StaufferWilliams
ASSET MANAGEMENT · LLC

APRIL 2012 INVESTMENT COMMENTARY

"WE LIVE IN A POST-AUTHENTIC WORLD" - BRUCE SPRINGSTEEN

STOCK PICKER'S MARKET

We have stated that stock picking is back in favor in 2012, not because the S & P 500 was up 12.60% in the first three months of the year, but because the positive performance was generated in a significantly different manner compared to 2011. In fact, in 2011 the only S&P 500 sectors posting positive performance over 5% were Consumer Staples (10.53%), Healthcare (10.18%) and Utilities (14.83%). These sectors are commonly considered defensive sectors. However, in the First Quarter of 2012 only one of ten S&P 500 sectors is negative—Utilities-- last year's best performing sector. What is important to note this year so far is that, excluding utilities, both "risk on" and risk off" sectors are performing well. This indicates that investors have been able to find opportunities across the board, regardless of the perceived risk level of a given sector. In our opinion, even the laggard Utility sector contains some compelling stock specific opportunities. The poor relative performance of utility stocks may have more to do with unseasonably warm temperatures in the U.S. this winter.

Evidencing the "stock picker" environment that we reference, the performance characteristics of our portfolios over the last three months have not followed any well defined themes. Strong performance of stocks in industries ranged from chemicals, emerging market utilities, agri-business, to biotech and automotive related companies. This environment is fundamentally driven, as opposed to macro-fear driven, and allows fundamental investors to add value by discriminating between investment opportunities based upon the value of the underlying businesses. This fundamental "go anywhere" approach to equity investing is what distinguishes the investment process at StaufferWilliams Asset Management from the "mass appeal", benchmark and product driven, financial advisor industry which is prevalent today.

PURPOSE & CORE VALUES

One of the most enjoyable aspects of creating a new business is answering the questions of why and how we are different. These questions lead us to discuss our core values. Some businesses have mission statements, others have strategic plans, but not every business is driven by core values. StaufferWilliams Asset Management, LLC is the product of merging the core values of two professionals who share a passion and a sense of purpose.

StaufferWilliams Asset Management was formed out of a common sense of purpose and shared core values. An investment manager can have a profound impact on the future well being of its clients. Unfortunately, for the vast majority of investment management clients, that impact is becoming much harder to distinguish. Greater financial services regulation, companies trying to do more with less, and the explosion of "manufactured investment product", has lead to an industry where an authentic asset management experience is very difficult to find.

The result of the virtual extinction of authenticity in the asset management business has lead to the equivalent of "big box" financial advisory, where sales and merchandising is paramount and the one-on-one relationship with a skilled portfolio manager has been virtually eliminated. By replacing local experienced portfolio managers with business development

professionals, and moving to an efficiency driven "manager of managers" business model, the investment management business has become commoditized. This commoditization has stripped away the client focus and authenticity that once was much more prevalent. We formed StaufferWilliams Asset Management because we knew that we could deliver client focused asset management services in a way that would not require these types of compromises, which have become so prevalent in our industry today. These compromises within our industry have been deliberate and are now unfortunately largely institutionalized.

POST-AUTHENTIC WORLD

This loss of authenticity, sadly, is not confined to the investment management business, but has crept into many other aspects of our lives these days, such as the music industry. During a recent keynote address at the South by Southwest Music Festival, Bruce Springsteen referred to this time in history as the "Post-Authentic World". The reference to a post-authentic world from one of the most authentic singer-songwriters of the last four decades is a reminder that authenticity has indeed become scarce. The music world of today is dominated by manufactured and mass produced "artists" who have songs written for them, who are surrounded on stage by carefully choreographed theatrical productions, and whose voices are synthesized and manipulated by auto-tune enhancements. Albums and songs have a very short shelf life, because what once took an artist three years to produce, now can take as little as several weeks.

In a recent online article in The New Yorker magazine titled, The Song Machine, by John Seabrook, explored the synthesized formula by which today's pop music is produced. He wrote, "whereas rock is about the sound of a band playing together and features virtuoso solos played on real instruments, today's Top Forty is almost always machine-made: lush sonic landscapes of beats, loops, and synths in which all the sounds have square edges and shiny surfaces, the voices are Auto-Tuned for pitch, and there are no mistakes. In comparison to Top Forty music, an authentic artist, such as 62 year old Bruce Springsteen or 22 year old Adele, craft music emanating from who they are and what they feel.

