January 29, 2013

INVESTMENT LETTER - FOURTH QUARTER, 2012

Floating on a Sea of Liquidity and Uncertainty (The financial markets are still waiting for government to get out of the way)

A year ago at this time, lowering one's expectations was the mantra counseled by most pundits. Given the uncertain backdrop at the time, this received wisdom seemed sensible advice. As history sometimes repeats, however, the cognoscenti often prove to be less than prescient. True, there were few evident reasons for optimism last January as 2012 was getting underway, but equity market valuations worldwide (following a decade-long decline in P/Es from 26x predicted earnings per share in early 2000 to 9x in September 2011) were rock-bottom and corporate earnings growth prospects still strongly positive.

As 2012 ended, continuing accommodative central bank *monetary* policy, in the absence of constructive *fiscal* policy, held borrowing rates at record lows and inflated demand for most financial assets. Deleveraging at the corporate, state and individual levels has proceeded apace in the U.S., but haltingly in the Eurozone. Elsewhere, the remedial process, repairing the world's financial system and banking infrastructure (not to mention business, consumer and investor confidence) continues, but with much remaining to be rebuilt.

Although our Federal authorities fail at almost every turn to exhibit adult behavior, there are some reasons for continued optimism, and even the potential for some positive surprises for investors. The three main issues for longer term U.S. (and indeed global) investors, of course, are: 1) U.S. tax and fiscal policy (only partially dealt with in the 2012 American Taxpayer Relief Act); 2) the Eurozone crisis; and 3) China's economic growth outlook. The latter seems to be resolving itself into a "soft-hard" landing with an evident turnaround underway. But lingering doubts about the longer-term sustainability of China's rate of GDP expansion persist. The Eurozone crisis continues to depend on the willingness of the Germans to finance the European southern tier countries' profligate ways; today further complicated by Germany's pending national elections scheduled for September. France, with its recently elected Socialist government (and 47% of GDP government-derived), still seems headed in the wrong direction.

If and when U.S. fiscal policy will be rationalized is anyone's guess. But our improving manufacturing competitive profile and the ability of the American business community to maneuver productively and profitably, despite the best efforts of our political class, should never be underestimated.

The Prospects for Real Fiscal Policy Reform

Waiting in the weeds, for the moment at least, are the "bond market vigilantes." These bond market traders and hedge fund managers ultimately determine credit market price levels, as well as the viability of yield spreads amongst various fixed income security issuers throughout the world. In many ways, it is these mostly institutional investors (for the most part agents managing other people's money) who are the only discipline to whom politicians seem to respond.

Currently, by flooding the global financial system with cash, easy credit and accommodative-sounding rhetoric, central bankers worldwide have neutralized these traditional fixed income security markets forces. As part of our Federal Reserve central bank's "quantitative easing" policy (e.g., most recently QE3 and "Operation Twist"), administered short-term interest rates are at negative REAL levels. Ten-year U.S. Treasury yields at 1.90% coupon rate provide buyers today a negative 0.60% after-inflation return (i.e., coupon 1.90% less CPI @ 2.50% = -0.60% adjusted for purchasing power loss). Such relatively low rates provide "cover" for present U.S. government deficit spending (net new Treasury debt of roughly $1.0 trillion annually), but when rates revert, or merely threaten to return to the mean, elevated interest costs to finance U.S. Treasury debt will surely prompt the rating agencies to consider further downgrades.

If interest rates rise to more "normal" levels, and (best case) it is because economic growth worldwide has returned to longer term trend lines, and if the Federal Reserve Bank's monetary policy exit strategy works, then the rating agencies need not further downgrade U.S. Treasury debt, and the bond market vigilantes will remain quiescent. However, if the Congress just sworn in January 4th fails to confront the obvious entitlement-generated fiscal gap, the bond markets, and most thought-to-be-riskless fixed income instruments, could be surprisingly vulnerable (see latest JP Morgan Bank exhibit "Interest Rates and Market Performance" which follows). For those who during the past 12-18 months have been chasing yield, extending bond portfolio duration, substituting or adding lower-grade credits, attempting to optimize the at-the-moment "fallow" fixed income portfolio segment, a rude confrontation may lie ahead. High quality credits, coupled with short duration exposure, continue a prudent fixed income security portfolio profile for client accounts.

