BLUE GRANITE CAPITAL, LLC

INVESTMENT COMMENTARY

January, 2012

The United States Congress has made an art form of gridlock in Washington, especially this past year! So how should their European counterparts and finance ministers be graded for their efforts to solve the precarious sovereign debt crisis in Europe? Despite a potentially catastrophic situation if any European governments were to default, no viable solution has been reached. The very survival of the European Union is in question, but no agreement has been reached. It appears European officials have been even more inept than U.S. politicians, despite the magnitude of their debt problems and the far-reaching global consequences. In a year in which global leaders have made a mockery of their incompetence to implement policy in order to ñright the shipò and get their economies back on track, the winner is é é .

The European financial crisis is volatile situation and its implications for the developed world may dwarf the impact from the 2008 U.S. financial crisis. The threat of credit downgrades for several European Union countries by Standard & Poorõs only heightens concerns. Without a European bailout, both the capital markets and world economies will suffer. The consequences of a financial collapse by any of European governments should logically imply that swift action is required. However, every day brings a new twist to an already complicated and risky situation. It has been 3 years since the U.S. financial crisis and the worst recession since the 1930õs. European officials should have learned from that predicament and swiftly taken action to avert their own crisis and recession. Currently, all signs point to a slowing European economy and financial insolvency, both leading to an expected recession. Whether it is just politics or a problem too complicated to fix, this is gridlock at its best!

As a result of the uncertainty and risk surrounding Europe, the U.S. has become the ñsafe-havenò for investors. In a ñflight-to-qualityò, the U.S. is now the country of choice to park investment capital. This is especially true for our sovereign debt (United States Treasuries), despite last yearõs credit downgrade by Standard & Poorõs. In the face of historically low yields, investors around the world still clamor to buy U.S. governmentõs bonds. Even with a lackluster economy, U.S. stock markets are receiving their fair share of attention because so many financially stable companies sport very compelling dividend yields. Itõs easy to make the case that stocks look attractive and with their dividend yields even harder to ignore as an attractive investment choice. What stocks may lack at this juncture is a catalyst to grow their revenue and earnings, which adds an element of risk to the story.

Attractive dividend yields are a prudent reason to invest. However, stocks could become nothing more than a bond alternative with nothing to propel their share prices. Until global economies get back on track, the market may languish and limit the upside potential for stock prices. Based on recent history and a lack of proactive solutions to fuel economic growth, the U.S. may experience several more years of listless conditions. Complicating matters are 2012 GDP growth forecasts which are considerably lower than even last yearõs weak pace. Slower growth represents a risk to the stock market, or even worse if our economy slips back into a recession.

Recent U.S. economic reports have demonstrated improvement over the past month, especially regarding employment issues. Unemployment claims and the unemployment rate have both fallen leading forecasters to signal a positive turn in hiring trends. The U.S. added 1.4 million jobs in 2011, but that's a still a vast difference from the 8.75 million jobs eliminated due to the recession. The biggest challenge we now face is getting the millions of unemployed back to work, which will take several years to accomplish. Although the unemployment rate recently dropped to a 3-year low of 8.5%, it is still well above the 5% rate when the recession began in December 2007. More jobs will lead to an increase in consumer spending, which is the key driver of economic growth and the catalyst for a sustained recovery.

2011 Recap. Last year the market gravitated between "risk on" & "risk off". An early year rally extended the rebound from the March 2009 low to 102%. Then markets stumbled through the summer and fell 19% by October 3rd. With a fourth quarter rally, the S&P 500 Index ended the year up 2.11%. Excluding dividends, the return was a negative 0.04%. The year's finish highlights the importance of dividends not just for 2011 but also historically where dividends account for 45% of the total return of the S&P 500. The Ten-year Treasury bond yield ended the year below 2% for the first time since 1977. The aforementioned "flight-to-quality" confirms investor concerns and their willingness to sacrifice income for the safety of owning bonds.

What to watch for in 2012. Pay close attention to pending bank regulation, U.S. tax reform, a housing sector recovery, the presidential election, Iran, energy prices, terrorism risk and China.

China may in fact be the one catalyst that either lifts the global economies or sinks them. China boasts one of the strongest economies in the world, but exhibited a slowdown last year. GDP growth fell from the 10% range to 7.5%, leaving investors focused on the global impact of this trend. Add to the mix inflation worries and the risk of a real estate bubble popping and… we might have seen this movie before. As the primary trading partner for most of the developed world, a major economic slowdown or recession in China would have devastating implications. China's own consumption is the key driver for so many companies around the world that produce raw materials and finished goods. Every day provides news and analysis regarding China's economy and her impact on global growth. In the midst of a slow U.S. recovery, and declining economic growth in Europe, China's situation is being very closely monitored.

At Blue Granite Capital, we adhere to proven techniques to mitigate risk through comprehensive asset allocation and extensive analysis. The current environment highlights the necessity of this approach as part of a full-scale investment strategy. As always, our firm makes every effort to insulate our clients from the volatility associated with the markets while enhancing both income and growth potential in your portfolios.

Thank you for the confidence you show in us and your continued patronage of our firm. Wishing you a very Happy New Year

Warmest regards,

Scott B. Shubert