The music industry, like the investment management industry, has mass produced itself to a point where performers are almost indistinguishable from each other. Mass production of "hits" relies upon a common subset of professional writing and production teams, all using virtually the same formula, spread across multitudes of performers, who are marketed and packaged slightly differently. In The New Yorker article, the author ended his piece with the following: "a massive smash such as Adele's "Someone Like You," with its heartfelt lyrics, accompanied by simple piano arpeggios—no arpeggiator required—could be the beginning of the end of urban pop".

A TROUBLESOME STRATEGY

We are beginning to see evidence that some industry watchers and regulators are beginning to address some of the innovation which has commoditized the investment management business. As we mentioned last month, more is beginning to be written and reported about the common practice of "closet indexing". Government regulators are finally getting serious about cracking down on high frequency trading, which leverages computer technology and access to split second trading patterns on the electronic stock exchanges in order to momentum trade securities minute by minute. This trading is not anything that a human trader could possibly accomplish, so it is left to computer programs to buy and sell securities without any consideration for what those securities represent.

Subsequent to the financial crisis, today's typical investor is very leery of high risk or highly complex stock investments. It is widely believed that this apprehension is keeping many individual investments out of the market. News reports about flash crashes and high frequency trading continue to raise the suspicions of average retail investors. However, many investors believe that stocks are the only classification of investments to be feared, but most will not give a second thought to the complexity within the bond funds they own. What many investors know about their investments unfortunately is limited to what they are told by their brokers or advisors. The problem is that many brokers and advisors follow a herd mentality and believe that there is safety in numbers. This false sense of security can end up exposing clients to risks that are not well understood. One of the most widespread examples of mass investor misperception/misinformation relates to the PIMCO Total Return Fund, managed by Bill Gross. This fund is the largest mutual fund in the world and is used as a bond fund in many portfolios and retirement plans. In reality this fund is not a traditional bond fund at all. Bloomberg published an article on March 11, 2011, titled, *Gross to Create a*

Derivative - Lite Version of the PIMCO Total Return Fund. In this article the author, Miles Weiss, referred to a study of the PIMCO Total Return Fund by Hewitt EnnisKnupp, which stated that, “this complex strategy relies heavily on derivatives and may not be ideal for all investors, particularly those investors that view their fixed-income portfolio as an anchor to windward as opposed to a source of total return.” The PIMCO Total Return Fund also has one of the highest expense ratios for, what is considered by most investors, a bond fund.

One indicator which can tip an investor off to potential dangers is a high expense ratio. High expense ratios are a very good indicator that an otherwise conservative sounding fund is much more complex and risky than it might seem. A Wall Street Journal article published January 15, 2011, written by Eleanor Laise, titled, *Are “Alternative” Bond Funds Safe?*, states that “a new crop of “alternative” fixed-income mutual funds employs hedge-fund-like tactics to protect against rising interest rates, defaults and other bond-market hazards”. Laise goes on to point out that “for such complex strategies, the funds generally charge significantly higher fees than plain-vanilla bond funds. The average intermediate-term bond fund, for example, charges expenses of 0.95% of assets, while the Bandon Isolated Alpha Fixed Income Fund, launched at the end of last year, charges 1.95%, while the Driehaus Select Credit Fund charges 1.75%”.

OUR APPROACH

At StaufferWilliams Asset Management, LLC we strive to maintain a high level of authenticity in how we approach asset management. Authenticity for us means transparency, simplicity and the fiduciary standard of always putting the client’s interests first. This month’s commentary is our reaction to the growing prevalence of complex products and sub-advised strategies being utilized by advisors to the detriment of their client’s interests. Many of these strategies and products have high fees, lack transparency due to complex strategies, and have investment risks which are not being properly disclosed. All of this is done to simplify the task of managing a client’s portfolio for the advisor; however the client is paying for that convenience with additional fees and a lack of transparency.

We see the market, whether it is the stock market or the bond market, as a market of securities, not a monolithic barometer upon which to place a directional bet or a relative under or overweight of a particular sector. We are encouraged that 2012 continues to reward those who see opportunities with granular clarity as we do. Fundamental investment qualities are back in focus, and markets are rewarding companies demonstrating revenue and earnings growth as evidenced by the outperformance of smaller, faster growing companies as compared to larger slower growing value equities.

CURT R. STAUFFER
Partner, 717 877 7422

JONATHAN M. WILLIAMS
Partner, 717 810 6705

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