April 12, 2012

QUARTERLY INVESTMENT LETTER – FIRST QUARTER, 2012

Have I Missed the Rally? What's Next for Equity Investors on the Rocky Road to Economic Recovery?

Among many others, these questions seem uppermost in the minds of investors at the moment. Having weathered the "double-dip" recession concerns of last summer and the Euro-crisis of Fourth Quarter 2011, during the past six months equity investors have been rewarded with a 25% rally in global stock prices. Hoping to buy time while individual and public balance sheet deleveraging continues, central banks throughout the world have continued to flood the international banking system and credit markets with low-cost liquidity. Those who since October followed (in the fashionable terminology of the day) a "risk-off" portfolio asset class strategy may well have missed the 2012 equity market rally. But if the current correction continues, a chance to participate once again may present itself.

In addition to an accommodative central bank monetary policy backdrop, the enduring trend during this period of improving equity markets has been the strong earnings performance turned in by both large and small corporations, particularly in the U.S. As has been covered in these past letters, a major portion of this corporate earnings growth has been disciplined, management-driven cost-cutting, yielding notable improvements in employee and capital productivity.

Only in the last few quarters have increases in top line revenue become evident. But rather than what might be expected at this stage of a traditional economic recovery, these revenue improvements have been anemic and sporadic. Thus the average business executive is still reluctant to hire, and since public policy uncertainty abounds, there isn't yet any strong motivation to commit meaningful amounts of the "excessive" corporate cash reserves building on corporate balance sheets to increasing private entity payrolls. For businesses, when the choice today is between investment in capital equipment or ramping up employment, the tilt remains to labor-cost-saving capital stock.

But corporate cost-cutting has nearly run its course, and to the extent disappointment against consensus expectations occurs, first quarter 2012 year-over-year corporate earnings results (which will begin to be reported later this week), may tend to hold investor sentiment in check while the markets have time to assess the longer-term outlook. Meanwhile, many equity investors, some of whom enjoyed a 12% absolute return during the first 3 months of this year, may be tempted to collect their gains, or in some measure reduce portfolio risk and rebalance to bonds. After enjoying what in this phase of the new era of reduced expectations might be regarded as more than a full year's return for money at risk in volatile stocks, it wouldn't be

surprising if some investors retired to the sidelines. But where to park such gains remains the dilemma?

What Are Investors Looking For; A Robust Economy or Easier Money?

As is often the case, rather than "good or bad" alternatives, equity investors as usual are faced with a "better or worse" Hobson's choice; should one wish for a revived self-sustaining macro-economic environment, or a continued interventionalist central bank pump-priming monetary policy? If the former evolves, the latter not only becomes unnecessary, but would be expected to be reversed. If, on the other hand, continued deleveraging in the U.S. and fiscal austerity in Europe restrain global economic growth (expected to be roughly 2-3% in 2012), both our Federal Reserve Bank and the European Central Bank could be expected to keep the monetary printing presses running with the hope to later drain the excess liquidity before its inflationary impact becomes unavoidable.

Shorter-term for equity investors, the old adage "Don't fight the Fed" should be kept in mind. If the U.S. central bank continues its easy money policy, this liquidity-fed equity market celebration might go on. But as a matter of what's best for achieving the greater good, of course, a return to improving *real* economic growth would be the preferred scenario. The irony, it goes without saying, is that should an unexpectedly strong positive economic growth break-out scenario occur, then interest rates would probably revert to a more normal pattern and range (i.e., 3% for cash reserves ranging up to 5-6% for longer-dated fixed income securities). This would be a scenario in which the "better" outcome would be improving GDP growth, resulting in rising interest rates.

A Concern for Intermediate and Longer Dated Bond Investors

If deleveraging abates, economic growth improves, and interest rates return to more normal levels, what happens to bond prices?

The simple answer to this multi-variable question is that in just a short period of time intermediate and longer duration bondholders could lose a few years' bond interest payments in declining bond capital values. Since 1982, bonds have enjoyed a 30-year bull market, earning nearly as much in compound annual total return (i.e., coupon interest, plus rising market price) as was the case for stocks. Bond coupon interest rates today are as low as they have been since WWII. Short-term cash account rates have been ratcheted down to near zero. For holders of intermediate and longer dated bonds, a shift in Fed policy toward higher administered rates, or a change in the bond market's assessment of the expected term structure of bond rates, poses a risk that our fixed income portfolio policy seeks to avoid. In early 1994, against similar circumstances, the market value of intermediate and long duration bonds were marked down 15% in the span of a few weeks. A repeat of such a hit is what our very short duration, high quality fixed income portfolio structure attempts to obviate.

