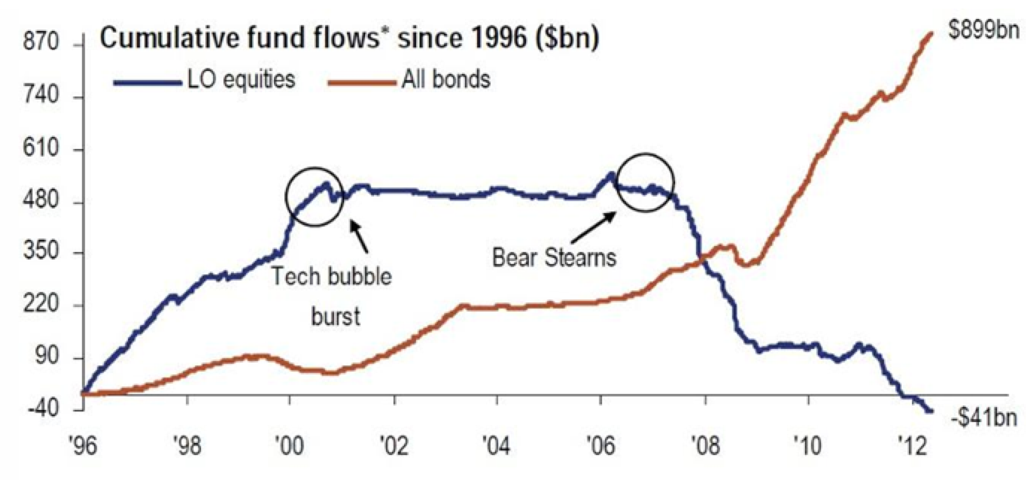
NICHOLAS HOFFMAN AND CO.

INVESTMENT COUNSEL

Dear Clients and Friends, October 2012

What a difference a quarter makes! It was a volatile start to the year, caused largely by the lack of direction in the political world, particularly Europe. After government institutions demonstrated their intent to do whatever it takes in the near term to provide liquidity, the equity markets responded positively with the S&P 500 Index up 16.4% through the third quarter, EAFE up 10.6%, and the Emerging Markets Index up 12.3%. The returns over longer time periods also began to look healthier. The S&P 500 Index was up 30.2% over the twelve months ending September 30th, resulting in an annualized return of 8.01% over ten years. These market advances have occurred not long after many pundits were giving the last rites to equity markets following the "lost decade" of 2001-2010 when the S&P 500 Index turned in an annual compound return of only 1.4%.

Government statements and actions also provided the backdrop to the bond market's continuing record low yields, with the 10 year US Treasury now yielding around 1.7%. The enduring strength of the bond market can be at least partly explained by the large flow of funds into fixed income since 2009 as investors have sought security. The chart below illustrates this flow and also shows the significant movement of funds out of equity markets in 2008 and again over the last 18 months.



* data 1996-2002 from Lipper FMI; 2002-onwards from EPFR Global
Source: BofA Merrill Lynch Global Equity Strategy, EPFR Global, Lipper FMI

The chart begs a number of questions, not the least of which is how long can the bond market sustain current low yields? While there is always a place for fixed income investments in a portfolio, we continue to caution our clients on the embedded risks in the bond market, especially if we start to see inflation.

So what is the best way to ride out this period of continued political and economic uncertainty? There are no easy answers, and certainly none that suit every investor's appetite for risk and desire for return. However, we are sure that the recovery in equity values over the last few years provides further support for our core belief that investing is a long term game where the players need to regard the advice of those on the sidelines with skepticism. Moreover, uncertainty is best managed by diversification including, where appropriate, a balance between public and private investments. Undue concentration of investment exposure, or frequent radical shifts in asset allocation, will tend to increase the risk of sub market performance. That is one of the main reasons that the "average investor" saw only 2.1% returns in the period 1992-2011. This was less than one third of the returns made from sticking to the S&P 500 (7.8%) or bonds (6.5%). The lesson in all of this is that good long term investors exhibit characteristics of patience and a commitment to finding long term value. As Warren Buffett once said, "I buy on the assumption that they could close the market the next day and not reopen it for five years."

While we face "interesting" times in assessing investment opportunities, we also feel it is important to take a close look at financial planning strategies given the new and expiring tax provisions. The historically low tax environment that has existed since the Bush-era tax cuts will likely change come January 2013, regardless of who takes office. In addition, there are provisions going into effect which will impact high-income taxpayers. For example, higher income tax payers ($250,000 if married and filing jointly) will be slapped with an additional 3.8% tax on dividends and capital gains under the new Medicare tax.

In light of these pending changes we are advocating that you review your tax strategies. Here are four ideas. First, consider accelerating income into 2012 and postponing losses until 2013. Second, consider realizing long term gains on taxable bonds in 2012 rather than receiving interest income in 2013 or beyond. Third, consider converting your traditional IRA into a ROTH IRA. Finally, 2012 provides a real opportunity to do some significant estate planning not the least of which involves making use of the $5.12 million lifetime Gift Tax Exemption set to expire this year.

For your benefit, we have attached a short summary of these expiring tax cuts and new tax provisions that may change come 2013. We would welcome the opportunity to meet and explore with you how various tax strategies may best suit your individual family circumstances.

No doubt this will be a very busy and exciting last quarter of the year. We are ever grateful for the support of each of you as we continue to build a firm focused on highly customized planning and investment solutions tailored to your particular needs.

Carl | Nick | Gary

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