

Capital Market Review

First Quarter, 2013

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Summary

The drama surrounding the fiscal cliff ended at the turn of the year. Tax rates became permanent for most Americans, but did increase on the wealthiest. More importantly, tax rates are no longer subject to short-term extensions, but were made permanent.

No major change to the U.S. economy. It continues its slow but steady improvement. Employment, consumers, and housing all seem to be contributing. No reason to expect any significantly faster economic growth. Europe remains a wildcard with respect to its fiscal situation.

Stock markets, particularly in the U.S., were strong during the first quarter. U.S. stocks returned 11.1%. Mid and small stocks outperformed large. However, going forward, we believe large stocks may perform better.

Broad bond market returns were negative during the first quarter -- particularly for developed international and emerging market bonds. U.S. bonds returned -0.1% during the quarter. Interest rates slightly increased. JIC believes future bond returns will barely exceed the rate of inflation.



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Economic Conditions

The uncertainty surrounding the fiscal cliff was eliminated early in the year. Not every area of the fiscal cliff was avoided as tax rates on the very wealthiest of Americans increased. But, for the vast majority of Americans, there was no increase in tax rates and there is at least a certain level of tax-rate permanence. Note that “permanence” is a relative thing as laws can be changed.

Payroll taxes reverted back to their pre-recession levels for wage-earning Americans. Recall that for the past several years, employees have paid a reduced amount to Social Security to provide extra income in the hopes it would help stimulate the economy.

The U.S. economy continues to grow at a slow but relatively steady pace. Employment is slowly improving (more employers are hiring), consumers seem to be in reasonable shape (retail sales are steady but growth in disposable income could be better), and housing continues to improve (prices are stable, new starts have increased, and demand has improved). The Federal Reserve will remain accommodative for the foreseeable future. Inflation remains relatively tame.

The stock market responded very favorably to the reduced uncertainty as both the Dow Jones Industrial and S&P 500 indexes reached new all-time highs.

Economic issues in Europe remain a wildcard. Italian elections were inconclusive and have raised concerns about the country’s commitment to necessary economic reforms. In addition, Cyprus became an area of significant focus as the small nation was forced to seek a bailout. Eventually, a deal was reached, but it is unlikely that we have heard the last of either Cyprus’ or Europe’s financial crisis.

Stock Market

US-based stock returns were particularly strong during the first quarter rising 11.1%. Developed international returns increased a much more modest 5.1%, while emerging markets declined -1.9%. Emerging market returns were particularly poor in the Czech Republic and Poland.

By company size, the mid-cap stock return of 13.0% outperformed both the large stock return of 11.0% and the small stock return of 12.4%. Value-stocks returned 12.3%, significantly ahead of the growth stock return of 9.8%.

It is somewhat surprising that, given such strong market performance, the best performing sectors were defen-

sive related. Health-care returned 15.8%, Consumer Staples returned 14.6%, and Utilities returned 13.0%. Sectors that lagged include Technology (4.6%), Materials (4.8%), and Telecommunications (9.5%).

Stock valuations have risen, but remain within a traditional “fair value” range (for the broad market). As such, future stock market returns will likely have to come from earnings growth and dividends. Valuations for mid-and small company stocks are much higher vis-à-vis large-company stocks.

Current 2013 earnings growth estimates are 15%, 18%, and 34% for large, mid, and small company stocks. Clearly, these estimates are too robust for current economic conditions and will have to be reduced.

Incorporating both valuation and earnings growth estimates, JIC estimates that large-company stocks offer more return potential compared to mid and small company stocks. With that said, we believe future large-cap returns will likely be modest (and mid and small will be lower). For higher future stock returns to exist, either multiples or earnings growth rates must increase.

Bond Market

Broad market bond returns were negative for the first quarter. Developed international and emerging market bonds returned -4.2% and -2.3%, respectively, while U.S. bonds returned -0.1%.

Within the U.S. market, long-term bonds were the worst performing maturity sector (returning -2.0%) as interest rates rose. Short- and intermediate-term bonds returned 0.2% and 0.3%, respectively. Corporate, government, and mortgage sector returns were all slightly negative.