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A Recap of TFC's Portfolio Strategy for First Quarter 2012

"Labor market conditions have improved further . . . Household spending and business fixed investment have continued to advance . . . The Committee expects moderate economic growth over coming quarters . . . Strains in global financial markets have eased, though they continue to pose significant downside risk to the economic outlook." FOMC Press Release, March 13, 2012. The positive economic commentary in the Fed's recent statement was nearly identical to their mid-December 2011 press release.

With several consecutive quarters of generally positive economic news in the U.S., the immediate stabilizing and calming effect of the European Central Bank's Long-Term Refinancing Operation program (initiated in December), as well as a moderate (vs. severe) deceleration of the Chinese economy, there has been a measurable improvement in investor sentiment and psychology recently.

Recent fund flows also reflect investors regaining some measure of confidence and a willingness to assume additional equity market risk in search of higher than cash or bond returns. Net cash flows into U.S. and global equity ETFs (exchange traded funds) for the quarter just ended totaled approximately $34B, compared with net positive fund flows of only $16B quarter-over-quarter for 2011.

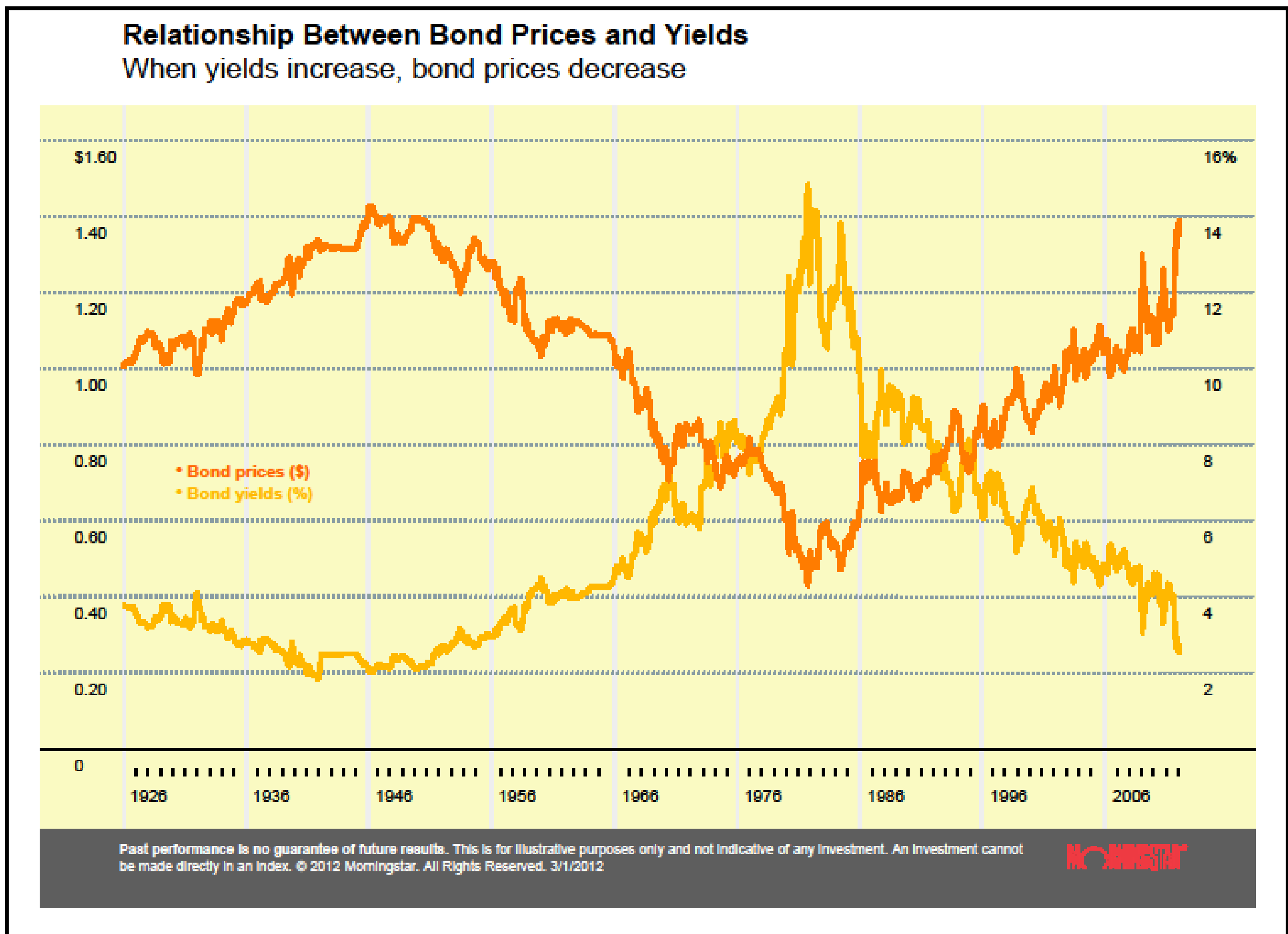
As mentioned, global equity markets, including the S&P 500 Index, have surged by over 25% since early October 2011. With current stock market valuations still at reasonable levels (price to forward earnings ratios of 11.2x for the MSCI All Country World Equity Index and 13.7X for the S&P 500 Index respectively), we will continue to rebalance client portfolios to agreed-upon asset allocation policy targets by reducing equities and increasing fixed income in most portfolios. For those portfolios in which cash was raised for income or retirement distributions or rebalanced to invest recent additions, no action will likely be necessary.