Investment Risk in 2013 (Where to Hide or Find Opportunity?)

The negative case for the financial markets is well known, documented by the media in painful detail, and behaviorally for investors the path of least resistance has been risk-aversion. The excessive demand for bond funds, and continuing equity net withdrawal patterns during the past 5-6 years are symptomatic of declining risk appetites on the part of institutional and individual investors. Today, over 80% of all stock fund balances remaining are dedicated to retirement savings and thus have withdrawal time horizons of 20+ years for most holders.* Yet despite such lengthy investment time horizons, most of these accounts remain very conservatively positioned. Often, individual investors and fiduciaries exhibit behaviors divorced from rationally-stated investment objectives. Cash is left uninvested or builds out of proportion in bond funds. Today, judged by recent retirement fund flow surveys, equities are an under-owned asset class.

*Avi Nachmany, EVP, Director of Research, *Strategic Insights*, December 26, 2012

Also evident is the tendency for those who do own equity mutual funds to opt for lower cost, passively managed index or asset class sector funds. Vanguard, now the world's third largest asset manager, gathered $141 Billion of net new cash last year; a record for any American fund company. As clients know, our portfolio approach to asset class representation favors low-cost passive vehicles whenever a clear case cannot be made for an active stock-picking manager selection. With the investor behavioral pendulum now swinging noticeably in favor of the passive mode (today 26% of total mutual fund assets*), active stock-picking managers with a specific macro-economic model, and market sector specialty, may find expanding room to outperform. In fact, during 2012 the majority of our client account active fund managers, net of all costs, bettered their asset class benchmarks for the first time in many years. Until reversion to the mean once again reasserts itself, we may already be in a period, however short-lived, during which the extra cost of active stock-picking management is worth its price.

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

Fixed Income:

Fixed income investors who have been willing to take credit and duration risk were rewarded again last year; the SPDR Barclays High Yield ("Junk") Bond ETF (4 year average duration), gave investors a total return of +13.5% in 2012, with the SPDR Long Term Corporate Bond Index (14 year duration) generating +9.8%.

The shorter term and higher quality Barclays Capital U.S. 1-5 Year Government/Credit Bond Index, with an average duration of 3 years, was up 2% last year. Our fixed income portfolios which have a similar duration and credit quality, and include international bonds, generally returned over 2.5% for the year.

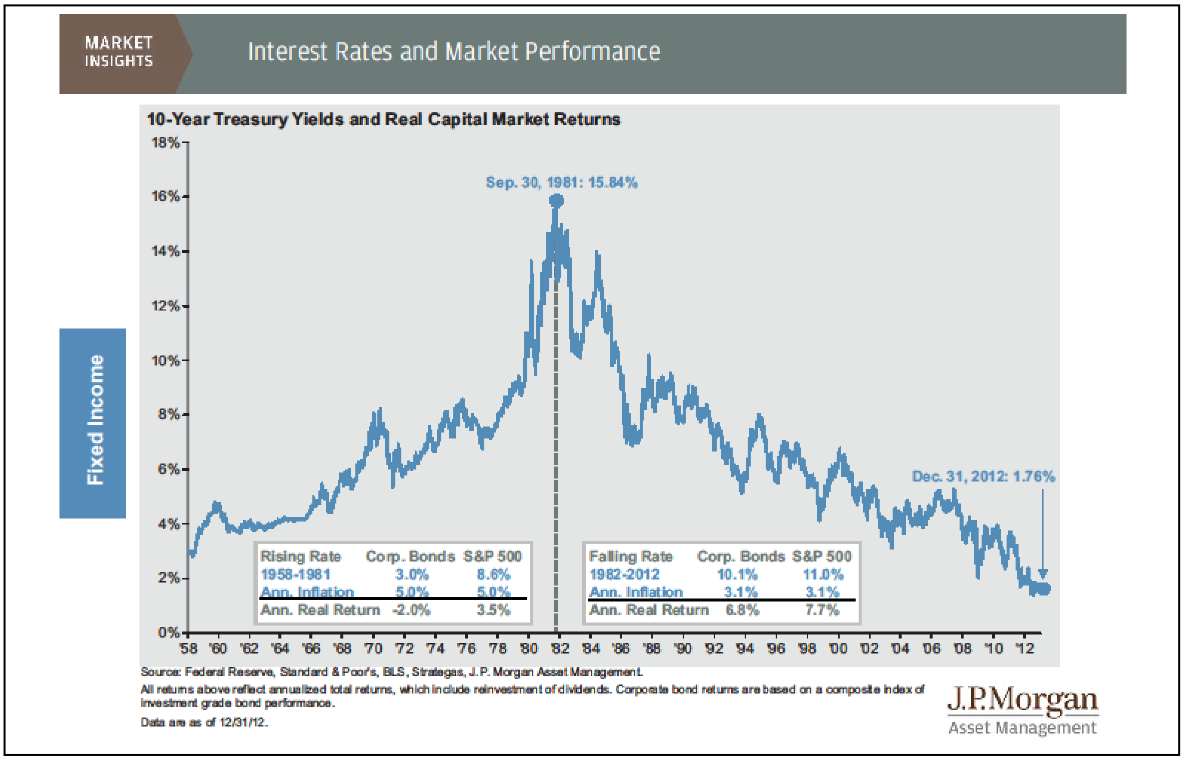
With historically low yields and interest rates, how do bonds generate returns significantly in excess of income yield? Answer: price appreciation. As indicated earlier, the financial and market crisis of 2008-2009 fueled an insatiable demand for bonds by those in search of safety and income.

