buyers may be enticed by shares providing the highest dividend yields, but choosing companies that have a demonstrated record of dividend growth may be a better investment answer. Further, a dividend-focused strategy may not be the panacea many believe. A comparison of three different dividend-centered indices against the S&P 500 total return (SPXTR) since the beginning of 1990 shows that dividend strategies have long periods when they "work" and when they do not "work". The longest-running index, the S&P Dividends Aristocrats Total Return (Dividend Aristocrats) index, outperformed the SPXTR from 1990 to late 1992 before beginning an extended period of underperformance that lasted until late 2000. Data for the other two indices, the STOXX[1] North America Select Dividend 40 index and the MSCI World High Dividend Yield USD Total Return index, is available during portions of the same timeframe; they show a pattern similar to the Dividend Aristocrats. After the aforementioned period of underperformance ended, each dividend index materially outperformed the SPXTR over the next 18 months, at which point the gains moderated and began exhibiting some volatility through September 2012. As with many strategies, then, it "works" until it doesn't, which is why it is often best within a portfolio to employ diversified strategies.

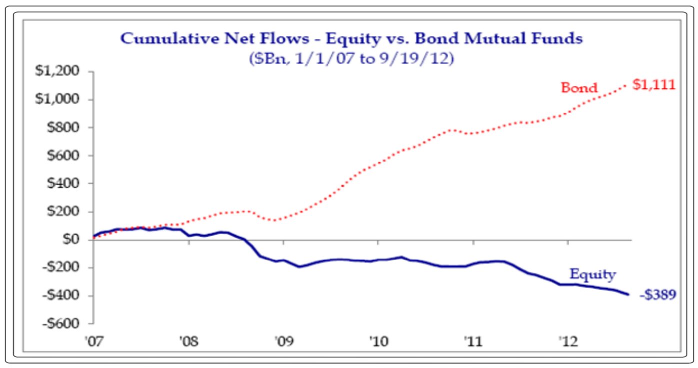
ECONOMICS AND FIXED INCOME

Fixed Income Market Performance[2]

During the third quarter of 2012, the Bank of America Merrill Lynch (BofA-ML) U.S. Treasury Master Index appreciated 0.6% while state and local debt (municipal bonds) returned 2.5%. The BofA-ML U.S. Corporate Master Index, which is only composed of corporate bonds rated A3/A- or higher, gained 4% during the quarter. The broad-based Barclays Intermediate Government/Credit Index, comprised primarily of Treasury bonds and corporate bonds with an average duration of almost half the BofA-ML index, was up 1.5% for the quarter. Investors' appetite for yield was evidenced by the performance of more volatile high-yield (a.k.a. junk) bonds during the quarter as the high-yield bond index rose 4.6%.

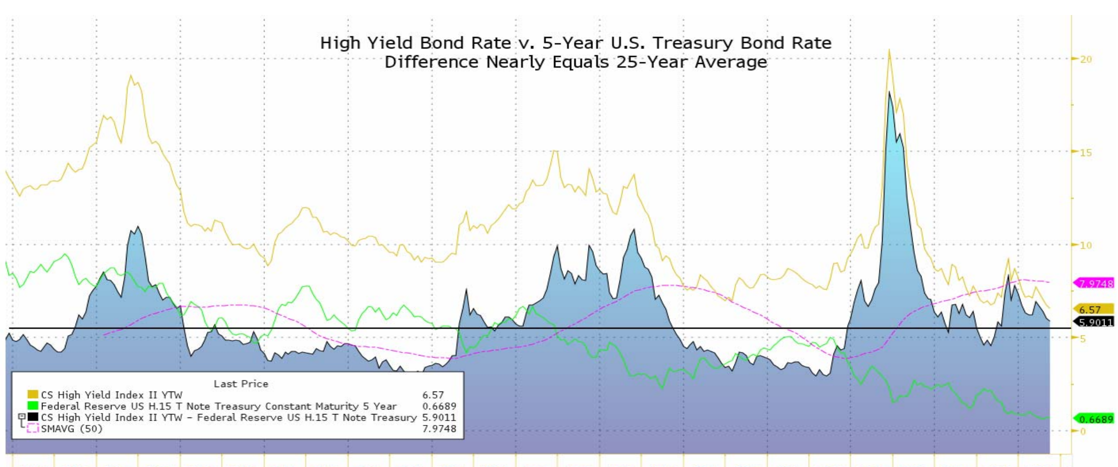
Hunt for Yield (Fixed Income)