Fixed Income Performance and Strategy

As indicated, in anticipation of rising interest rates (and declining bond prices), and to protect principal values, in recent years we positioned our fixed income portfolios in shorter term, higher quality bonds/bond funds than many bond market benchmark indices (such as the Barclay's Intermediate Government/Credit Bond Index, or the longer duration Barclay's Aggregate Bond Index). This conservative portfolio fixed income strategy resulted in our bond portfolio returns underperforming longer term bond indices over the past 18 months, when interest rates continued to decline further.

Using 20 year U.S. Government bonds as a proxy, the Morningstar chart (Chart 1) below illustrates the inverse relationship between bond prices and their respective yields. Many may recall the early 1980's when long term bond yields peaked at over 15%! Since then, and for the past 30 years, yields have declined steadily to 60-year lows, with prices appreciating significantly.

Chart 1



While no one can accurately predict the timing or magnitude of changes or increases in interest rates for any type of bond (U.S. or foreign government, high or low quality corporate, municipal, etc.) in the future, it is highly likely that interest rates and yields, particularly in the U.S., will rise, which would correspond with declining bond prices. Further, investor cash flows

into bonds, fixed income funds and bond ETFs since 2008 are so large ($837 Billion into bond mutual funds), that a reversal of funds flows through net redemptions would certainly impact markets and bond prices negatively.

Today, we believe it would be prudent to continue to adhere to a shorter term, diversified, low-cost, investment grade fixed income strategy. Longer term interest rates have begun to rise, particularly for U.S. government bonds. For example, year-to-date the Barclay's 20+ Year Treasury Bond Fund (ETF) is down 6.7% through March 31, 2012.

Global Equity Performance and Strategy

During the first quarter of 2012, global and regional equity markets posted double digit returns (+14.1% for the MSCI All Country World Equity Index). Emerging Markets, along with European equities, led the way after posting the worst relative performance last year.

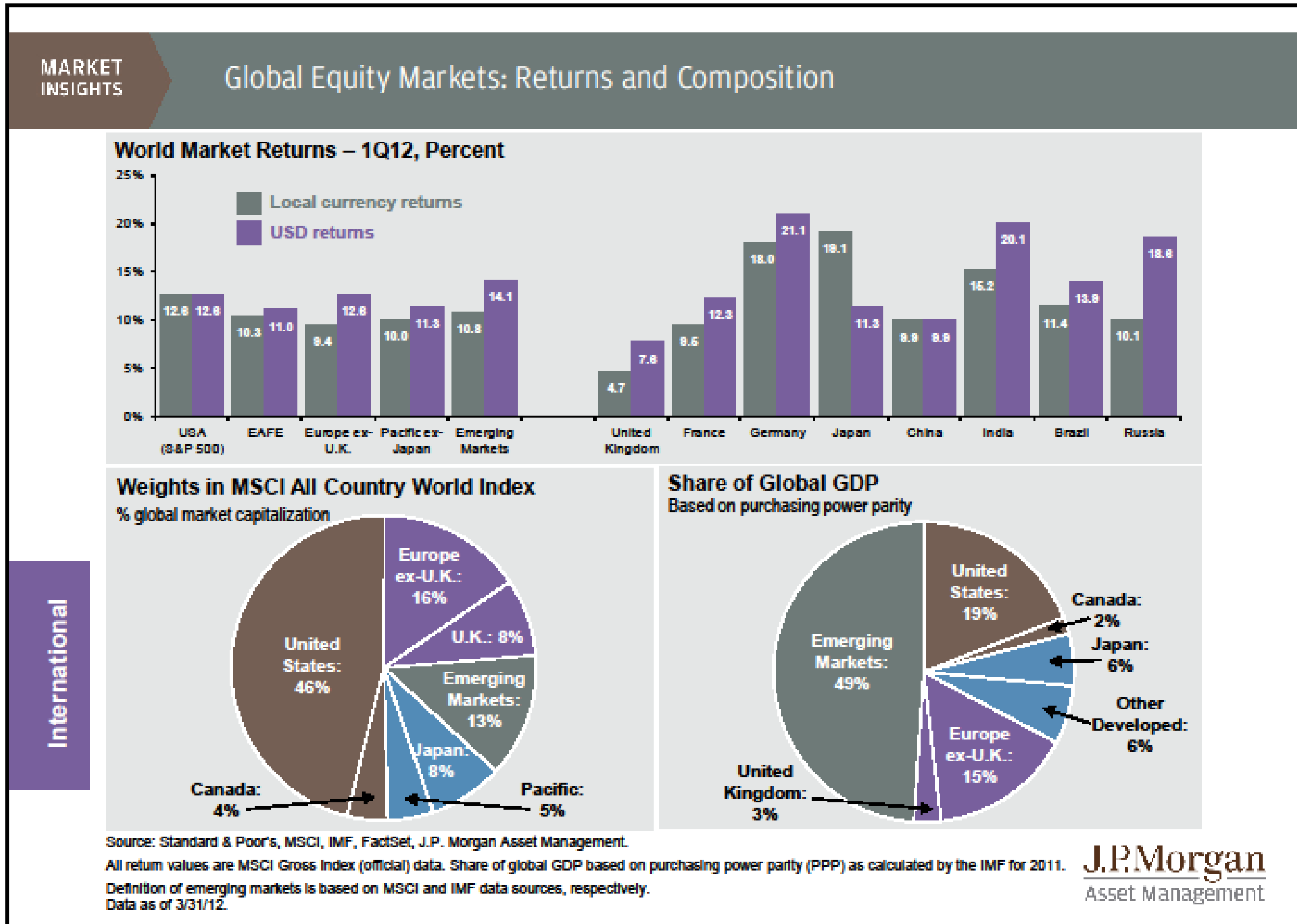
Global natural resources and commodities prices increased slightly in Q1, with the Dow Jones Commodity Index of 19 commodities futures up 1% and the Morgan Stanley Commodity Related Equity Index of 20 individual stocks up 5.4%. Our actively-managed Van Eck Global Natural Resource Fund gained 6.6% by comparison.

