"Don't worry about the world coming to an end today. It is already tomorrow in Australia."
- Charles M. Schulz

February 28, 2013

Dear Friends & Family,

The well-known saying that "stocks climb a wall of worry" proved especially true in 2012. Despite a multitude of macroeconomic stumbling blocks, including the European sovereign debt crisis, Asian economic slowdown, and American fiscal cliff saga, U.S. equity indices delivered returns between 7 and 16%.

Against this backdrop, Roundview Capital maintained fully weighted equity allocations for client accounts, reflecting our view that a number of businesses were available for purchase at attractive valuations. Furthermore, the three to five year risk-reward framework for equities was superior to that of fixed income or cash equivalents.

The 2012 year-end letter offers a discussion of the various major asset classes as well as a summary of recent tax reform and a general firm update.

DÉJÀ VU?

"There is an inevitable divergence between the world as it is and the world as people perceive it."
– J. William Fulbright

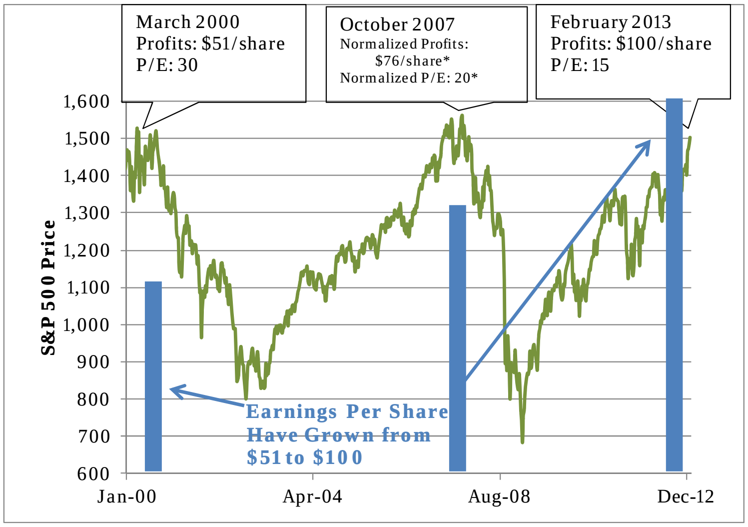
As we write to you, the S&P 500 Index has pushed past 1,500, a level only previously attained in March 2000 and October 2007. The other two times the index reached this benchmark, it retreated sharply. Will it be different this time?

We won't keep you waiting for the answer. It is your Advisor's view that the underpinning of the equity market is firmer than it was at the prior highs.

By way of example, per share S&P 500 profits have doubled since 2000 from $51 to over $100. Accordingly, from a valuation perspective, the equity market is now trading at 15 times earnings, roughly in line with the historical norm of the last hundred years, and in stark contrast to a multiple of 30 at the beginning of the century. This is illustrated in Exhibit 1.

Curiously, investors are willing to pay half as much for earnings compared to 2000 at a time when US companies currently carry a record $2 trillion in cash. With these funds, businesses possess tremendous financial flexibility that can be deployed to improve the lot of shareholders through dividend increases, share repurchases, and investments in future growth.

Exhibit 1: S&P 500 Prices Level Since 2000,
But Profits Double



*Normalized earnings calculated by subtracting non-recurring bank earnings. Source: Bloomberg, Yardeni Research.

An additional filter that supports a reasonably constructive view on equities is market sentiment, which remains neutral to slightly bearish. This serves as a contrary indicator for your Advisor. For example, over the past five years, institutional pension funds reduced their stock allocations from 60% to 52%. In addition, Wall Street strategists on average are recommending an underweight position in equities of 50% compared to a 70% bullish stance when markets reached previous highs. Retail investors also continued a four-year string of selling equity mutual funds, liquidating $153 billion in 2012.

More recently, capital has begun to flow back into stocks, with $27 billion returning to equity funds. Your Advisor suspects that investors are beginning to seek alternatives to diminished bond yields and non-existent cash returns. This process is just beginning, and renewed confidence can often serve as a new leg in a bull market cycle. That said, we are wired to buy fear and sell greed, so a further acceleration is worthy of attention.

AVOIDING RISK IN A YIELD-STARVED MARKET

"Problems worthy of attack prove their worth by hitting back." - Adam Smith

Your Advisor and the investment community at large currently face the challenge of finding reliable sources of income in a low interest rate environment, as highlighted by Exhibit 2.