Not all bond segments produced negative returns as high yield returned 2.9% and municipal bonds returned 0.3%.

JIC does not expect continued declines in interest rates. As such, the appreciation potential associated with bonds is likely near zero and future returns will come from coupon payments. JIC expects very modest investment grade bond returns during the next few years -- perhaps barely exceeding the rate of inflation. Given this forecast, JIC is seeking to reduce clients’ exposure to bonds and has increased the allocation to alternative investments.

Stock Returns For Periods Ending March 31, 2013

	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>		<u>Qtr</u>	<u>1 Year</u>	<u>3 Year</u>
<u>Nationality</u>						<u>Developed Country</u>			
U.S. Market	11.1	11.1	14.6	13.0	6.3	U.S.	11.1	14.6	13.0
Developed Intl	5.1	5.1	11.3	5.0	-0.9	Canada	0.3	1.2	0.4
Emerging Market	-1.9	-1.9	-0.6	0.8	-1.3				
<u>Size</u>						<u>Europe</u>			
Large	11.0	11.0	14.4	12.9	6.2	France	0.4	5.5	-3.0
Mid	13.0	13.0	17.3	14.6	8.4	Germany	-0.1	5.4	3.0
Small	12.4	12.4	16.3	13.5	8.2	Italy	-9.8	-10.0	-14.0
Micro	16.8	16.8	21.5	15.7	10.1	United Kingdom	1.4	5.6	3.7
<u>Approach</u>						<u>Pacific</u>			
Value	12.3	12.3	18.7	12.7	5.1	Australia	7.8	16.7	7.6
Core	11.1	11.1	14.6	13.0	6.3	Hong Kong	3.1	13.6	7.0
Growth	9.8	9.8	10.4	13.2	7.4	Japan	10.8	6.4	0.6
<u>Sector</u>						<u>Emerging Market</u>			
Cons Discretionary	12.2	12.2	19.9	19.5	13.5	China	-4.5	3.3	-2.1
Cons Staples	14.6	14.6	20.3	16.0	10.4	India	-2.7	0.6	-5.0
Energy	10.2	10.2	11.0	13.1	3.0	Korea	-4.7	0.2	6.8
Finance	11.4	11.4	17.6	6.3	-4.1	Czech Republic	-14.1	-23.9	-12.2
Healthcare	15.8	15.8	25.2	15.3	10.6	Hungary	-6.6	-9.8	-16.2
Industrials	10.7	10.7	14.7	12.5	4.0	Poland	-11.5	-0.6	-4.8
Technology	4.6	4.6	-1.1	10.0	8.0	Russia	-3.6	-10.8	-3.2
Materials	4.8	4.8	8.4	8.9	2.0	Brazil	-1.3	-15.8	-9.3
Telecomm	9.5	9.5	26.9	19.6	7.5	Mexico	5.9	16.6	11.0
Utilities	13.0	13.0	16.4	14.5	5.0				

Stock Fundamentals As Of March 31, 2013

	<u>United States</u>		<u>Developed</u>		<u>Emerging</u>					
	<u>Current</u>	<u>1 Year Ago</u>	<u>Current</u>	<u>1 Year Ago</u>	<u>Current</u>	<u>1 Year Ago</u>				
Price/Earnings Current	16.4	15.3	13.0	12.0	11.6	10.9				
Price/Forecast Earnings	14.3	13.7	13.1	11.4	11.1	11.2				
Price/Book	2.2	2.1	1.4	1.4	1.6	1.8				
Price/Cash Flow	9.5	9.2	8.0	6.9	7.0	7.0				
Price/Sales	1.3	1.3	0.9	0.8	1.1	1.2				
Forecast LT EPS Growth	10.7	10.7	9.0	7.7	11.7	10.4				
	<u>Est. P/E Ratio</u>		<u>Est. EPS Growth</u>		<u>2013 Fair Value Returns</u>		<u>2014 Fair Value Returns</u>			
	<u>2013</u>	<u>2014</u>	<u>2013</u>	<u>2014</u>	<u>13x</u>	<u>17.5x</u>	<u>7% DR</u>	<u>13x</u>	<u>17.5x</u>	<u>7% DR</u>
Large	14.3	12.8	14.7	12.1	-9.4	22.0	-0.4	1.6	36.8	11.7
Mid	17.9	15.6	18.5	14.2	-27.2	-2.0	-20.0	-16.8	12.0	-8.6
Small	18.2	14.9	34.4	22.1	-28.6	-3.9	-21.6	-12.8	17.3	-4.2