Low interest rates and low yields on fixed income securities, resulting from the Fed's efforts to support the economy with monetary policy, have resulted in an attractive environment for borrowers, even as savers/investors have had to make hard choices with respect to realistic yield goals. For investors, the effects of the Fed's "low for long" policy have been as follows:



Source: Strategas Research Partners

1. Mutual Fund Flows – According to Investment Company Institute (ICI) data, taxable bond funds continue to attract assets, while domestic equity funds continue to lose assets. For example, since the beginning of 2007, taxable bond funds have attracted approximately $14 billion per month versus losses (outflows) of $7.9 billion per month for domestic equity funds. In addition, the 67-month span features just seven months when taxable bond funds posted net asset outflows. Domestic equity funds, on the other hand, experienced net outflows during 51 months, including the current 15-month losing streak that dates back to May 2011.
2. High-Yield ("Junk") Bond Yields – Despite the lackluster economic situation in the U.S., Europe's ongoing problems and the slowdown in China's economy, high-yield "junk" bonds offer buyers a yield spread over similar-maturity U.S. Treasury (UST) bonds of about 5.6%. One might expect the concern about future economic growth to call into question the credit worthiness of low-quality debt, driving the spread higher than normal. However, the stretch for yield by investors has brought the spread back to roughly in line with its 25-year average.



Source: The Bloomberg

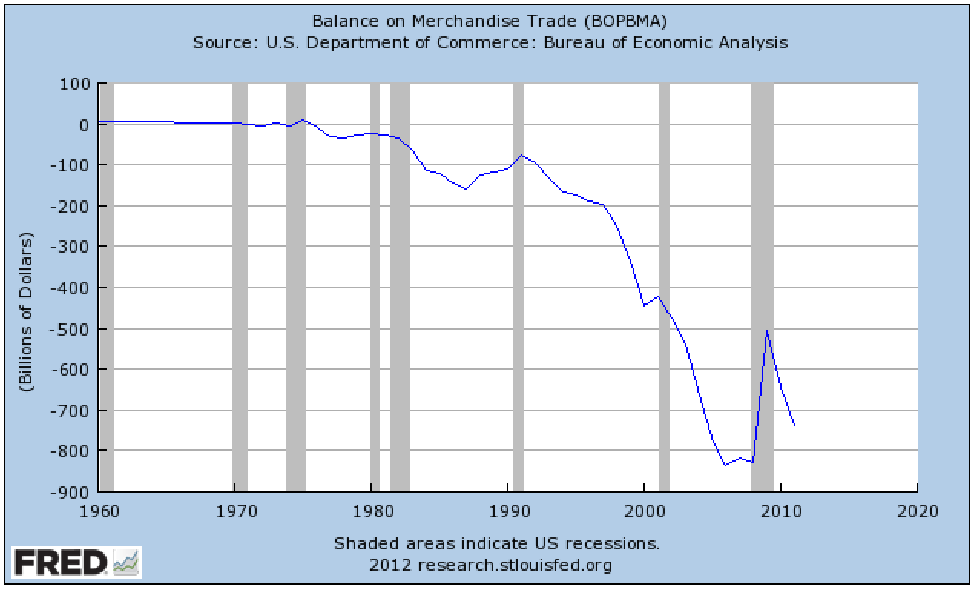
[1] STOXX Limited is a European-based financial market index provider.

[2] As measured by Bank of America Merrill Lynch's fixed income indices.

3. U.S. Treasury Yields – At the end of the quarter, the 10-year Treasury bond yielded 1.65%, even as inflation, based on the CPI, was last recorded at 1.7%. Those who purchase U.S. Treasury debt maturing in less than 10 years are accepting an even lower yield.