Since 2009, a significant portion of bond returns has been attributable to price appreciation, which is not a typical component of fixed income investing. For example, The Barclays U.S. Aggregate Bond Index, a broad-based fixed income benchmark with an average duration of 5 years, had a cumulative total return of nearly 20% (6.2% annualized) from 2010 to 2012, with 8% from price appreciation and 11% from interest income.

The chart following provides a long term historical perspective on interest rates and market performance, with two distinct time periods segmented: 23 years of rising interest rates followed by 31 years of declining interest rates and inflation. From 1958 to 1981, when 10 year Treasury yields peaked at nearly 16%, and annual inflation averaged 5%, the annualized real return from corporate

*Avi Nachmany, EVP, Director of Research, *Strategic Insights*, December 26, 2012 bonds was negative 2% compared with a positive annualized real return of 3.5% from stocks (S&P 500 Index). Since 1981 to the present, with 10 year Treasury bonds yielding 1.8% at the end of last year, and average annual inflation of 3.1% over the 31 years, the total real annualized return of 6.8% from intermediate investment grade bonds nearly equaled equity market returns of 7.7%.

Since the timing and the triggers of rising interest rates and inflation in the future cannot be accurately predicted, we continue to structure our clients' fixed income portfolios in anticipation of this perhaps secular shift (from declining to rising yields and inflation) by remaining invested in diversified, high-quality, short duration bonds and low-cost bond funds.



