Market Comments

April 9, 2013

S&P 500	1569
10 Year Treasury	1.75%

Stocks enjoyed a very strong first quarter. The S&P 500 had a total return of 10.61%. The S&P Midcap Index returned 13.45% and the S&P Small Cap Index rose 11.81%. The NASDAQ Composite Index had a total return of 8.51% as technology stocks, and in particular Apple, lagged the broader market during the quarter. International stock returns were positive but lagged U.S. equities; the MSCI EAFE Index had a total return of 5.28%.

Bond returns significantly lagged equity returns in the first quarter. The Barclays U.S. Aggregate Index fell 0.12%; the yield on the 10-year U.S. Treasury rose from 1.76% to 1.85% during the quarter. We believe that it is likely that interest rates will continue to move higher on balance during the rest of 2013 and into 2014, making it difficult to earn returns from fixed income investments.

Despite the carnage wreaked on the equity market by the bear market of 2007-2009, during which the S&P 500 fell 60%, stock returns have bettered bond returns, as measured by the S&P 500 and the Barclays U.S. Aggregate Bond Index, over the past 1, 3, 5 and 10 year periods ending March 31, 2013. The S&P had a total return of 13.95% during the past four quarters, versus 3.77% for the Barclays Agg; 43.01% or 12.68% compounded for the trailing three years versus 17.50% or 5.53% compounded for the trailing three years; 32.63% or 5.81% compounded versus 30.49% or 5.47% for the bond index for the trailing five years; and 85.01% or 8.52% compounded for the S&P 500 versus 63.27% or 5.02% compounded for the Barclays Agg over the trailing ten years. We believe that this is the first time in many years that stock returns have bettered bond returns over the one, three, five and ten year trailing time periods.

And, given our outlook for stock and bond returns, which is based on the current valuation of the two asset classes, we believe that stock returns will continue to hold the upper hand over bond returns over the next several years.

Equities got out of the gate quickly in 2013, gapping up 2.3% on the first trading day of the year as investors welcomed an eleventh-hour deal to postpone the fiscal cliff. Stock prices never looked back after the hot start to the year, as the largest pullback during the quarter was a 2% drop between February 19 and February 25. Better-than-expected corporate earnings results for the fourth quarter supported higher stock prices into the first half of the quarter.

U.S equities pushed to historic highs at the end of the first quarter. The S&P 500 closed the quarter at 1569, an all-time closing high, which eclipsed the prior closing highs of 1565 on October 9, 2007, and 1527 on March 24, 2000. Valuations are materially lower, and earnings quality is much higher, than at the prior market highs in 2007 and 2000, factors which support our continued positive stance toward equities.

The S&P 500 closed 2012 at 1427. The Index's strong first quarter has lifted it to 1569, essentially at the bottom end of the range of our 2013 fair value estimate for the Index. Fair value does not necessarily mean "sell"; rather, it means a valuation level approximation or estimate at which we believe an asset should be priced, and a level from which future gains

should approximate any future underlying growth in intrinsic value. In a sense, at current levels, the equity market is no longer undervalued (for the first time since 2008), but stocks should continue to appreciate in line with their earnings and/or business value growth over time.

Our fair value range for the S&P 500 is 1575-1650 for 2013 (15x estimated 2013 earnings of $108-112 per share), and we believe fair value for the Index for 2014 is around 1725-1800 (15x estimated 2014 earnings of $115-118 per share). Our fair value estimates imply mid-single digit returns for stocks during the rest of 2013, and low to mid-double digit returns for equities over the next six to eight quarters.

The rapid ascent of stock prices since November (16% since November 15, 2012) raises the probability of an interim correction over the next several quarters, but the market's relentless move higher during the first quarter indicates that investors are intent on getting capital invested in equities, and are using small pullbacks in stock prices to increase equity exposure.

We remain constructive on equities over the next several years because valuations remain below average, and earnings growth, while not spectacular, continues to be solid. If interest rates continue to rise, stocks could benefit from a significant inflow of capital to the equity market from the bond market, where interest rates remain very low, valuations are unattractive, and where risk in our view remains above average. We continue to expect that stocks will provide total returns of 7-10% annually over the next five to ten years, based on their current valuations and earnings growth prospects.

We continue to believe that stocks remain far more attractive than bonds on an intermediate to longer term basis, but we expect that the remainder of 2013 could be marked by more stock price volatility than was evident in the first quarter, as significant risks continue to face investors, and equities, while still attractive and undervalued from a long-term perspective, now trade at materially higher valuations than a year ago.

We continue to be defensively positioned in bond portfolios in terms of duration and average maturity life, and we continue to emphasize high-quality companies with strong growth prospects and attractive valuations in equity portfolios.

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