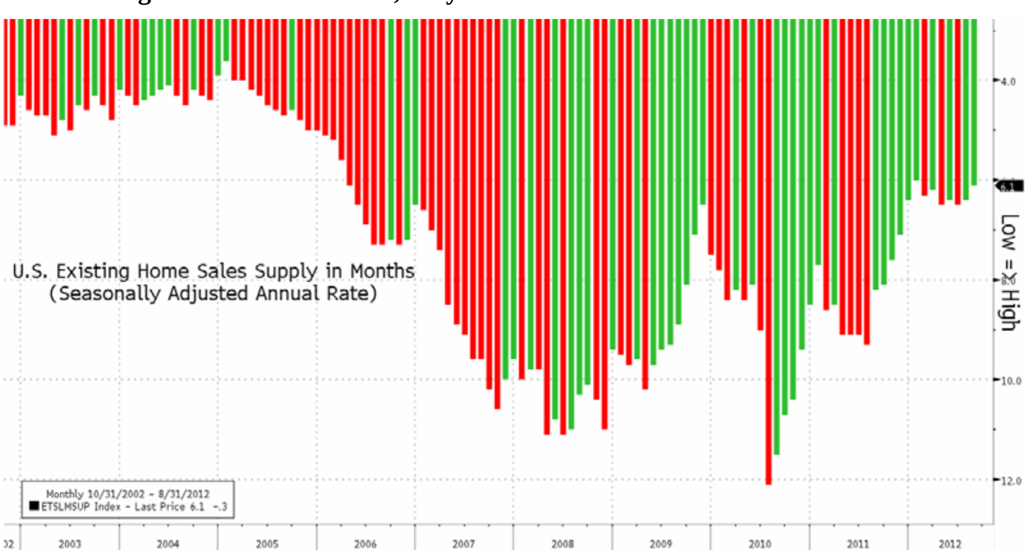
Made in the U.S.A.

Since the labor market bottomed in 2009, U.S. manufacturers have added 500,000 jobs and there is much hope in Washington that this is just the beginning. Manufacturers around the world are increasingly looking to relocate part of their global manufacturing footprint to the U. S. in order to take advantage of lower power costs, what some have indicated as a relatively more educated and innovative workforce, and an efficient transportation network. If this trend continues, the impact on the U.S. economy will be profound. The U.S. has been running a merchandise trade deficit for almost 40 years which, at present, is a $750 billion annual headwind to the U.S. economy, or 5% of Gross Domestic Product (GDP). This deficit is part of the reason that an estimated 7 million manufacturing jobs have disappeared since 1980. While the value proposition for relocating manufacturing to the U.S. may be compelling on paper, there are other factors to consider. Many countries, such as China, offer large financial incentives to global companies if they locate their factories within their borders. Also, manufacturers typically need to be near other suppliers, so moving just one part of the supply chain may not be practical. An additional consideration is the high degree of automation that is occurring globally, including in China, which is helping companies control their overall costs. Still, the "Made in the U.S.A." label is increasingly showing up on store shelves around the world.



Source: Federal Reserve Board's FRED Charting System

U.S. Housing Market – Not Worse, Maybe Better



Source: The Bloomberg

A number of economic metrics show encouraging signs that the U.S. housing market may have bottomed or at least stopped declining. For instance, the histogram to the left shows an improvement (decrease) in the supply of existing homes for sale (measured in months). Also, according to the latest data from S&P/Case-Shiller and the latest reading of the median price of existing homes sold in the U.S., home prices also seem to be advancing. Although referring to the situation as a "recovery" may be too bold, it does appear that housing will no longer be a drag on U.S. GDP.

