



Investors have enjoyed the recent run up in equity markets, despite the lack of material improvement to the global macro environment. Threats remain largely unresolved relative to the European debt crisis, slowdown in emerging markets, geopolitical unrest etc... and in the U.S., the national debt now exceeds \$15 trillion or 100% of GDP, government spending outpaces tax revenues by 156% and amounts to 24% of GDP, unemployment persists at 8.5%, the housing/mortgage crisis refuses to mend, and a polarized electorate is represented by political leaders who seem incapable of fashioning viable bipartisan policy initiatives to solve the nation's most pressing economic issues. Nonetheless, markets have proven resilient in the face of these conditions and we at CB&T have taken full advantage of pricing dislocation for clients as reflected in the accompanying performance charts. We expect 2012 will unfold in a similar manner and invite you to catch up on our thinking concerning these matters in this winter edition of our newsletter.

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## Benign Economy vs. Resilient Market...

The S&P 500 began the year at 1257 and ended the year at 1257, the smallest calendar year price change ever. While U.S. equity markets experienced modest increases for 2011, with the S&P 500 gaining 11.80% for the 4th quarter and ending 2011 up 2.10% (with dividends) and the Dow Jones Industrial Average up 11.95% for the quarter and 5.53% for the full year, international markets didn't fare as well, with the MSCI EAFE up 3.40% for the quarter but ending 2011 down 11.68%. In the U.S., small cap stocks were the laggards for the year despite stellar 4th quarter performance. The Russell 2000 gained 15.47% for the 4th quarter, but still ended 2011 down 4.18%. (See chart 1.)

Periods of optimism were interspersed with periods of fear and risk aversion and many threats to the recovery remain unresolved, resulting in uncertainty and caution. The debt crisis in Europe has been front and center in the headlines and investors have closely watched the actions taken by the European Central Bank to stabilize the financial markets, but a comprehensive solution has yet to come. Regarding

Chart 2

**S&P 500 Sector Performance**  
Q4 2011 - Total Returns

	Q4	YTD
Utilities	8.28%	19.96%
Consumer Staples	10.26%	13.99%
Information Technology	8.72%	2.43%
Telecommunication	7.95%	6.31%
Healthcare	9.96%	12.73%
Consumer Discretionary	12.67%	6.23%
Energy	18.19%	4.71%
Industrials	16.52%	-0.59%
Financials	10.84%	-17.02%
Materials	15.39%	-9.65%

Chart 1

**Market Performance**  
Q4 2011 - Total Returns

	12.31.11 Level	Q4	YTD
Dow Jones	12217	11.95%	5.53%
S&P 500	1257	11.80%	2.10%
NASDAQ Composite	2605	8.21%	-0.79%
Russell 2000	740	15.47%	-4.18%
S&P Midcap	879	12.98%	-1.73%
Russell 1000 Growth	580	10.60%	2.62%
Russell 1000 Value	626	13.08%	0.36%
MSCI EAFE	1412	3.40%	-11.68%
	Yield	Q4	YTD
Barclays Municipal	2.82%	2.12%	6.02%
Barclays Aggregate	2.24%	1.12%	7.84%
Barclays High Yield	8.36%	6.46%	4.98%

the U.S. political landscape, two episodes of bickering over the U.S. debt ceiling and a last-minute, short-term, holiday "patch" to our income tax code creates a lot of concern. While corporate profits and fundamentals continue to be surprisingly healthy, businesses remain hesitant to hire new workers. In addition, corporate productivity continues to increase as companies invest in efficiency rather than hiring. The job market showed signs of improvement and the unemployment rate fell to 8.5%, but some attribute the decline to a sharp contraction in the number of people looking for jobs at all. The housing sector remains stubbornly resistant to significant improvement. In the near future, it will remain difficult for stocks to break out of the current range without significant progress being made toward a solution to the European crisis and more certainty as to the U.S. political and tax landscape.

**Proprietary Performance Results**

	4th Quarter	1 Year	3 Year	5 Year	Since Inception
Focused Equity Fund <sup>2</sup>	11.23%	7.76%	16.37%	N/A	16.37%
Aggressive Growth Fund <sup>1,3</sup>	10.64%	7.69%	17.41%	3.32%	7.84%
Science/Technology Fund <sup>4</sup>	8.00%	-1.38%	18.81%	4.00%	2.45%
S&P 500	11.80%	2.10%	14.11%	-0.25%	14.11% <sup>2</sup> / 8.61% <sup>3</sup> / 1.63% <sup>4</sup>
Russell 2000	15.47%	-4.18%	15.62%	0.15%	15.62% <sup>2</sup> / n/a <sup>3</sup> / 0.80% <sup>4</sup>
MSCI EAFE	3.40%	-11.68%	8.23%	-4.17%	8.23% <sup>2</sup> / 2.04% <sup>3</sup> / -1.13% <sup>4</sup>
Strategic Income Fund <sup>5</sup>	7.12%	6.89%	12.22%	N/A	12.22%
60% Russell 3000 Val/ 40% Barclay Agg	8.44%	3.41%	10.28%	N/A	10.28%