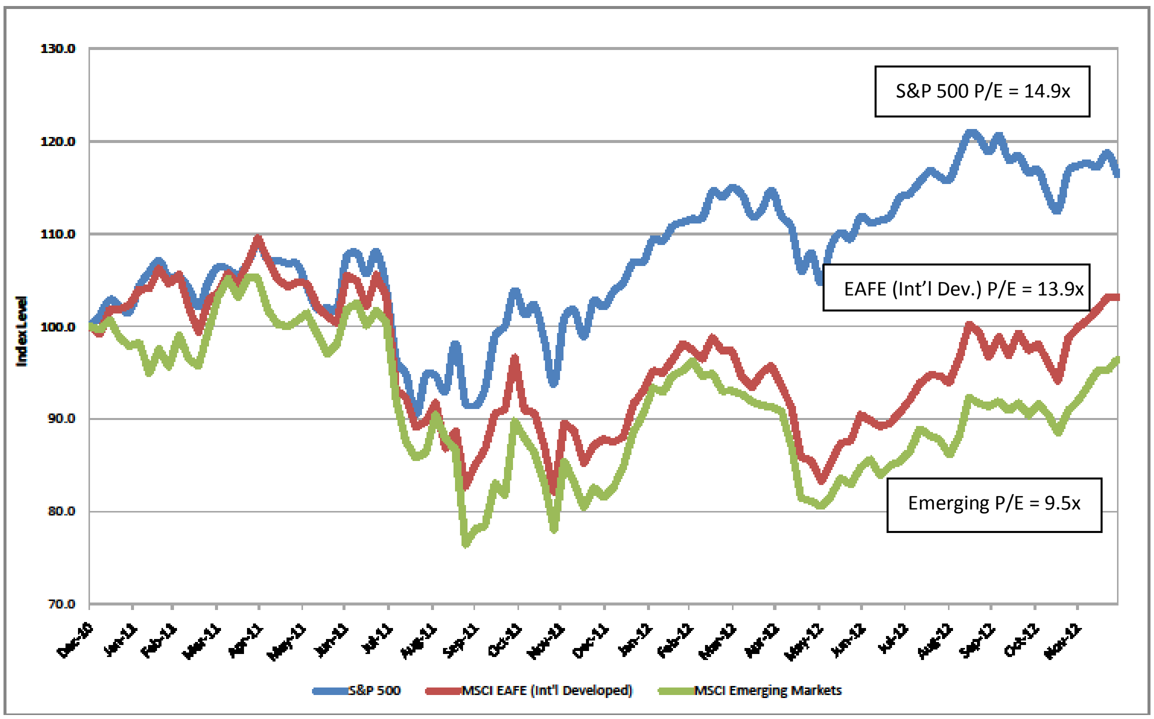
<u>Global Equities</u>:

Despite sluggish real global GDP growth for the year, estimated at +2.2% by Decision Economics, 2012 will be remembered as a banner year for most global equity markets. Continued central bank stimulus, particularly by the European Central Bank (ECB), was certainly a factor in boosting financial confidence and equity markets. However, earnings and dividend growth were the main drivers of performance for global stocks. In the U.S., the S&P 500 Index posted a total return of +16%, and the MSCI All Country World Index Ex. U.S generated +16.8% for the year. Our global equity portfolios produced total return of nearly +20%, benefiting from our strategic allocation to global real estate and outperformance by several key actively-managed funds, such as the Walthausen Small Cap Value Fund.

The chart below illustrates that U.S. equities have outperformed international equities, both developed (EAFE) and emerging markets, by a significant margin over the past 2 years. This divergent market performance has resulted in a relative valuation gap. U.S. stocks which returned +18.5% in this time period, are now (not surprisingly) valued at the highest price earnings ratio, at 15x estimated 2013 consensus earnings. (Note that several independent economic and market research firms, including BCA Research, Decision Economics and Ned Davis are estimating lower than consensus earnings for the year.) International developed and emerging markets, with minimal returns for the past two years are currently trading at discounted valuations to U.S. equities, at 14x and 10x forward earnings respectively.

2 Year Global Stock Market Performance and Valuations

12/31/2010 - 12/31/2012



Source: S&P and Capital IQ Consensus Earnings Estimates

If the Chinese economy reflates to a moderate annualized rate of 7.5% to 8.5% (real growth) and the Eurozone muddles through, albeit in slow, halting steps as we expect, then international equity markets are likely to outperform U.S. stocks in the coming quarters and narrow the current valuation gap. The U.S. is also now confronting a potentially extended period of Congressional discord, policy uncertainty and fiscal austerity.

Presently, Eurozone stocks are trading at a 15% discount to U.S. equities and may be poised to rebound as financial and political risks diminish further. In Japan, with the election of a new Prime Minister, the possibility of easing monetary policy, a weaker yen and higher fiscal spending may finally end a painful 20+ year period of deflation, declining stock prices and a chronically-weak economy. Our present underweight to both European and Japanese equities (relative to the MSCI All Country World Equity Index market capitalization weights) will be revisited in upcoming Investment Committee sessions.

As previously communicated, we are in the process of increasing our emerging and frontier market allocation from 12% to 15% of total equities to position portfolios to potentially capture additional market returns from improving economic conditions, particularly in China, attractive fundamentals and valuations. The combined aggregate economic (GDP) value of emerging and frontier countries exceeds 50% of the global value today.

Account Information

For taxable portfolios, your account custodian (Charles Schwab, Fidelity or National Advisors Trust) will be mailing Form 1099 Report(s) to you by mid-February. This Report will include realized gain/loss information and summary of fees and expenses. Please note you may also view our summary of investment management fees through the client login/portal access of TFC's website under the "Reports" tab by selecting *Income and Expenses* (2012 Expenses).