Even if demand is returning to the housing market, it is clear that the type of home desired has changed, at least for the near-term. In particular, since the Great Recession, numerous sources have documented the increased prevalence of "doubling up" – two or more families in single-family homes. As a testament to the prevalence of this phenomenon, some homebuilding companies have begun to offer "home-within-a-home" options. From the Lennar website: "Lennar offers NEXT GEN[SM] – The Home within a Home[SM],…It's a complete suite with bedroom, eat-in kitchenette and living room. It can be integrated into a home's living space or kept as a private residence."

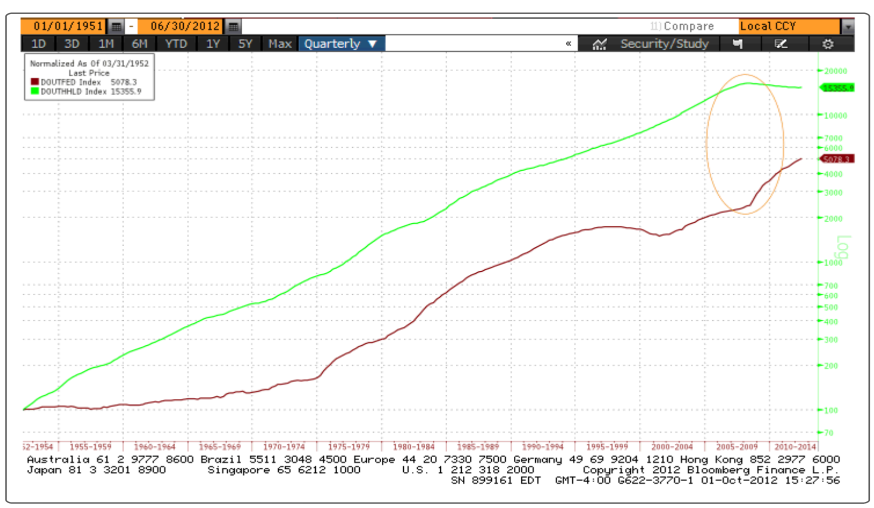
Source: http://lennarnextgen.com/

Euro-Area Leaders Act to Save the Common Currency

September 2012 may have marked the beginning of the end for the Euro-area financial crisis, although it is likely to be a long period of time before sovereign balance sheets are effectively repaired. First, European Central Bank (ECB) President, Mario Draghi, announced the ECB would begin purchasing sovereign bonds issued by crisis-plagued Euro-zone countries. Under the plan, the ECB will purchase bonds on the secondary market, with maturities of three years or less, of a troubled member country in order to reduce the country's interest rates to levels the ECB deems appropriate. The member country in question must a) formally request assistance and b) accept the terms of the European Financial Stability Facility (EFSB) or its permanent successor, the European Stability Mechanism (ESM). The new program virtually eliminates the possibility of a troubled country being priced out of the short-term debt markets due to default fears. Interestingly, the ESM had not been officially agreed upon by the requisite number of Euro Member States when the ECB made its announcement. However, Germany's Federal Constitutional Court removed the last obstacle when it approved of the ESM's structure. The ESM has the discretion to lend up to 500 billion Euros, which some believe could be leveraged to provide up to 2 trillion Euros if needed.

Leverage in the System – Consumer v. Government

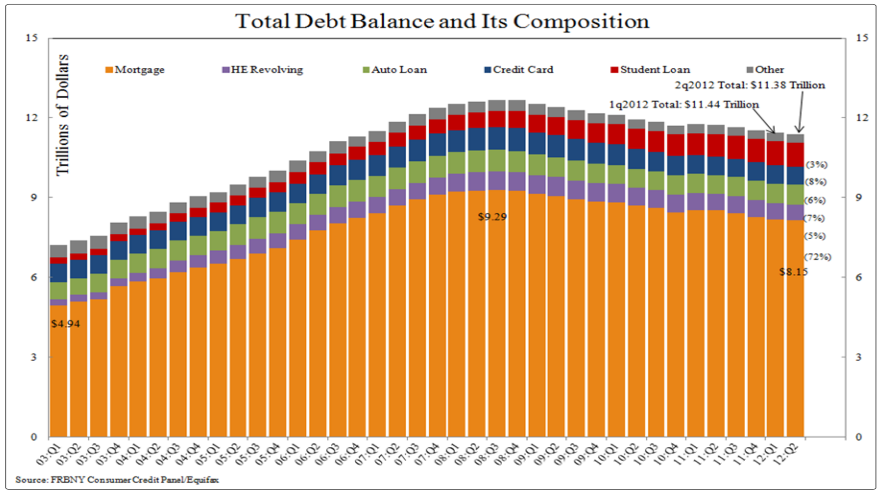
In the wake of the Great Recession, consumer debt levels declined for the first time on record, at least according to the Fed's Flow of Funds report. The nearby graph, using data compiled by Bloomberg, clearly shows a) growth in consumer debt stopping in the spring of 2008 as a prelude to an outright decline (green line), and b) government debt levels rising sharply versus the prior ten-year trend in the same timeframe (red line). Commentators often state that the Federal government increased its



