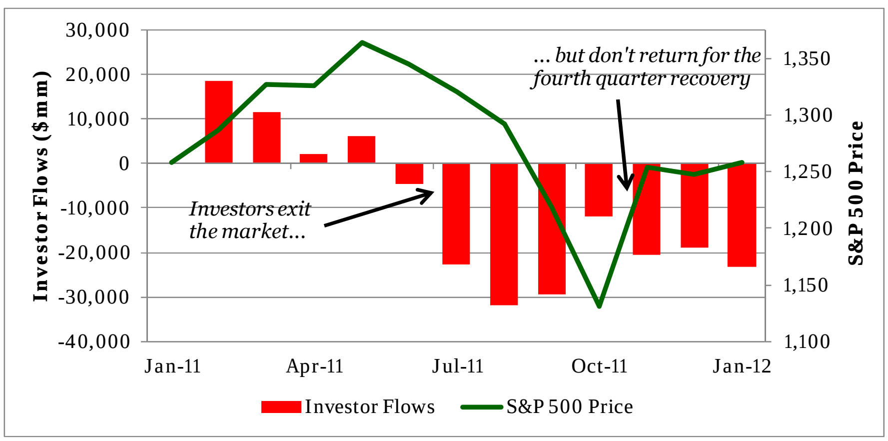
"Sometimes the questions are complicated and the answers are simple."
– Dr. Seuss

March 1, 2012

For U.S. equity investors, 2011 was like being on a roller coaster. The ride featured extreme twists and turns that left most market participants queasy and several high-profile money managers looking green about the gills. Despite the gut-wrenching volatility, the S&P 500 finished down 0.003 percent for the year.

Retail investors once again demonstrated their ability to buy high and sell low. They piled into U.S. mutual funds as the market rose early in 2011. As the market swooned in the spring and summer over sovereign debt concerns, investors aggressively sold their U.S. equity holdings. The average investor ended up missing a good portion of the fourth quarter rally, as strong corporate earnings and moderate valuations led to a rally in share prices that has continued through the start of 2012.

The S&P 500 and U.S. Mutual Fund Flows in 2011

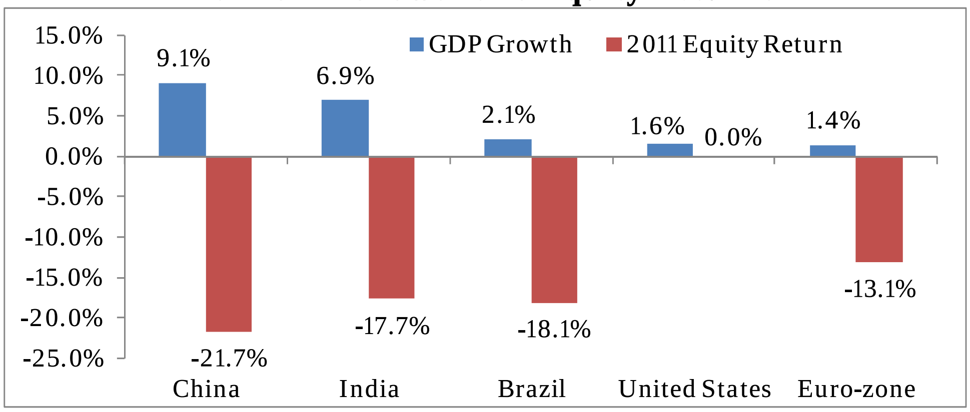


Professional investors in aggregate did not do much better in this volatile market. Hedge funds that focus on stocks suffered losses of over 7 percent, and one high profile manager, whose bet against mortgage-backed securities a few years ago was dubbed "the greatest trade ever," saw one of his largest funds drop over 50 percent.