Exhibit 2: February 2013 Interest Rates

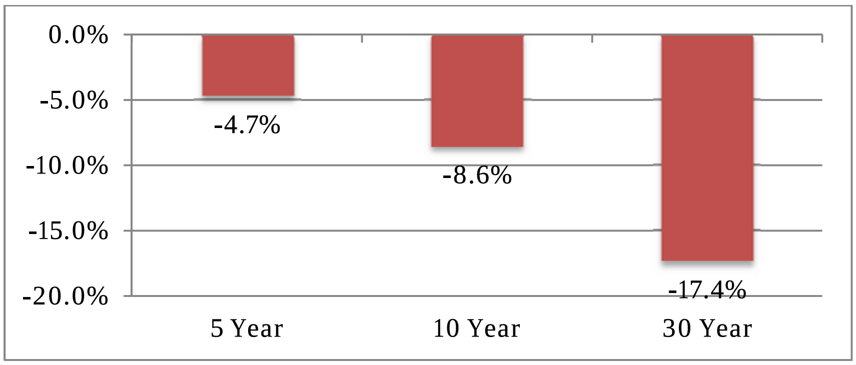
Fixed Income Instrument	Current Yield	Average Since 1980
Banks Savings Account	0.12% (national average)	
5-year Treasury Bond	0.9%	6.3%
10-year Treasury Bond	2.0%	6.8%
30-year Treasury Bond	3.2%	7.0%

Source: Bankrate.com, Bloomberg

With yields near all-time lows, many of our peers are purchasing longer-dated securities and lower credit quality issues in order to boost income. We view this as folly, since these alternatives offer little reward while exposing bondholders to interest rate, reinvestment, and credit risk.

Interest rate risk plays out when one owns longer-dated bonds in an environment of rising interest rates. It is particularly dangerous when the instrument's maturity does not match the timing of future cash needs. If interest rates were to rise a modest 100 basis points or 1%, the bond price of a ten-year Treasury would fall by 8.6%. A bond with a longer maturity carries more substantial risk, as illustrated in Exhibit 3.

Exhibit 3: Treasury Price Decline if Interest Rates Rise 100 basis points

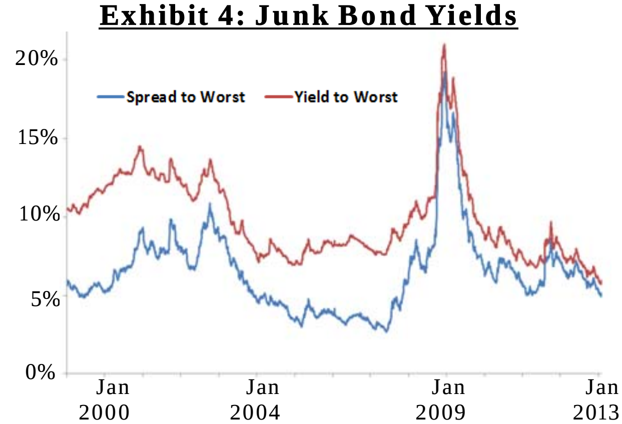


Reinvestment risk confronts the investor who receives principal back from a maturing bond, and must find income through a new fixed income asset. For instance, a bondholder who was astute enough to buy a thirty-year, triple AAA corporate bond in 1982 enjoyed a 15% coupon. With the bond maturing in 2012, this investor is faced with the prospect of achieving a much lower yield for a quality bond that matches future funding needs.

This is very often where the foolishness begins. Unknowingly, investors often try to maximize yield by purchasing bonds of lower credit quality.

In the search for income, investors have bid up prices for high yield or "junk" bonds. These securities, sold by companies with relatively weak balance sheets, are offering yields comparable to those during the years leading up to the 2008 financial crisis.

Exhibit 4: Junk Bond Yields



Source: JP Morgan, Financial Times

Your Advisor is acting with caution in the fixed income space. At this point, we are more concerned with a disciplined "return <u>OF</u> capital" approach rather than chasing "return <u>ON</u> capital." From time to time, we do find credit securities that provide equity-like returns, as they are tied to distressed businesses that your Advisor believes are money good. Unfortunately, these opportunities have become less prevalent. So in summary, expect unexciting returns on cash and fixed income allocations until further notice.

NOTHING BEATS A SOLID FOUNDATION

"A hard fall means a high bounce... if you're made of the right material." - *Unknown*

In the 25 years leading up to the 2008 financial crisis, an average of 1.6 million homes were built each year. That number fell by 60% in 2009 and has only bounced back slightly since. The falloff in homebuilding has put a significant damper on the economy. For example, a study from the Bureau of Economic analysis estimates that low levels of construction could account for 35% of the gross decline in the nation's economic output and 52% of the decrease in employment.

That said, we are bullish on job creation facilitated by an improving housing sector over the next three to five years. 1.2 million households were formed in 2012, and at least 1.5 million more are expected to form each year in the foreseeable future. If immigration reform is passed, our numbers could be conservative.

With depression-like creation of new housing stock but continued demand for homes, supply is beginning to tighten and home prices are once again on the ascent. Exhibits 5 and 6 highlight the low level of current inventory and resultant rise in home prices.

The more positive environment is not only good news for homebuilders, but also for the broader economy, as new construction increases business for materials, mortgage finance/legal services, and transportation companies, to name a few.