Source: The Bloomberg

debt load to counterbalance the deleveraging in the private sector.

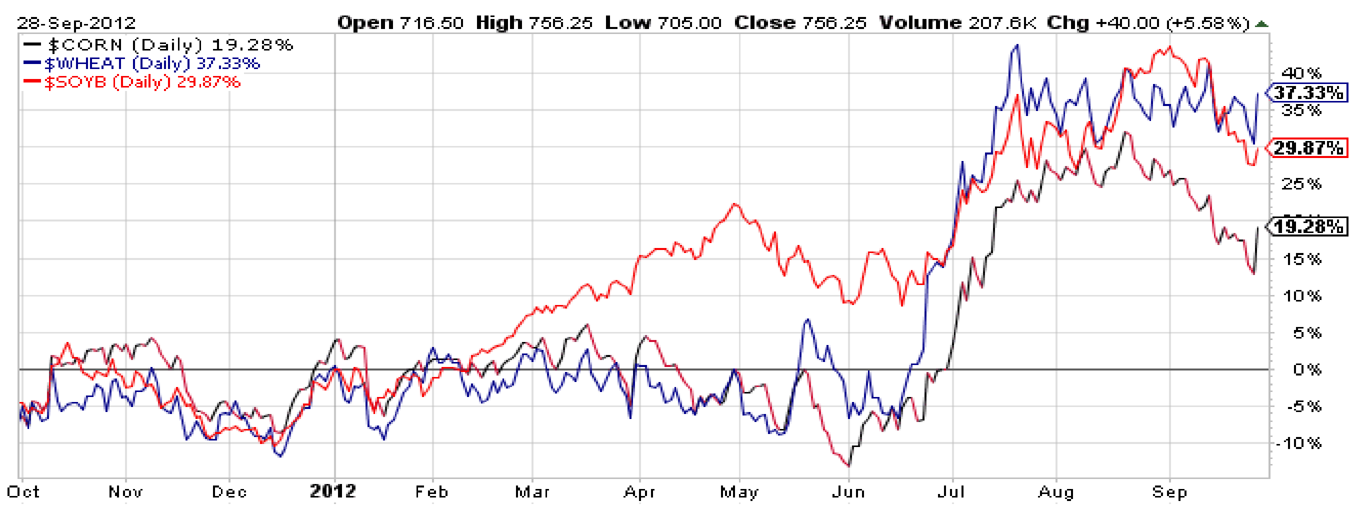
The Federal Reserve Board of New York (FRBNY) provides an interesting subset of data that categorizes consumer debt and adjusts for charge-offs and other credit events. The data points contained in the accompanying chart highlight the rise and fall of mortgage debt (orange portion), as well as the increase in student loans outstanding (red).



