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Sandpiper Capital

Gleanings

Market Returns Annually and Through Five Years Ending 06/30/2012

Index	2009	2010	2011	5 Yrs
S&P 500	26.5	15.1	2.1	**-1%**
ML 1-10 yr Gov't/Corp	5.7	6.0	5.9	**4.7%**
EAFE (Dev Fgn Mkts)	31.8	7.8	-12.2	**-7%**
Emerging Markets	78.4	19.0	-18.4	**-1%**

"Slow Growth, Low Rates"

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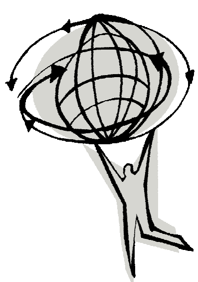


"What we're stuck with is a stock market that creates a lot of drama with little upward progress and a bond market that only offers forward returns in the 3 to 4% area."

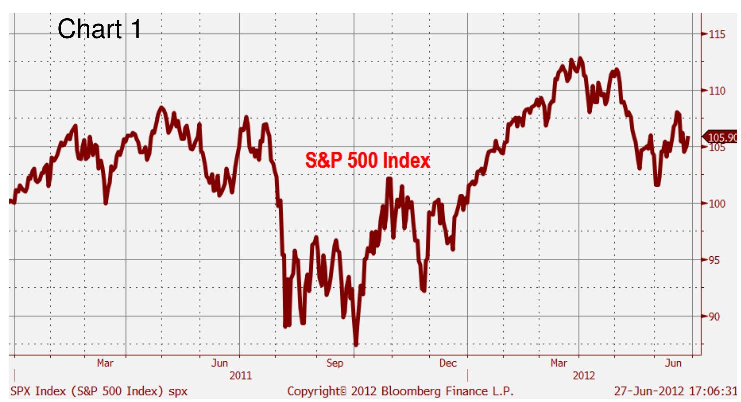
Investment managers have a couple of big challenges in the current low growth environment. Stock market volatility hasn't changed. If anything, it's even greater than usual. But average annual returns are still limited to the low single digit rates at which the economy is growing. So, we have these big swings up and down every couple months to contend with while the overall progress of the market is almost nill. (See Chart 1.)

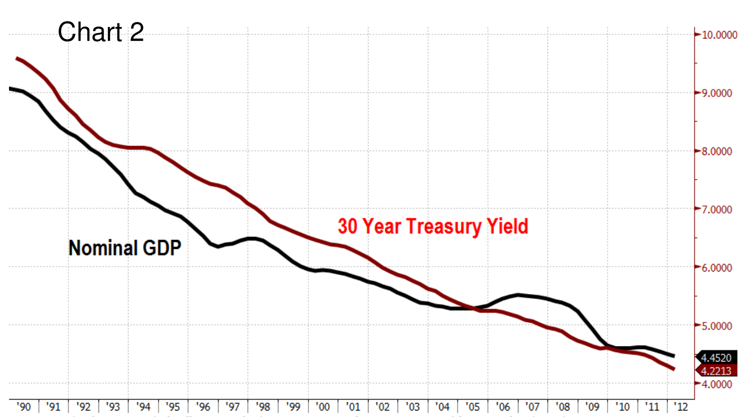
And, to boot, as long as the domestic economy is only expected to be growing at 3 to 4% per year, long term, high grade bond yields will tend to gravitate to that type of rate. (See Chart 2.)

So, what we're stuck with is a stock market that creates a lot of drama with little upward progress and a bond market that only offers forward returns in the 3 to 4% area. With money market yields near zero, total account returns will have to be generated from asset classes that in isolation, will each offer long run returns of 0 to 4-5%.

So, what is a portfolio manager to do?