Perhaps sounding like a proverbial broken record, we reiterate that a globally-diversified equity portfolio continues in our opinion to be the optimal long-term investment strategy. Chart 2 on the following page reminds investors that the U.S. is not likely to be the dominant driver in future global economic growth or global equity market returns and that attempting to time specific country or regional market performance correctly and consistently is difficult, if not impossible. Who predicted that the German and Japanese stock markets, +18% and +19.1% respectively, would outperform U.S. equities (+12.6%) in the first quarter?

Availability of Updated Form ADV Part 2A Brochure and Part 2B Brochure Supplements

Annually, at this time of year, Registered Investment Advisors (RIAs) like TFC are required to update our SEC disclosure reports. You will find attached a notice of our recent filing, as well as information about how to access this more current material. The firm takes these compliance requirements and our fiduciary responsibilities seriously. If you have any questions about these reports, please don't hesitate to contact us directly.

Chart 2



As always, we welcome your comments and questions.

Sincerely,

James L. Joslin
Chairman, CEO & CCO

Renée Kwok
President

Notice of Availability of Updated Form ADV Part 2A Brochure
And Form ADV Part 2B Brochure Supplements

As an SEC-registered investment adviser, we are required to update annually in the first quarter of each calendar year our Form ADV, which includes our Form ADV Part 2A Brochure and Form ADV Part 2B Brochure Supplements. If, in connection with our annual update, we make material changes to our Brochure or Brochure Supplements since the date of our last annual update, we are required to provide (or offer to provide) our clients with copies of them.

In connection with the just completed annual update of our Form ADV, we made material changes to our Brochure and Brochure Supplements. These relate to our 2011 hiring of Scott Swartz as a Vice President, his becoming a participant of our Investment Committee and assuming other client responsibilities. We also made some editorial revisions to our Brochure and Brochure Supplements that we do not consider material singly or collectively.

By this notice, we are offering to provide you, without charge, a copy of our Brochure and Brochure Supplements, both dated March 30, 2012. You may obtain copies by sending an email to Michelle Volpe, Senior Client Service & Compliance Administrator, at mvolpe@tfcfinancial.com, or by calling Ms. Volpe at 617-210-6700. Our updated Brochure and Brochure Supplements are also available on our website: www.tfcfinancial.com.

You can also find our Brochure and Brochure Supplements, as well as other information about us, through the SEC's Investment Adviser Public Disclosure (IAPD) portal: www.adv.adviserinfo.sec.gov. You can search this site by a unique identifying number, known as a CRD number. Our firm CRD number is 105062.

Please do not hesitate to call us if you have any questions.

Notice dated April 12, 2012