Investors hoping to find shelter in international markets fared poorly. 2011 was a year where global diversification did not work. The Euro Stoxx 50, a broad index of European equities, declined 13.1 percent. Even more surprising for many investors was that the worst performers in 2011 were fast-growing emerging markets. For example, equity markets in Brazil, India, and China declined 18.1 percent, 17.7 percent, and 21.7 percent respectively.

At the start of 2011, it was clear that emerging market country economies would grow faster than that of the United States and the debt-laden economies in the Eurozone. In the fourth quarter of 2011, it is estimated that Gross Domestic Product in Brazil, India, and China grew approximately 2.1 percent, 6.9 percent, and 9.1 percent respectively, which outpaced the United States' 1.6 percent expansion and Euro region's 1.4 percent growth.

2011 GDP Growth and Equity Returns



Why did the emerging markets fare so poorly vis-à-vis the United States and Europe when their growth was so much stronger?

In this letter, we will address this question using two examples and data compiled by Professor Jeremy Siegel of the Wharton School of the University of Pennsylvania. We will see that good economic headlines are not always correlated with good returns. Afterwards, we will discuss our thoughts on the current investment environment and conclude with some general updates.

BACK TO THE FUTURE – THE BENEFIT OF HINDSIGHT

We're back in the 1950s and the United States is in the midst of a massive technology boom. Recent innovations include the first mass-produced, leak-proof ballpoint pen and the first copy machine. Television is now broadcast in color, and the wireless remote has just been invented. Sony, a new Japanese company, has just introduced the first pocket-sized transistor radio.

We begin our case study with International Business Machines (IBM), one of the firms most synonymous with innovation in the 1950s. During this period, IBM went from building computers with electromechanical switches to vacuum tubes to transistors. Processing power went from 17,000 calculations per second to 229,000 – an increase of over 1,300%. IBM was clearly a leading company in the fastest growing sector of the economy. From 1950 to 2000, the technology sector increased from 3 percent to about 18 percent of the economy.

In contrast, Standard Oil of New Jersey, which was to become ExxonMobil, was in a sector that would shrink dramatically over the next half century. Oil stocks comprised 20 percent of the market value of all U.S. stocks in 1950, but fell to less than 5 percent by 2000.

With this brief background of IBM and Standard Oil of NJ, let's take a look at the growth rates of these companies from 1950-2003.

Annual Growth Rates of IBM and Standard Oil
1950-2003

Growth Measure	IBM	Standard Oil of NJ	Advantage
Revenue Per Share	+12%	+8%	IBM
Dividends Per Share	+9%	+7%	IBM
Earnings Per Share	+11%	+7%	IBM
Sector Growth	+15%	(-14)%	IBM

IBM handily beat Standard Oil in every measurement during this time period – revenue, dividends, earnings per share, and sector growth. Surprisingly, if you had invested the same amount in both companies in 1950, your Standard Oil investment would have been over 30 percent greater than your IBM investment by 2003.

Why did an investment in Standard Oil beat IBM? It came down to valuation.

IBM was a higher growth company compared to Standard Oil, but IBM also had a richer valuation during this period. The average price-to-earnings ratio (the price investors pay for every dollar of earnings) for IBM was 27 while the average for Standard Oil was 13. The price you pay clearly matters.

The fact that strong growth does not imply robust investment returns can also be seen by comparing China and Brazil in the early 1990s.

By the early 1990s, China's economy had begun its remarkable growth trajectory. During the previous decade, under the leadership of Deng Xiaoping, the country had begun to move in the direction of a market-oriented economic system. In 1990, the Shanghai and Shenzhen stock exchanges were opened, and the country's GDP proceeded to surge over 9 percent per year for the remaining decade.

In stark contrast, Brazil began the 1990s in crisis. In 1992, the president was impeached and forced to resign. Inflation soared to over 1,100 percent and by 1994 inflation surpassed 5,000 percent. The currency was devalued in 1999 when severe budget deficits prompted a flight of international reserves. The country's GDP grew less than 2 percent per annum during this period.