Recently, we have been able to lower the transaction fees for trading mutual funds in your account: Charles Schwab has reduced commission charges from $22 per trade to $17, Fidelity and National Advisors Trust from $25 per trade to $20.

Sincerely,

Jim — Renée — Tim

James L. Joslin	Renée Kwok	Timothy S. Meckel
Chairman & CEO	President	Managing Principal & CCO

TFC Financial Management
U.S. Equity Fund Asset Classes
Sorted by 1 Year Performance
12/31/2012

Name	Fund Category	3 MO	1 YR	2 YR	3 YR	5 YR	10 YR	2011	2010	2009	2008
MSCI AC World Daily TR Net USD	**Global Equity**	**2.4**	**16.1**	**4.3**	**6.6**	**-1.2**	**8.1**	**-7.3**	**12.7**	**34.6**	**-42.2**
Russell 3000 Total Return Inde	**Large Blend**	**0.3**	**16.4**	**8.4**	**11.2**	**2.0**	**7.7**	**1.0**	**16.9**	**28.3**	**-37.3**
VANGUARD LARGE CAP INDX-SIGN	Large Blend	-0.1	16.1	8.6	10.9	1.9	n/a	1.6	15.8	27.8	-37.0
S&P 500 INDEX	**Large Blend**	**-0.4**	**16.0**	**8.8**	**10.9**	**1.7**	**7.1**	**2.1**	**15.1**	**26.5**	**-37.0**
VANGUARD 500 INDEX FUND-ADM	Large Blend	-0.4	16.0	8.8	10.8	1.7	7.1	2.1	15.1	26.6	-37.0
DFA US LARGE COMPANY PORT	Large Blend	-0.4	15.8	8.7	10.8	1.7	7.1	2.1	15.0	26.6	-36.8
MSCI Daily TR Net USA USD	**Large Blend**	**-0.7**	**15.3**	**8.9**	**10.3**	**1.1**	**6.6**	**1.4**	**14.8**	**26.3**	**-37.6**
FMI LARGE CAP FUND	Large Blend	0.8	14.9	8.0	9.1	4.2	9.7	1.5	11.4	29.7	-26.9
GMO QUALITY FUND-III	Large Blend	-2.4	12.0	11.9	9.7	3.7	n/a	11.8	5.5	19.8	-24.1
VANGUARD DIVIDEND GROWTH-INV	Large Blend	-0.4	10.4	9.9	10.4	4.0	8.8	9.4	11.4	21.7	-25.6
VANGUARD GROWTH INDEX FD-SIG	Large Growth	-1.1	17.0	9.2	11.8	3.3	n/a	1.9	17.1	36.4	-38.2
RUSSELL 1000 GROWTH INDX	**Large Growth**	**-1.3**	**15.3**	**8.8**	**11.3**	**3.1**	**7.6**	**2.6**	**16.7**	**37.2**	**-38.4**
DFA TAX MNGD US MKTWIDE VAL	Large Value	3.8	22.2	8.8	12.9	2.0	9.0	-3.1	21.6	31.1	-41.6
DFA US L/C VALUE PORTFOLIO	Large Value	3.5	22.1	8.7	12.4	1.8	8.4	-3.1	20.2	30.2	-40.8
RUSSELL 1000 VALUE INDEX	**Large Value**	**1.5**	**17.5**	**8.6**	**10.9**	**0.6**	**7.4**	**0.4**	**15.5**	**19.7**	**-36.9**
DFA TAX MNGD US SMALL CAP PO	Small Blend	3.0	18.5	7.2	13.9	2.8	9.7	-3.0	28.6	26.3	-38.4
DFA US SMALL CAP PORTFOLIO	Small Blend	3.1	18.4	7.1	14.4	5.5	10.8	-3.1	30.7	36.3	-36.0
DFA US MICRO CAP PORTFOLIO	Small Blend	2.6	18.2	6.9	14.5	4.0	10.4	-3.3	31.3	28.1	-36.7
RUSSELL 2000 INDEX	**Small Blend**	**1.9**	**16.3**	**5.6**	**12.2**	**3.6**	**9.7**	**-4.2**	**26.9**	**27.2**	**-33.8**
VANGUARD TAX-MGD SML CAP-ADM	Small Blend	2.1	16.0	8.4	13.9	5.1	10.4	1.2	26.0	25.6	-30.8
VANGUARD S/C GROW INDX-INST	Small Growth	1.9	17.7	7.7	15.0	5.3	11.2	-1.4	31.0	42.1	-39.9
RUSSELL 2000 GROWTH IDX	**Small Growth**	**0.4**	**14.6**	**5.5**	**12.8**	**3.5**	**9.9**	**-2.9**	**29.1**	**34.5**	**-38.5**
ALGER SMID CAP GROWTH FUND-A	Small Growth	1.0	14.1	4.6	10.5	0.0	10.8	-4.2	23.3	44.0	-48.6
WALTHAUSEN SMALL CAP VALUE	Small Value	7.0	32.1	11.5	20.8	n/a	n/a	-5.9	41.9	42.4	n/a
DFA US S/C VALUE PORTFOLIO	Small Value	4.8	21.7	6.1	13.8	4.5	11.3	-7.5	30.9	33.6	-36.8
DFA TAX MGD US TARGET VAL PO	Small Value	5.3	20.9	6.7	14.1	3.4	10.2	-5.8	30.4	27.6	-37.8
DFA US TARGETED VALUE	Small Value	4.6	19.2	5.7	12.9	4.7	11.2	-6.3	29.0	31.9	-33.8
RUSSELL 2000 VALUE IDX	**Small Value**	**3.2**	**18.1**	**5.6**	**11.6**	**3.5**	**9.6**	**-5.5**	**24.5**	**20.6**	**-28.9**