*There is no assurance that any of these investment strategies will meet its investment objective. Performance results for each strategy are computed on the strategy's overall returns. Each strategy and index includes the reinvestment of dividends. Past performance does not guarantee future results. Current performance may be lower or higher than the performance results quoted. <sup>1</sup> Net of management fees; performance results of SMC Capital and/or its principals as advisor from inception to 2/28/06 and as sub-advisors to CB&T since 3/1/06. <sup>2</sup> Inception date 12/31/2008. <sup>3</sup> Inception date 7/1/1989. <sup>4</sup> Inception date 3/31/2006. <sup>5</sup> Inception date 12/31/2008.*

## Fixed Income

Headlines this quarter were again dominated by the ongoing Euro-zone crisis. However, the perception of the news was more positive than not. On October 26th, European leaders reached a "three-pronged" agreement described as vital to solve the region's huge debt crisis. But then Italy and Spain became focal points as their 10-year rates jumped to 7.5% and 6.7% in November. Italy's debt ended the year at a relatively high 7% while Spain's recovered to 5%. Currently the market's assumption is that write-downs can be contained mostly to Greece. As part of the agreement, the leaders said some private banks have accepted a loss of 50% on Greek debt. Markets are pricing for more as 10-year Greek bonds ended the year at \$23 per \$100. Discussions are ongoing with nothing finalized to date.

Our markets mirrored the news. In October, the 10-year Treasury rate began by closing at 1.75% and hit 2.4% on the 27th. By November 1st, it was back under 2% where it has remained range-bound ever since. In all, Treasury rates were basically unchanged for the quarter despite signs of an improving U.S. economy. The Fed's stance was little changed as well. They remain committed to keeping rates low through mid-2013 and have not announced another round of asset purchases (QE3) as some expected.

Fixed income markets are always mindful of inflation. As measured by the TIPS market, 10-year inflation expectations rose slightly to 2.0% from 1.8%. Real yields are near record lows and remain negative inside 10-years.

Performance was respectable for the quarter as broad investment-grade indices returned over 1%. Corporate returns were closer to 2%. Municipal returns were solid again at over 2%. For the year, investment-grade fixed returns ranged from 8-11% with municipals leading the way. High Yield bounced back this quarter with returns over 6% and ending the year up only 5%. For 2012, we anticipate a gradual increase in market yields driven by higher economic growth and normalization of policies

## Managed Equities

Total return for the Managed Equity Composite, which consists of all equities under CB&T discretionary management, was up 11.43% for the 4th quarter of 2011 compared to 11.80% for the S&P 500, 3.40% for the MSCI EAFE Index and 15.47% for the Russell 2000 Index. Our Managed Equity Composite finished the year with strong performance, up 5.15% compared to 2.10% for the S&P 500, -11.68% for the MSCI EAFE Index and -4.18% for the Russell 2000 Index.

### Focused Equity

For the quarter, the fund posted a gain of 11.23%, in-line with the 11.8% advance for the S&P 500. The fund finished the year up 7.76%, 5.66% ahead of the benchmark S&P 500, and has outperformed by 2.26% annualized for the prior three years since the fund's inception.

Volatility continued in the final quarter of the year as evident in our Consumer Discretionary holdings. Disney (DIS, 26.33%), Lowes (LOW, 32.10%) and Carmax (KMX, 27.80%), laggards last quarter, were top contributors to performance this quarter. We used the sell off to initiate a new position in Wells Fargo (WFC, 14.79%), our first foray into the banking sector since the financial crisis. Though we remain cautious on the group as a whole, selectively we see opportunities to initiate and build positions over time.

Shares of Waste Management (WM) declined nearly 10% following the quarterly earnings release and continued to drift lower over the next few weeks before rebounding by year end. Revenues grew 9%, primarily from non-core operations such as recycling and benefitted from recent acquisitions. Volumes were weaker and margins were lower, which led to the sell-off, primarily due to aggressive pricing from municipalities and rebates from the recycling program. Waste Management's core business is a relatively stable, essential service and valuations remain reasonable. Management announced a 4.4% increase in the quarterly dividend early December, bringing the current yield to 4.2%. Waste Management is now a top five holding in the fund as we added to our position on the weakness.

### Strategic Income Builder

The Strategic Income Builder strategy returned 7.12% compared to its benchmark of 8.44% for the quarter. The fund closed the year with a 6.89% return, ahead of its benchmark by 3.48% for 2011 and 1.94% annualized for the three year period since the fund's inception.