Exhibit 5: Existing Home Inventories

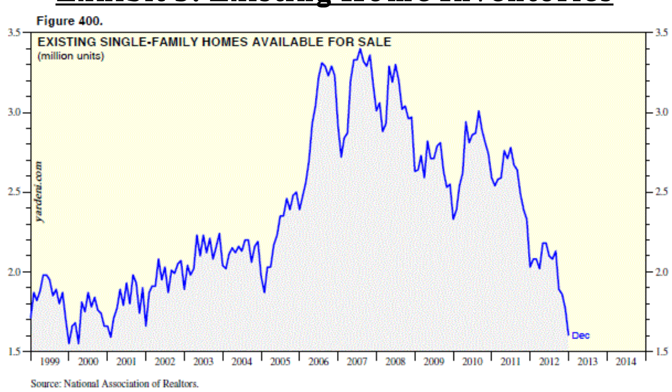
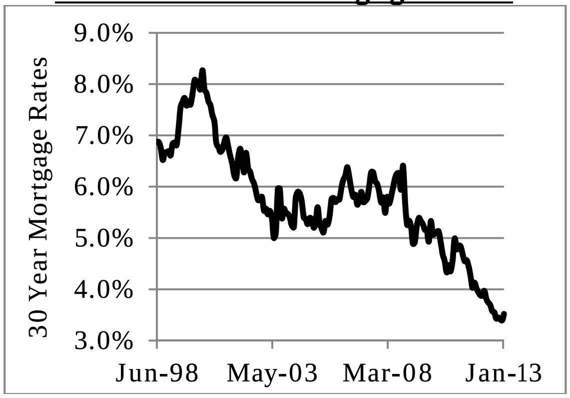


Exhibit 6: Home Prices

Our confidence in a continued housing recovery is further supported by a high level of affordability in residential real estate. For example, 30-year borrowing rates have fallen from over 8% in 2000 to under 4% in 2013, as highlighted in Exhibit 7. On a $417,000 mortgage, a homeowner would pay $14,200 less per year.

Together the supply and demand imbalance and affordability of homes create a very positive backdrop for those looking to purchase a primary residence. Your Advisor is comfortable with buying as much house as can be comfortably afforded.

Exhibit 7: Low Mortgage Rates



Source: Bloomberg

CONCLUSION

While we are constructive on equities and primary residential real estate, our view on long-term bonds and cash equivalents is more guarded. But there is no free lunch. Even with stocks, you must be willing to accept on average three or four short-term declines of 5-10% in value each year, along with the possibility of a 20% to 50% temporary decrease. One must only look back to 2008 and the first quarter of 2009 to see the sell-off coupled with your Advisor's subsequent response in action. We seek to use these declines as allies, increasing our allocation to equities and buying extremely high quality businesses at fire-sale prices.

Unlike stocks, which offer continuous and easy liquidity, real estate is a true buy-and-hold investment that should be made within one's financial means and with a reasonable down payment. That said, we have never seen a better period to make such a purchase in many local markets than today.

There are some very immediate changes to government regulation that have modified our investment approach and our advice to our client families. Specifically, the resolution to the "fiscal cliff" includes several adjustments to income, estate, and gift taxes. Many of the changes are considered "permanent." Of course, in Washington this only means that the law will not be modified until politicians decide to change it. Nevertheless, several of the provisions do provide clarity over the foreseeable future.

Highlights of the tax changes include:

- The 2% payroll tax holiday was not extended.
- The Bush-era tax cuts have been made "permanent," with the exception of those with household incomes above $450,000 or individual incomes above $400,000. If income exceeds those thresholds, at the margin federal taxes will increase by approximately 5%. Furthermore, personal exemptions and itemized deductions will be phased out for incomes beyond $250,000 ($300,000 for married couples).
- The top capital gains and dividend rate will increase to 20% for those earning more than $400,000 a year ($450,000 for married couples).
- A new 0.9% Medicare surtax on ordinary income and 3.8% surtax on investment income will be imposed on incomes over $200,000 (single) and $250,000 (married) as part of the Affordable Health Care Act.

- The Federal estate tax exemption has been "permanently" set at $5 million per person, with the top rate rising to 40% from 35%. Because of adjustments for inflation, the amount for 2013 amounts to $5.25 million.
- Annual tax-free gifts have increased from $13,000 in 2012 to $14,000 in 2013 as a result of an inflation adjustment.

General Updates

At world headquarters, the extended Roundview family continues to grow. Andrew and his wife Bonnie welcomed Samantha Lieu into the world on January 4th. The newest addition to the family arrived four weeks early, just missing the chance to share a January 5th birthday with Howard's oldest daughter Ella and Stephen's youngest son Zachary. Ask Andrew to send pictures. You can look at them after perusing a copy of the Firm's ADV Part 2A & B, which is included with this report.

As always, we remain able to provide any information required for tax preparation. But as you may know, all custodians are now required to provide cost basis information on form 1099 documents. So while in the past you have called on us to generate this information internally, the relevant data is provided in the 1099 document that you should have already received.

Finally, from our family to yours, we appreciate your confidence in us and we work hard every day to honor your trust. Please read through your 2012 Roundview Capital Annual Report and as always we are eager to hear your feedback. We look forward to seeing and talking to you in the coming months, especially if there are any changes to your financial situation or investment objectives. In the interim, we wish you and those you love a healthy, happy, and prosperous 2013.

Sincerely,

Howard Alter   Stephen Shueh   Andrew Lieu

George Andresen   Janet Chen   Janice Puccio