Source: Bloomberg

TFC Financial Management
Non U.S. Equity Fund Asset Classes
Sorted by 1 Year Performance
12/31/2012

Name	Fund Category	3 MO	1 YR	2 YR	3 YR	5 YR	10 YR	2011	2010	2009	2008
MSCI AC World Daily TR Net USD	**Global Equity**	**2.4**	**16.1**	**4.3**	**6.6**	**-1.2**	**8.1**	**-7.3**	**12.7**	**34.6**	**-42.2**
SCOUT INTERNATIONAL FUND	Foreign Large Blend	7.1	21.3	3.1	6.3	0.2	10.5	-12.3	13.2	35.5	-38.1
DFA INTERNATIONAL CORE EQTY	Foreign Large Blend	7.5	18.7	0.4	4.7	-2.2	n/a	-15.1	13.9	39.3	-44.0
DFA GLOBAL EQUITY PORT-I	Global Equity	4.0	18.2	4.6	9.3	1.1	n/a	-7.4	19.4	34.5	-40.0
VANGUARD TOT INT ST IDX-INV	Foreign Large Blend	6.7	18.1	0.5	3.9	-3.0	9.4	-14.6	11.1	36.7	-44.1
DFA L/C INTERNATIONAL PORTF	Foreign Large Blend	6.8	17.7	1.6	4.1	-2.9	8.4	-12.3	9.2	30.6	-41.4
MSCI Daily TR Net EAFE USD	**Foreign Large Blend**	**5.6**	**17.3**	**2.0**	**3.6**	**-3.7**	**8.2**	**-12.1**	**7.8**	**31.8**	**-43.4**
MSCI AC World Daily TR Net Ex	**Foreign Large Blend**	**5.1**	**16.9**	**1.0**	**3.9**	**-2.9**	**9.7**	**-13.7**	**11.2**	**41.4**	**-45.5**
DFA INTERNATIONAL VALUE	Foreign Large Value	7.9	16.6	-1.5	2.3	-4.3	10.2	-16.8	10.6	39.5	-46.3
DFA TAX-MANAGED INTL VALUE	Foreign Large Value	7.7	16.3	-1.6	2.2	-3.9	10.3	-16.7	10.2	37.8	-44.4
MSCI AC World Daily TR Net USD	**Global Equity**	**2.4**	**16.1**	**4.3**	**6.6**	**-1.2**	**8.1**	**-7.3**	**12.7**	**34.6**	**-42.2**
T ROWE PRICE INTL DISCOVERY	Foreign Sm/Mid Growth	5.4	26.0	4.0	9.2	0.3	14.7	-14.1	20.5	55.7	-49.9
DFA INTL SMALL CAP VALUE PT	Foreign Sm/Mid Value	8.7	22.3	0.5	6.0	-0.6	13.5	-17.5	18.1	39.5	-41.7
MSCI EAFE SMALL CAP	**Foreign Sm/Mid Value**	**6.1**	**20.6**	**0.9**	**7.7**	**-0.4**	**12.6**	**-15.6**	**22.6**	**47.4**	**-46.7**
DFA INTERNATIONAL SMALL CO	Foreign Sm/Mid Value	6.5	18.9	0.3	7.6	-0.1	12.7	-15.3	23.9	42.0	-43.9