After a mid-year correction, shares of Home Depot (HD) finished the year strong, increasing 28.6% for the quarter in the portfolio. Better than expected earnings and stabilization in housing helped lift shares of the home improvement retailer. Despite the dividend increase in November, the yield has been eroding with the strength in the stock price and now yields just 40 bp more than the S&P 500. Home Depot is currently trading

near our price target and we may look to trim our position with the recent rally. We did trim shares of Philip Morris (PM) as shares rose nearly 27% for the quarter and traded through our fair value price target.

The recent addition of Avon Products (AVP, -9.66%) was short lived in the fund. Late October the SEC began looking into bribery allegations in some of the company's overseas operations and in December the company announced that Andrea Jung would be replaced as CEO but remain as Chairman of Avon. We expect these issues to be isolated, but Avon may continue to trade sideways until the CEO position is filled and the claims are resolved. Avon remains a viable position for patient investors and boasts a 5.25% dividend yield in the interim.



## Science & Technology Strategy

Markets were choppy during the 4th quarter, but started to gain traction the last week of December, providing momentum for much of January, while headlines from Europe remained quiet. The fund returned 8.00% in 4Q11, beating the NASDAQ 100 by 117bps (+8.00% vs. +6.83%), but trailing the broader NASDAQ by 21bps (+8.00% vs. +8.21%). The fund finished the year off with a return of -1.38% vs. the NASDAQ 100 return of +3.67%, and the NASDAQ return of -0.47%.

Top performers in the quarter included Akamai (AKAM - up 83%), the leader in internet optimization solutions (enables internet sites to operate and streaming videos to download faster). Google (GOOG) rallied 25%, but fell 8% in January after missing earnings. We remain bullish on the stock and plan to buy on dips all else being equal. Visa (V), which we view as a payment technology company, not a financial, continued to rise on positive earnings (+19%).

Enterprise software leader, Oracle (ORCL), fell 8% in the quarter after pre-announcing a negative 4Q outlook in mid-December while diversified

chipmaker Broadcom (BRCM) fell 12% over concerns about weakness in PC sales. Both stocks have since rebounded. We view both stocks as core holdings, however, we look to trim Oracle somewhat on slower growth prospects for 2012.

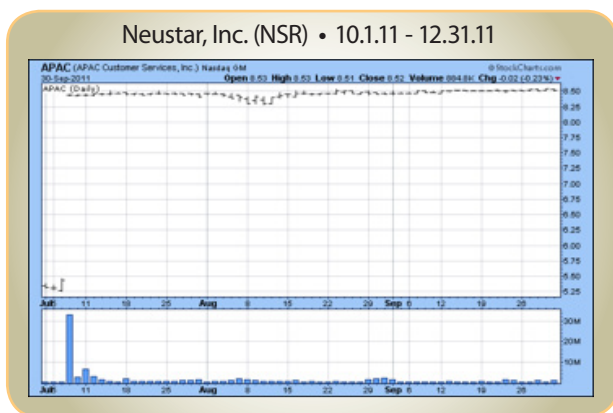
Our goal is to fall less than the overall benchmark in downturns and capture most of the upside, which enables us to outperform over the longer term. We will likely trail the NASDAQ indices whenever Apple is rallying due to its huge weighting in these indices.



We have positioned the fund to take advantage of two interconnected, long-term secular technology spending trends that should remain strong for the rest of this decade: 1) the migration of content and computing to mobile devices enabled by 2) efficiencies in computing resources pooled in public and private clouds. Healthcare remains a challenging investment environment due to the political debate over funding a deficit cut with further health reform cuts in the Medicare and Medicaid program. We are focusing on sectors that develop products for scientific research and discovery or services that lower costs to the health system.

## Small Cap Composite

The Small Cap Value Composite returned 14.60% for the fourth quarter of 2011, versus 15.95% for the Russell 2000 Value index. For the full year 2011, the Small Cap Composite returned -1.40% while the Russell 2000 Value index returned -5.50%.



The sectors with the highest contribution to relative performance during Q4 were Utilities and Information Technology. Utilities benefited from an underweight allocation, while Technology benefited from strong stock selection. One top contributing holding in the Portfolio during Q4 was NeuStar Inc. (CI A) (NSR, +36%). NeuStar is an IT company that manages phone number portability, call routing, area codes and the unused inventory of phone numbers in North America. The company was overcapitalized, with \$410 MM of cash and no debt, until it announced the acquisition of TARGUSinfo, the largest independent provider of Caller ID information services. This acquisition optimized NeuStar's capital structure and also reduced its dependence on its largest contract and looming re-bid. Another top contributor in the quarter was Rent-A-Center Inc. (RCII, +36%),

the largest retail chain in the U.S. offering branded rent-to-own merchandise. The company reported Q3 revenue growth of +6% driven by the continuing rollout of RAC Acceptance kiosks, which offer rent-to-own contracts within a variety of furniture, appliance and electronics retail stores. Rent-A-Center also announced strong 2012 initial guidance, with expectations to grow revenues between +8% and +11% and EPS between +8% and +15%.