Source: Federal Reserve Board of New York Consumer Credit Panel / Equifax

The Drought of 2012

The drought of 2012 in the U.S. made its mark on the history books. According to the National Climate Data Center, the summer of 2012 was the fifth driest since 1895. Other countries such as Brazil, India and Russia also experienced extraordinary droughts this year. As a result, global grain production is expected to fall 2.2% this year according to the Food and Agriculture Organization. Agriculture commodity prices have reacted: corn has posted a year-over-year price gain of 19.3%, soybeans have gained 29.9% and wheat has jumped 37.3%. The impact of these higher prices on consumers is just starting to be felt with the full impact looming in 2013. The first to feel the effect of higher prices are livestock farmers whose cost of feeding chickens, pigs and cows has risen dramatically. It is likely that these elevated input costs will ultimately be passed on to the consumer in the form of higher milk, egg and meat prices. Perhaps the biggest impact will be felt in emerging markets, where consumers spend 35-40% of their income on food compared to 7-8% in the U.S. In 2008 and 2010, food prices also spiked higher, leading to civil unrest in many emerging markets. Food inflation is a key reason the central banks of India and China tightened monetary policy in 2010 and may be why they remain reluctant to adopt a looser monetary policy lately (ceteris paribus). A bountiful harvest next year will be required to restore inventories back to normal.



Source: Stockcharts.com

COMMENTARY: The Fiscal Cliff

One topic which has received an increasing amount of media coverage lately is the "fiscal cliff" and the impact it may have on individual taxpayers and ultimately the economy. While this topic more directly applies to individuals, it also has the propensity to impact institutional investors through performance differentiation within subclasses of equities. Undoubtedly, this topic will continue to be widely discussed in the next few weeks and months. Therefore, we thought it would be beneficial to identify key fiscal cliff issues and share our thoughts on appropriate courses of action from a portfolio management perspective.

Fiscal Cliff Explained

The fiscal cliff refers to the automatic tax increases and spending cuts that take effect in January 2013 assuming Congress and President Obama take no action. Economists estimate that without some agreement, the total impact could be between $400 billion and $800 billion, representing as much as 5% of our nation's total gross domestic product. The tax increases mostly center on the Bush tax cuts enacted in 2001 and 2003, the expiration of which equates to approximately $180 billion in additional taxes, but also involve some of President Obama's tax cuts that will expire at the end of the year.

Noteworthy Changes for Individual Taxpayers

Currently, there exist six income brackets which are taxed at rates of 10%, 15%, 25%, 28%, 33%, and 35%. Future individual income tax rates would be reduced to five income brackets taxed at rates of 15%, 28%, 31%, 36% and 39.6%. There would also be a return to the phase-out in individual personal exemptions based upon income levels. Itemized deductions, which are currently not limited, would be reduced by 3% of the amount that the taxpayer's adjusted gross income exceeds an annual threshold. The current 4.2% payroll tax rate withheld from employee checks would increase back to 6.2%. More estates would also face increased taxes as the exemption amount would decrease at the federal level from $5.12 million to $1 million. The federal estate tax rate would also jump from 35% to 55%.

Noteworthy Changes Directly Related to Investment Securities

Currently, most long-term capital gains are taxed at 15% and investors in the 10% and 15% tax brackets do not pay any capital gains taxes on asset sales. Qualified dividends receive the same treatment as capital gains. With the expiration of the tax cuts, the top long-term capital gains rate for most investors would be 20%. The "zero" capital gains rate would return to 10%. All dividends would be taxed as ordinary income meaning the top rate could be as high as 39.6%. Additionally, a 3.8% tax on investment income, which includes income from dividends, capital gains, interest, rent and passive income, would apply to those who earn over $250,000. (This tax was passed in 2010 and becomes effective January 2013.)

Investment and Portfolio Management Implications

Should investors with unrealized gains on securities held in a taxable account purposely realize (accelerate) those gains in 2012 to take advantage of current low capital gains rates? The short answer is the benefit in accelerating gains may not be nearly as appealing as it intuitively appears on the surface and in fact, could prove to be a negative course of action for certain investors. At Wallington Asset Management, we have spent considerable time modeling various scenarios to determine the benefit of gains acceleration. Many variables are involved which include expectations on the change (differential) in capital gains tax rates, portfolio turnover, asset allocation, future rates of return and the composition of those returns between dividends and appreciation. Further complicating the matter is the fact that changes in the capital gains rates have an unknown life span, as political parties could make further changes in the future. Obviously the high degree of uncertainty on so many issues makes it difficult to arrive at a concrete answer. What we determined, though, through our modeling is the acceleration of gains in many cases proved detrimental to the accumulation and/or utilization of wealth for an investor. This is particularly apparent in cases when portfolio turnover is not excessively high.