Bond Returns And Characteristics For Periods Ending March 31, 2013

	<u>Returns</u>					<u>U.S. Bond Yields</u>	<u>Last</u>	<u>1 Year</u>	
	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>		<u>Qtr</u>	<u>Qtr</u>	<u>Ago</u>
<u>Nationality</u>						Fed Funds	0.14	0.16	0.13
U.S. Market	-0.1	-0.1	3.8	5.5	5.5	Prime Rate	3.25	3.25	3.25
Developed Intl	-4.2	-4.2	-2.7	3.7	2.7	3 Month Treasury	0.09	0.07	0.08
Emerging Market	-2.3	-2.3	10.1	9.9	9.4	1 Year Treasury	0.15	0.16	0.19
						3 Year Treasury	0.39	0.35	0.51
						5 Year Treasury	0.82	0.7	1.02
<u>Maturity</u>						5 Year TIP	-1.43	-1.4	-1.03
Cash	0.0	0.0	0.1	0.1	0.3	10 Year Treasury	1.96	1.72	2.17
Short-Term	0.2	0.2	1.1	1.7	2.4	30 Year Treasury	3.16	2.88	3.28
Intermediate-Term	0.3	0.3	3.5	4.7	4.6	Aaa Corporate	3.93	3.65	3.99
Long-Term	-2.0	-2.0	8.9	12.3	9.6	Baa Corporate	4.85	4.63	5.23
<u>Sector</u>						Barclays Aggregate	2.43	2.54	2.82
Corporate	-0.2	-0.2	7.0	7.9	7.5	Barclays Credit	3.48	3.51	4.01
Government	-0.2	-0.2	3.0	5.0	4.4	Barclays Treasury	1.56	1.60	1.84
Mortgage	-0.1	-0.1	2.0	4.2	5.2	Barclays Mortgage	1.46	1.82	3.27
						Barclays Municipal	2.78	2.83	3.25
<u>Other</u>						Barclays High Yield	6.64	6.78	7.32
High Yield	2.9	2.9	13.1	11.2	11.7	Citi Intl Treasury	2.00	2.13	4.03
Inflation Protected	-0.4	-0.4	5.7	8.6	5.9	JPM Emerging	4.35	4.20	4.72
Municipal	0.3	0.3	5.2	6.2	6.1				

10-Year Sovereign Bond Yields

Spreads Versus 10-Year Treasury

<u>Developed Mkts</u>	<u>Qtr</u>	<u>Last</u>	<u>1 Year</u>		<u>Qtr</u>	<u>Last</u>	<u>1 Year</u>
		<u>Qtr</u>	<u>Ago</u>			<u>Qtr</u>	<u>Qtr</u>
United States	1.91	1.62	2.29%	Aaa	1.97	1.93	1.82
Canada	1.82	1.75	2.24	Baa	2.89	2.91	3.06
France	2.05	2.21	3.01	Barclays Aggregate	0.47	0.82	0.65
Germany	1.34	1.45	1.97	Barclays Credit	1.52	1.79	1.84
Italy	4.58	5.29	4.99	Barclays Treasury	-0.40	-0.12	-0.33
United Kingdom	2.02	1.75	2.47	Barclays Mortgage	-0.50	0.10	1.10
Euro Zone	1.34	1.45	1.97	Barclays Municipal	0.82	1.11	1.08
Australia	3.58	2.98	4.39	Barclays High Yield	4.68	5.06	5.15
Hong Kong	1.28	0.78	1.50	Citi Intl Treasury	0.04	0.41	1.86
Japan	0.55	0.78	1.03	JPM Emerging	2.39	2.48	2.55
<u>Emerging</u>				Maturity (10yr-1yr)	1.81	1.56	1.98
Brazil	9.64	9.57	3.14	Implied Inflation	2.28	2.13	2.07
China	3.30	3.16	3.18				
India	7.99	8.17	8.40				
Russia	7.32	8.17					