The sectors with the lowest contribution to relative return for Q4 were Industrials and Consumer Staples. Industrials suffered from poor stock selection, while Staples lagged primarily as a result of the Portfolio's overweight allocation. One negative contributor to performance in Q4 was private prison operator GEO Group Inc. (GEO, -10%). Persistent budgetary pressures faced by its state clients weighed on GEO's stock. Despite these challenges, the company's management team believes cost savings from new privatization projects will lead to more bidding opportunities and outweigh any per-diem pricing pressures on its existing contracts. GEO continues to be a high-conviction holding within the Portfolio. Another negative contributor was Industrias Bachoco S.A.B. de C.V. ADS (IBA, -15%), Mexico's largest chicken producer and second largest egg producer. Falling prices from an oversupply of chickens in Mexico have pressured revenues while sharply higher feed prices have squeezed margins. Despite these industry challenges, IBA used their strong balance sheet to make opportunistic acquisitions. During the quarter, it announced a deal to acquire OK Industries, an integrated chicken and feed producer based in Fort Smith, AR.

## Kentucky Municipals

Quarterly bond issuance by Kentucky municipalities increased to \$754 million from \$567 million with 74 issues. New issue size averaged only \$10.2 million. Taxable issuance was \$155 million or 21% of the total. The majority of these taxable issues were longer dated Qualified School Construction Bonds (QSCB). Bank-Qualified "BQ" issuance was only \$236 million or 31% and non-BQ of \$363 million or 48%. For our clients, we tend to participate in the non-BQ market because yields are typically higher. However, this distinction has no credit risk implications.

During the quarter, our 10-year KY tax-exempt yield target fell 0.40% to 2.55%. This compares to 3.80% a year ago. The 10-year rate over various interest rate cycles averages closer to 4% in comparison. Our 15-year yield target fell 0.20% to 3.45%. This compares to 4.55% a year ago. Given these yield levels, we once again find ourselves being cautious with respect to our portfolio reinvestments. That said, tax-free bonds still look attractive on a relative basis to taxable alternatives, particularly Treasuries.

In January 2011, we dismissed widespread default predictions within the municipal market and were amply rewarded. While our opinion has not changed, this remains one of the "Big-Picture" risks that concern us in 2012 and beyond. Should U.S. public finances at the federal and state level continue to deteriorate, we would become increasingly concerned about financial market performance. It is imperative that our political leadership get the right policies in place to deal with our large debts, slow growth and aging society. It is our belief that the U.S. has the resources and ability to correct course and fix its public finances; however, we are not sure that politicians have the will to make the tough decisions that will be necessary in the years ahead. This year's political cycle will make for a lot of negative rhetoric.

# Summary of Our Outlook For 2012

**ECONOMY:** Although the U.S. economy has shown recent signs of improvement, uncertainty in Europe and pressure on leading indicators suggest that risks remain to the downside. We expect growth to be slow in the developed markets, with the potential of a recession in Europe and to a lesser degree the U.S. Macro cycles will drive performance in 2012.

**FIXED INCOME:** Inflation in the large developed economies should remain benign over the next year or so, leaving monetary policy in a highly accommodative position and little chance that short-term rates will rise in the U.S. or Europe any time soon.

In our opinion, the yields on most investment grade (IG) bonds look unattractive on a longer-term basis. Should markets enter another "risk-off" period, IG bonds can perform moderately well near-term. Otherwise, we expect low returns for several years. Municipal bonds have rallied strongly during the past year, yet still look attractive relative to their taxable bond counterparts. High-yield and emerging market debt have a significant yield advantage over IG bonds and should outperform over a full market cycle, with a higher level of volatility and risk of underperformance shorter-term.

**EQUITY:** U.S. stocks are priced to deliver mid-single digit returns over the next five years; our base case for this year is in that range, with the potential for much wider outcomes. S&P 500 consensus earnings estimates for 2012 (\$107) and 2013 (\$120) look too high, and price-to-earnings multiples are likely to stay pressured until risk-free rates normalize. We continue to emphasize higher quality large-cap stocks and dividend payers. Short-term, this is a "crowded" trade, however, we think the theme will hold up and provide good risk-adjusted returns.

In our opinion, emerging market stocks should outperform the developed markets over the next five years. That performance will come with greater volatility as they continue to be higher beta plays in the developed markets in "risk-on" and "risk-off" environments. European valuations are attractive, however, they remain higher risk investments until the debt/political risks improve.

We continue to view gold as insurance against an imbalanced global economy and monetary/fiscal policy mishaps. We also like alternative investment strategies which have a lower correlation to traditional asset classes.

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