Should investors who own dividend paying stocks in a taxable account sell those stocks in favor of stocks which have little or no dividend yield to avoid the higher expected tax rate on dividends? In other words, should investors now concentrate their holdings in growth stocks and shun value stocks (usually higher dividend paying stocks)? While this would serve to lower the potential tax burden, minimizing or even eliminating dividend paying stocks could seriously compromise the total return generated by stocks in a portfolio. Investors place capital at risk in equities for two reasons, capital appreciation and dividend yield; the combination of which provides the "total return" to the investors. Generally speaking, stocks of companies that pay higher dividends are considered "value" stocks. Stocks of companies that focus on reinvesting earnings to generate future growth as opposed to paying those earnings to shareholders in the form of a dividend are considered "growth" stocks. To underweight or eliminate the value stock component of an equity portfolio because of a potential tax law change could very well lead to subpar returns. As the chart on the following page illustrates, in all full decade periods with the exception of the 1930s and the 1990s, value stocks outperformed growth stocks. In fact, from 1930 through 2011, value stocks outperformed growth stocks by over two percentage points on an annualized basis. Much of this is due to the fact that dividends contributed nearly 40 percent of the total return. Since owning both value and growth stocks in a portfolio serves to smooth returns (generate consistency) relative to owning only one type of stock, this type of diversification is an important element in generating superior risk-adjusted performance over the long term. In fact, from 1980 through 2011, a combination of value and growth stocks produced a better return than either one of the data series on its own, and did so with less volatility.

Large Cap Value vs. Large Cap Growth

Return & Risk Analysis

1930 - 2011

	1930-2011	1930s	1940s	1950s	1960s	1970s	1980s	1990s	2000s	2010s
Large Growth CAGR	8.74%	1.55%	7.33%	17.58%	7.94%	3.43%	15.80%	19.89%	-1.80%	9.85%
Standard Deviation	19.73	31.08	15.43	17.45	14.54	21.08	14.83	16.5	20.62	N/A
Large Value CAGR	10.88%	-5.55%	17.20%	22.20%	10.73%	12.23%	20.22%	13.95%	0.26%	5.17%
Standard Deviation	28.01	54.19	21.56	33.09	19.51	23.04	10.39	16.61	28.14	N/A
Blend CAGR	10.10%	-1.32%	12.35%	20.12	9.47%	7.97%	18.17%	17.15%	-0.48%	7.62%
Standard Deviation	22.8	41.54	18.01	25	16.29	21.21	11.13	14.75	23.63	N/A

Green Highlight Indicates Best Period Return
Past Performance Is No Guarantee of Future Results. Source: Ibbotson Utilizing Fama-French Index Construction

Evidence also shows that dividends play the same role for equity returns that compounding plays in computing interest. If $100 had been invested in a stock portfolio such as the S&P 500 at the end of 1925, and all dividends were reinvested, the investor would have had $304,572 at the end of 2011. The annual return would be 9.78%. If the dividends had been consumed and not reinvested, the investor would have had only $9,856 at the end of 2011, resulting in a return of 5.48% annually; so reinvestment of dividends would have created 31 times more wealth than if they had not been reinvested. It is important to note that the same power of dividend reinvestment generally holds true for shorter periods of time as well and even after the detrimental effect of taxes is taken into account.