Commodity, Real Estate, & Currency Returns For Periods Ending March 31, 2013

	<u>Qtr</u>	<u>Ytd</u>	<u>1 Year</u>	<u>3 Year</u>	<u>5 Year</u>
<u>Commodity</u>					
DJ UBS Commodity	-1.1	-1.1	-3.0	1.4	-7.1
CRB Commodity Spot	-0.9	-0.9	-3.5	3.6	0.6
CRB Fat & Oils	0.9	0.9	-5.0	9.1	1.3
CRB Foodstuffs	-4.5	-4.5	-8.1	5.6	1.5
CRB Livestock	-3.9	-3.9	-1.4	8.7	4.4
CRB Metals	-2.3	-2.3	-2.9	2.0	-3.0
CRB Raw Industrials	1.7	1.7	-0.3	2.3	0.1
CRB Textiles & Fibers	4.8	4.8	-0.1	0.2	1.9
<u>Agriculture</u>					
Coffee	-0.8	-0.8	-24.2	-1.9	0.7
Corn	4.5	4.5	13.1	26.5	8.8
Soybean	1.4	1.4	11.5	15.6	4.8
Sugar	-4.6	-4.6	-35.7	-8.1	0.9
Wheat	-7.6	-7.6	6.4	17.7	-6.3
<u>Energy</u>					
Oil	5.4	5.4	-12.4	4.6	-2.5
Unleaded Gas	10.5	10.5	-7.0	8.8	2.1
<u>Metals</u>					
Aluminum	-8.4	-8.4	-12.5	-4.7	-8.7
Copper	-3.9	-3.9	-9.7	0.8	-1.9
Gold	-5.7	-5.7	-4.8	12.7	10.5
Nickel	-4.1	-4.1	-10.3	-9.4	-11.7
Zinc	-5.5	-5.5	-5.2	-5.4	-5.1
<u>Real Estate</u>					
MSCI U.S. Reit	8.1	8.1	14.9	17.3	6.8
MSCI World Reit	5.7	5.7	20.9	13.9	2.8
<u>Currency</u>					
	<u>U.S. Dollar Returns</u>				
Euro	1.3	1.3	2.0	1.6	3.6
Japan	13.1	13.1	14.9	1.5	-1.2
U.K.	6.6	6.6	4.7	0.0	5.5
Brazil	-13.6	-13.6	0.0	0.2	1.0
China	1.3	1.3	0.0	-2.6	-2.3
India	-7.8	-7.8	0.0	3.5	4.6
Mexico	-2.8	-2.8	-2.0	-0.2	3.1