Given this background, how did equity markets in these two countries fare during this period? A $1,000 investment in China at the end of 1992 earned a mere 2.7% in dollar terms annually through 2003. A similar investment in Brazil would have resulted in a 15.9% annualized gain.

LESSONS FOR TODAY

What lessons can we draw from the IBM/Standard Oil and China/Brazil examples?

As we read today's newspaper headlines, we see the excitement and hype surrounding new Internet companies in social media like LinkedIn, Groupon, and Zynga. Investors are providing them with premium valuations today, but what will be the fate of these young, relatively unproven companies?

Groupon lost $351 million dollars in the past year and owns very few tangible assets, and yet the company's investment bankers brought the company public at a valuation of $12.7 billion dollars. Although the stock quickly rose on the first day of trading, Groupon has fallen below its IPO price.

The political soap opera that is the European Union's struggle to contain its debt crisis dominates the headlines. We're all waiting for something bad to happen, and bracing for a second Lehman-like crisis.

What should investors do?

Our compass amidst all the uncertainty in the world has always been our focus on valuations, which we believe has provided our investors with a margin of safety over time. As we look at the world, we believe equity valuations continue to be reasonable, as the global economy's challenges are already well-documented, and the difficult, economic realities are already reflected in current prices. Furthermore, when compared to bonds, which have benefited from investor flight to perceived safety, equities are more than reasonable.

CONCLUSION

Some believe that the ancient Mayans predicted the end of the world in 2012. We have no insight into whether or not global doom is in our immediate future. We simply focus on what we can control, which is buying good businesses at reasonable valuations.

We do know that the 2012 Presidential race will likely be the ugliest on record. Based on two landmark court cases in 2010, unlimited sums of money can now be raised by Super Political Actions Committees (Super PACs). These Super PACs openly support their own candidates, and will have a disproportionate impact on this year's election because of the resources they command. Simply put, brace yourself for the unprecedented deluge of negative political ads this summer and fall. Our guess is that after watching enough of these ads, many of us will believe that the Mayan prediction may in fact be accurate.

Your Advisor started managing money in Princeton, New Jersey twenty years ago during the height of the Savings and Loan Crisis, the First Gulf War in Iraq, a severe recession, and growing uncertainty about our country's standing in the world. At the time the Dow Jones Industrial Average stood at 3,200. Over the last 20 years this gauge of market performance has quadrupled even in the midst of unspeakable tragedy and unforeseen economic and political challenges.

The willingness to buy securities when circumstances appear dire must be embedded into the DNA of a sound investment program. In helping you to reach your long-term financial objectives, we have put this discipline into practice most recently in early 2009 and the fourth quarter of 2011. During these periods, the competition with other buyers was modest, sellers were plentiful, and prices supported purchases that were advantageous for long-term investment.

Our most important measure of success is providing you with peace of mind. We strive to be good listeners and communicators, financial coaches with an emphasis on keeping client families focused on long-term plans and away from short-term fears.

Furthermore, given the knowledge, experience, and contacts we have built up over the last two decades, we have worked to become your family CFO. The deeper we engage in conversation, the better we are able to serve you in this capacity. Most importantly, we want to be your first call when there is something on the horizon that may impact your financial life, or more generally your peace of mind.

As Dr. Robert Hastings, author of the poem "The Station" wrote, "Sooner or later we must realize there is no station, no one place to arrive at once and for all. The true joy of life is the trip." We look forward to continuing that trip with you in 2012.

As Roundview Capital has grown, we have been able to drive down both commissions and fees for our client families by re-negotiating existing arrangements with our custodians, Schwab and TD Ameritrade. Having two custodians has proved very beneficial, as the healthy competition has led to improved service and pricing.

A copy of the Firm's ADV Part II is included for your review.

We wish you all a pleasant spring, and look forward to talking to you soon.

With Best Regards,

Howard Alter
Stephen Shueh
Andrew Lieu

George Andresen
Janet Chen
Janice Puccio