Due to the potentially higher tax rates on dividends, should investors with both taxable and tax-deferred (e.g. IRA) accounts, only own the higher dividend paying stocks in tax-deferred accounts? Obviously paying less taxes or deferring tax payments can enhance wealth creation/generation. However, just as with the acceleration of gains, the answer is not simplistic since there are too many variables and factors involved. We have modeled various scenarios related to holding different types of securities in taxable versus tax-deferred accounts to determine the after-tax impact on wealth. The variables used in the modeling process, to name a few, include both the levels and differentials in tax rates for dividends, interest and capital gains; dividend payout ratios, the length of time in which taxes will be deferred and portfolio turnover. What we found, *generally speaking*, is that tax efficiency for investors is still enhanced by utilizing taxable account funds first for equities and tax-deferred funds first for the fixed income component of an investment portfolio even at the higher proposed tax rates on dividends and capital gains. We also found even with the higher tax rates, there are times when a lower yielding stock may be best held inside a tax-deferred account. For example, if the volatility associated with a lower yielding stock increases the probability of not holding the position long enough to meet the long-term characterization threshold, it may be best buying the stock in a tax-deferred account. Finally, similar to the acceleration of gains discussed above, on many occasions it did not prove beneficial to sell a higher yielding stock and realize a gain in a taxable account, then ultimately buy it or a similar stock in a tax-deferred account to defer taxation on future dividends. As with the acceleration of gains, each situation needs to be evaluated on its own merits.

Should investors move to the sidelines in anticipation of a decline in the stock market resulting from economic implications associated with the fiscal cliff? While intuitively appealing, history has shown repeatedly that it can be very costly to make significant moves in an investment portfolio in speculation of the future direction in stock prices. The odds are heavily stacked against the speculator; sooner or later a bad decision becomes very difficult to overcome. Stock prices are expectational in nature, and with the fiscal cliff it is impossible to determine with a high degree of certainty how much of the impact is already reflected in prices. Larry Fink, Chief Executive Officer of Blackrock, the world's largest money manager at over $3 trillion, recently opined that the economy already is feeling the impact of the fiscal cliff. CEOs of companies of all sizes have already reigned in spending and put the clamps on hiring until more visibility exists. Should the economic impact be greater (more negative) than expected, stocks would no doubt decline in the near term. On the other hand, Blackrock feels that a substantial rally could result from some type of substantive solution from Congress. Jeff Saut, Chief Investment Strategist for Raymond James, recently said that once we have clarity on the election and the fiscal cliff issues, "companies will start to spend again, resetting the economy and getting GDP growth happening again". Thus, he recommends adding stock exposure to a portfolio should prices decline. At Wallington, our philosophy is to manage client portfolios according to a predetermined allocation benchmark (risk and return parameters). While we may not necessarily be invested exactly on a particular benchmark allocation in stocks and/or bonds at all times, studies conducted on the returns generated by a market timing approach have shown it to be inferior in managing investment portfolios. Many hedge funds follow such a strategy and considering the sub-par returns generated by them this year and longer term, as documented by Simon Lack in his book *The Hedge Fund Mirage,* further credence in our opinion is lent to maintaining a fundamental philosophy based upon asset allocation benchmarking rather than market timing.

An unfortunate result of the current political environment is we now find ourselves well into the latter part of 2012 without clear visibility on the laws that will be in place next year and in the few years that follow. Without such clarity, any action taken prematurely could prove costly. As the above discussion implies, any action taken in a portfolio without looking beneath the surface could also prove costly. We would be surprised if all of the fiscal cliff tax changes become effective due to their negative impact on the U.S. economy, particularly now with it growing at a fairly weak pace. However, we still feel the responsibility and obligation to invest time into understanding the issues and how they could possibly impact client portfolios. As some recent studies unfortunately show, not doing so would put us in the same place as many voters who choose to make an uninformed vote. Whatever political platform one prefers, the lack of clarity on fiscal cliff issues is a microcosm of the economic and business climate being faced today and is indicative of the fact, partisanship aside, that many of our politicians have failed us, their constituents. After all, they are *our* elected officials, which is something that seems to have been lost along the way. It is not surprising today's young adults sometimes look at the "baby boom" generation with such critical eyes. It is also not surprising many of us in this generation abhor the legacy we could leave them and future generations if we do not get our fiscal house in order soon.

Whenever the people are well-informed, they can be trusted with their own government. ***– Thomas Jefferson***

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