Current Economic & Financial Conditions

	Percent Change					Data As Of
	3 Month		6 Month		1 Year	
	3 Month	Annualized	6 Month	Annualized		
Gross Domestic Product	0.1	0.4	0.9	1.7	1.7	December/2012
Leading Economic Indicators	1.0	3.9	1.6	3.2	1.7	March/2013
ECRI Weekly Leading Index	2.3	9.6	2.2	4.4	2.2	March/2013
Commercial and Industrial Loans At All Commercial Banks	2.4	10.0	5.2	10.7	11.4	March/2013
Retail Sales	0.6	2.5	1.2	2.4	2.6	March/2013
Retail Sales (Excluding Food Service)	0.6	2.5	1.2	2.4	2.6	March/2013
Real Disposable Personal Income	-0.8	-3.0	0.3	0.6	0.9	February/2013
Industrial Production	1.4	5.7	2.6	5.3	3.5	March/2013
ISM Manufacturing: Purchasing Managers Index	2.2	9.1	-0.6	-1.2	-3.8	March/2013
4-Week Moving Average of Initial Claims	-2.6	-10.0	-5.0	-9.8	-2.9	March/2013
Hires: Total Private	-0.4	-1.5	0.9	1.7	-1.5	February/2013
Job Openings: Total Private	1.9	7.7	8.2	17.0	11.9	February/2013
Consumer Price Index	0.5	2.1	0.5	1.0	1.5	March/2013
Consumer Price Index Less Food and Energy	0.5	2.1	0.9	1.9	1.9	March/2013
New One-Family Houses Sold	6.9	30.7	10.0	21.1	18.5	March/2013
Median Sales Price of Homes Sold	1.2	4.7	5.4	11.2	13.8	December/2012
S&P 500 Earnings	-1.6	-6.3	-2.3	-4.6	-0.6	September/2012
CRB Commodity Spot Index	-0.9	-3.5	-3.6	-7.1	-3.5	March/2013
Spot Oil Price (West Texas Intermediate)	5.4	23.6	-1.8	-3.5	-12.4	March/2013
Gold Price	-3.6	-13.6	-10.0	-19.0	-3.9	March/2013

	Actual Value / Diffusion Index				Data As Of
	Current	3 Months	6 Months	1 Year	
	Value	Ago	Ago	Ago	
Phili Fed: General Activity - vs. Prior Month (Diffusion)	2.0	4.6	1.4	8.6	March/2013
Phili Fed: General Activity - 6 Months Ahead (Diffusion)	32.5	23.7	40.9	28.6	March/2013
Chicago Fed: National Activity Index	-0.2	0.2	-0.1	-0.6	March/2013
St. Louis Financial Stress Index	-0.7	-0.5	-0.4	-0.2	March/2013
Loan Officer Net % Tighter Criteria Consumer Loans	-2.0	-11.1	-10.9	-11.6	March/2013
Loan Officer Net % Willingness to Make Consumer Loans	11.1	12.7	21.7	11.5	March/2013
Consumer Sentiment	78.6	72.9	78.3	76.2	March/2013
Manpower Employment Outlook (Net % Hiring)	11.0	11.0	10.0	7.0	February/2013
Unemployment Rate	7.9	8.3	8.3	8.6	March/2013
University Of Michigan Inflation Expectations	3.2	3.2	3.3	3.9	March/2013
S&P 500 PE	17.9	16.4	16.7	15.8	March/2013
S&P 500 PE	17.9	16.4	16.7	15.8	March/2013
S&P 500 Earnings Yield	5.6	6.1	6.0	6.3	March/2013
S&P 500 Earnings Yield Less 10 Year Yield	3.6	4.4	4.3	4.2	March/2013
AAII Survey: Stock Allocation	59.5	58.6	60.1	60.7	March/2013
AAII Bull/Bear Investor Sentiment Spread	9.7	14.2	-0.4	17.0	March/2013
AAII Percent Bullish 8-Week Average	38.6	40.0	36.6	44.4	March/2013
CBOE Volatility Index	12.7	18.0	15.7	15.5	March/2013
3 Month Treasury	0.1	0.1	0.1	0.1	March/2013
1 Year Treasury	0.2	0.2	0.2	0.2	March/2013
5 Year Treasury	0.8	0.7	0.7	1.0	March/2013
10 Year Treasury	2.0	1.7	1.7	2.2	March/2013
30 Year Treasury	3.2	2.9	2.9	3.3	March/2013
5 Year TIP	-1.4	-1.4	-1.5	-1.0	March/2013
10 year TIP	-0.6	-0.8	-0.7	-0.1	March/2013
30 Year TIP	0.6	0.3	0.4	0.9	March/2013
Bond Buyer 20-Bond Municipal Bond Index	4.0	3.5	3.7	3.9	March/2013
ML BBB	3.4	3.3	3.5	4.1	March/2013
ML High Yield	5.9	6.3	6.6	7.3	March/2013
ML AAA-A Emerging Market	2.4	2.4	2.5	3.3	March/2013

A diffusion index is the difference between the percent of respondents expecting an increase less those expecting a decrease.