Prepared Comments from 7/16/2012 Conference Call

The US stock market is down about 1% from its mid-April level. It is up 100% since its March 2009 panic low levels, it remains 14% below its October 2007 highs.

The past quarter generally brought continued good news for the US economy. Leading economic indicators, as monitored by the Conference Board, continue to point to growth. This has been almost uninterrupted since early 2009—the only reversal was during last summer. The unemployment rate has come down slightly this year, and stands currently at 8.2%. Our civilian jobs have risen over 3 million (+1.5%) in the past year, while net government jobs have fallen, but by less than 200,000 (-0.8%) in the past year.

Take note of the scale here. Private sector jobs increased at twice the percentage rate of government job loss, and yet produced 15 times as many jobs as government job loss. This is because our private sector employment is over ten times the size of our combined federal, state, and local employment.

US companies' profits are doing fine, growing at mid to high single digit levels. Companies remain very strong financially, with excessive cash in the bank. This provides them with flexibility, to hire, to build/buy plants and equipment, to meet all financial commitments such as bond payments, and to consider dividend increases. Companies can spend, when their confidence rises.

Consumer confidence, however, remains depressed. Not coincidentally, the US stock market has hardly budged in the past three months. That oversimplifies the stock markets. While down only 1% in the past three months, the market has been a roller coaster this spring/summer, down a bit in April, down sharply in May, both up and down sharply in June, and down and up so far this month.

Our confidence has been restrained by continued government inaction, both in the US and abroad. The US faces a recession next year if our federal government does not address the year-end 'fiscal cliff.' This is the term that describes the impact of government spending cuts and tax rate increases which are set to begin on January 1st. The problem is not that there are spending cuts and tax rate increases coming on January 1st, it is the size of them. The size is so great that, if nothing is done, our country will definitely enter a recession. Most recessions are caused by external events. If our government fails to act by year-end, we will enter an entirely optional recession. Investors appear to fear that the same government that created the self-inflicted debt-ceiling-related credit rating downgrade last summer will again fail to put the country ahead of ideology and permit significant economic pain to result from their inaction.

Due to our government's challenges, and due to European governments' challenges, the global economy is expected to grow at a subdued pace. The silver lining here is that oil prices have fallen more than 20% since April, before recovering a bit this month. This, and the mild winter, has enabled consumers to improve their financial situations. Our savings rate remains well above our 2006 low levels, and stands at 3.7%. This indicates that consumers are able to spend when their confidence returns.

In the second calendar quarter of 2012, investors gave up a third or so of their first quarter gains. Stocks fell, led by foreign stocks, including those of Latin America which are affected by falling oil prices, and lower expectations of exports to China. China is expected to slow its growth, not shrink, but rather grow more moderately.

Bond investors had an unexciting quarter, earning between 1 and 2%. The top story in bonds remains their very expensive prices. I have written about this in detail in the recent newsletter, and in the regular Market Reviews. I have also written often about the wide range of bonds available to investors. We are now using seven subcategories of bonds for managing our clients' bond money. We adjust the 'dials' regularly, reflecting the yields and prices of each, paying particular attention to expectations of their future, not their past. The fatal mistake that most bond investors are making at this time is to drive their car by staring out the rear view mirror. Buying a \$100 bond for \$120, based on its 20% appreciation, fails to consider that by maturity that \$20 gain will turn into a \$20 loss.

We therefore recommend an extra dose of stocks at this time—we are currently using a 5% overweight—so a client with a 60% long-term target level of stocks is currently getting about 63% of stocks in their portfolio, as 5% of 60% is that extra 3%. We feel that this provides a reasonable additional exposure to the higher-than-normal upside potential to stocks (and reducing modestly our exposure to overpriced bonds), without varying too far from the long-term stock level targets.

We are also increasing our emphasis of large companies, both in the US and abroad. US large companies have recovered far slower than smaller US stocks since the March 2009 market bottom. We feel that prices for large US stocks are more attractive at this time as a result. We further suspect that as investors get more comfortable building their stocks, they will begin with boosting their larger stocks.

This relates to the 'snake and egg' analogy presented in my July Market Review, with its upsetting picture. When a snake eats an egg, the egg moves slowly and steadily through the snake, as it digests the egg's nutrients. When investors have run from the stock market, and for that matter from bonds, they slowly and steadily (well, maybe not steadily) shift their dollars to invest in greater and greater risk, beginning with low risk investments. This is seen very clearly in the high prices for treasury bonds. In time, I expect investors to shift more dollars into corporate bonds, then large US stocks, and then foreign stocks and/or smaller US stocks, although which may occur first is beyond me. Emerging markets stocks may be the last area to attract returning investor's dollars.

This raises the issue of foreign stocks. I have had several clients ask me why we should be buying foreign stocks at this time, while Europe has such a great amount of challenges before it. I offer two answers.

First, European companies are not in the headlines. European governments are. The problem is the sovereign debt, the loans made to European governments. This problem does directly affect some European companies, however this is largely limited to banks and insurance companies, those with a high level of government bonds on their balance sheets. The rest of the European companies are largely shielded from harm.

The companies are shielded, but their stocks are not. While European companies continue to sell to customers in Europe and across the globe, their profits are reasonable. Yet European companies' stock prices have been hammered. At some point, the stock prices are too low. We reached that point in the US on March 9, 2009, while there were still gigantic challenges and uncertainties left to be addressed. I am not brave enough to load up on European stock funds, however I am confident enough to happily boost diversified foreign and global stock funds, including those with a healthy helping of European stocks.

That is a lot of information and opinions. I would like to open up the lines for questions and answers. After the Q&A on this topic, I am willing to provide a brief summary of what I am doing outside of Mallard at this time, and try to field your questions.

Campaign update—we are in our second month of campaigning. My campaign activities have been largely limited to evenings and weekends, when people are home. This is because I have a great team, and my job is simply to meet voters, LOTS OF VOTERS. I spend about 16 hours a week meeting voters, evenings and weekends. I have already dramatically reduced the time I spend on several of the non-Mallard organizations I work with, in order to help free up that time for campaigning (rather than taking it from Mallard time).

I am continuing to meet with clients, and expect to be away from the office twice this summer to meet clients who live a few states away, as I typically do every year. Our high commitment to our clients is unchanged.

We are in the final months of a software conversion which enables us to prepare the quarterly reports in less time than in the past. The software also enables us to begin the process about five days earlier in the reporting month. We have linked that process to improving our process of generating client quarterly reports. Together these changes enable us to produce what we believe are better reports, with better recommendations, faster.