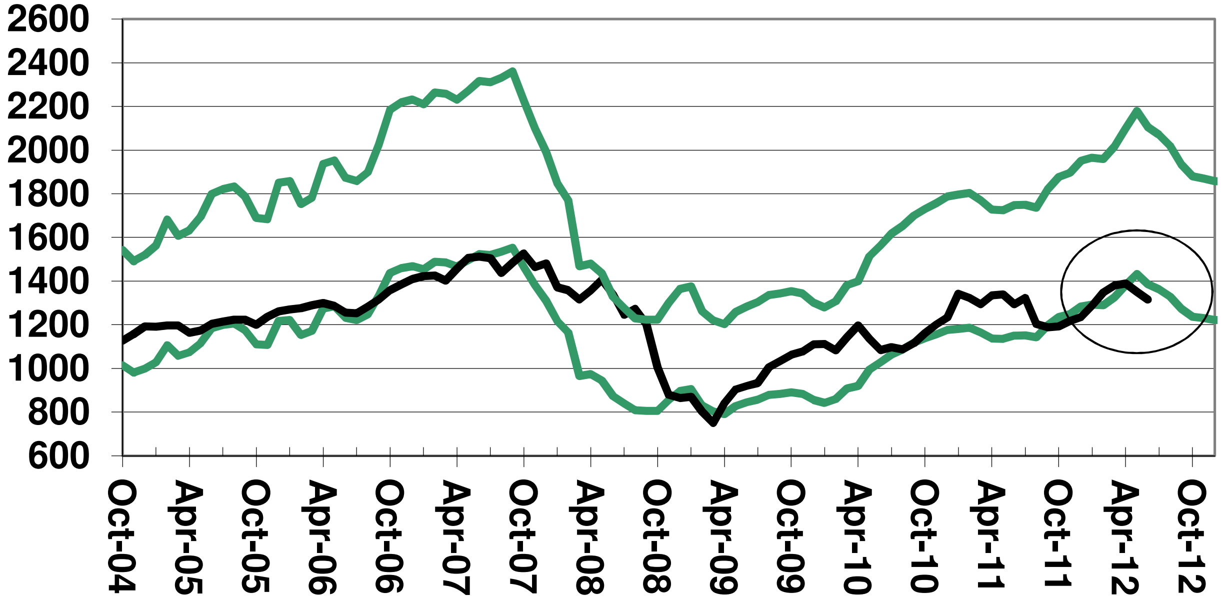
Well, work harder is certainly going to have to be true. It's no longer enough to identify good companies in good industries at good prices. We need to also constantly be taking the pulse of the market to know the direction money is flowing so that we can avoid being swamped by traders jumping on and off the latest trend. Smarter, of course, too, discriminating between useful improvements to time-tested methods and over-reactions to significant but temporary market factors. But most importantly, we need to act more bravely. We need the courage of conviction to trim back stocks when everyone's buying and to buy stocks when everybody else is afraid. To trust our experience and to believe that good research and good analytics will continue to allow us to preserve capital as well as to grow it, if we are willing to act deliberately and methodically.





The numbers that feed our S&P 500 fair value model are from reported earnings and inflation statistics. That is, the computation of the upper and lower bands of fair value up until the current date are not from our own estimates, but from published data. The extension of the green lines that continues to the right of the current month are from the values that we *are* guessing will come for the balance of the year based upon leading economic indicators.

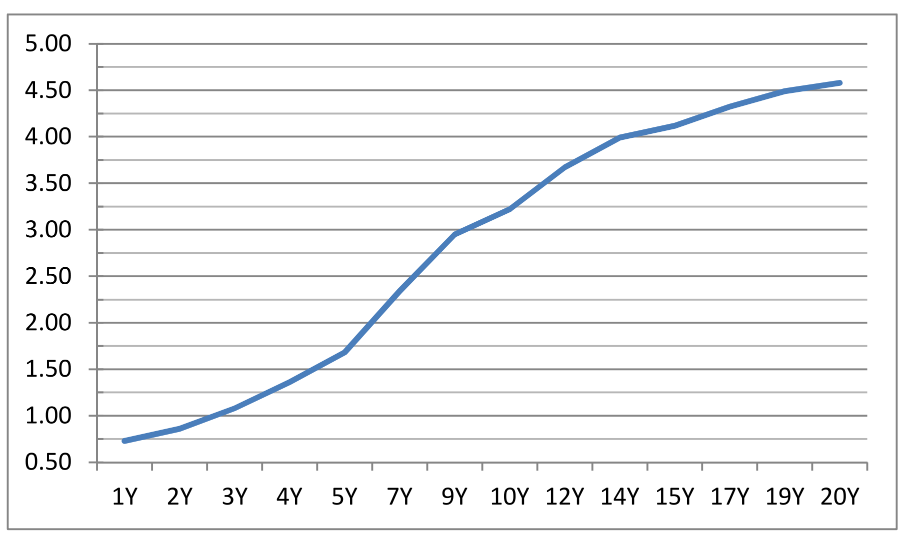
Green lines- the upper and lower bands for our calculation of fair value for the S&P
Black line- The average monthly price for the S&P 500
Investment environments characterized by greed will send the market to the top green line. Fear will drive the market as low as the bottom band. The slope of the green lines reflects the market's expectations for earnings and inflation. (2012 estimated)



The chart below illustrates the yield curve for AA Taxable Municipal bonds. The yields are on the left axis and the years to maturity are on the bottom axis. As long as developing countries continue to add new productive capacity faster than we can print money, inflation will stay subdued, domestic growth will be modest and interest rates low. We expect that periodic episodes with inflation scares will allow us to build laddered portfolios that average 3-4%.

Muni Taxable AA Curve

1Y	0.73
2Y	0.86
3Y	1.08
4Y	1.36
5Y	1.68
7Y	2.34
9Y	2.95
10Y	3.22
12Y	3.67
14Y	3.99
15Y	4.12
17Y	4.32
19Y	4.49
20Y	4.58



Tom Lukic