TEMPLETON FRONTIER MARKET-AD	Emerging Markets	6.3	25.4	1.0	n/a	n/a	n/a	-18.7	n/a	n/a	n/a
DFA EMERGING MARKETS SML CAP	Emerging Markets	7.6	24.4	-1.9	7.8	2.6	19.7	-22.6	30.2	99.7	-54.5
LAZARD EMERG MKT EQY-INST	Emerging Markets	5.5	22.4	0.3	7.3	1.8	18.4	-17.8	22.8	69.8	-47.9
DFA EMERGING MRKTS VALUE	Emerging Markets	7.1	19.4	-5.8	2.7	-0.8	20.0	-25.6	22.1	92.3	-53.9
DFA EMERGING MKTS PRTFOLIO	Emerging Markets	6.6	19.2	-0.8	6.2	0.9	17.4	-17.4	21.8	71.8	-49.2
MSCI Daily TR Net Emerging Mar	**Emerging Markets**	**5.4**	**18.3**	**-1.6**	**4.7**	**-0.9**	**16.5**	**-18.4**	**18.9**	**78.5**	**-53.3**
TEMPLETON DEVELOPING MKTS-AD	Emerging Markets	5.4	13.4	-2.1	4.1	-1.9	14.1	-15.6	17.7	74.4	-53.8
MSCI FM (Frontier Markets) Dai	**Emerging Markets**	**2.9**	**8.8**	**-6.1**	**3.1**	**-10.9**	**n/a**	**-18.7**	**23.8**	**11.6**	**-54.1**
SPDR GOLD TRUST	Natural Resources	-5.7	6.6	8.1	14.7	14.4	n/a	9.6	29.3	24.0	4.9
VAN ECK GLOBAL HARD ASSETS-I	Natural Resources	-2.9	1.9	-8.4	2.0	-1.9	n/a	-16.3	28.9	53.2	-44.5
MS CMDTY RELATED EQUITY	**Natural Resources**	**-0.3**	**1.4**	**-4.7**	**4.5**	**0.7**	**15.4**	**-10.5**	**25.7**	**54.8**	**-41.2**
MORGAN STANLEY INS INTN RE-I	Real Estate	11.6	44.0	7.4	8.1	-1.5	11.2	-19.9	9.5	46.5	-50.0
MORGAN STANLEY INS GLBL RE-I	Real Estate	6.9	30.2	8.4	12.2	1.9	n/a	-9.7	20.2	41.0	-45.0
EPRA/NAREIT Dev TR USD	**Real Estate**	**5.8**	**28.7**	**10.1**	**13.4**	**1.1**	**12.1**	**-5.8**	**20.4**	**38.3**	**-47.7**
DFA GLOBAL REAL ESTATE SEC P	Real Estate	4.3	23.2	12.0	15.8	n/a	n/a	1.8	23.8	32.7	n/a
ISHARES DJ US REAL ESTATE	**Real Estate**	**1.7**	**18.2**	**11.7**	**16.4**	**4.4**	**10.1**	**5.5**	**26.6**	**30.5**	**-39.9**
DFA REAL ESTATE SECS PORT	Real Estate	2.5	17.5	13.1	18.1	5.7	11.4	9.0	28.7	28.2	-37.4
MORGAN STANLEY INS US REAL-I	Real Estate	2.3	16.3	10.8	16.8	5.1	12.6	5.6	29.9	29.6	-38.1

Source: Bloomberg