



Strategy Update: The Pendulum Always Swings

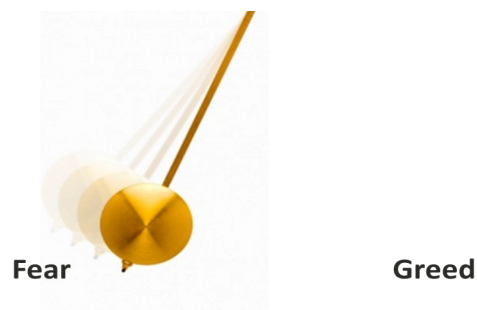
By Tealwood's Strategy Group

What We Learned in 2011: A Year of Paradox

Profits were up 17% and reached all-time highs, only to be met with declining price-to-earnings ratios and historically low valuations. The “flight to safety” made even the *downgraded* U.S. debt the world’s asset class of choice and the U.S. equity market a top global performer (a very low hurdle in 2011). Simultaneous with longer term inflationary concerns, investors were willing to accept what are very likely to be negative real rates of returns (10 year Treasuries yielding 2% or less) as an alternative to perceived risks to principal.

There is a pendulum that swings from fear to greed in the

marketplace. In the first quarter of 2000, with tech stocks leading the charge, that pendulum swung to an extreme of greed (the S&P 500 Index traded at a record high of 32X earnings!) The consequence was a decade of regression to the mean for equity valuations as the pendulum took valuations back to an average valuation of 15X earnings.



Today this same index trades at 12.6X earnings and the pendulum will again regress to its mean, this time moving up to its average. Could it move lower before it moves up? Of course it could, is it probable? We think not. We are not so simplistic as to argue that the glass is full, but we are opportunistic enough to calculate the math on what happens when it is half empty.



The Really Big Picture

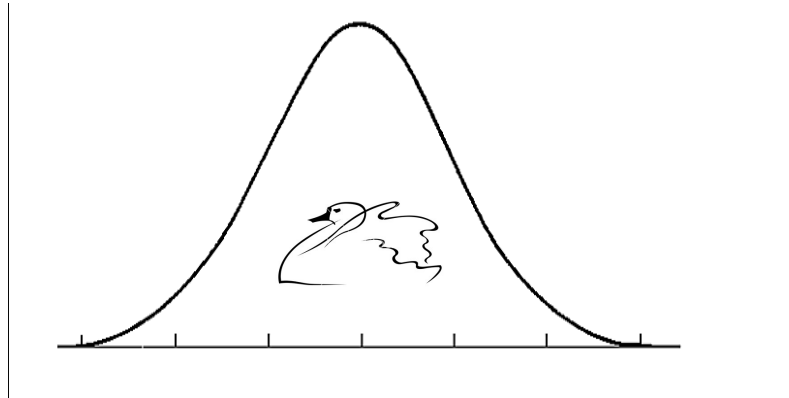
The developed economies spent a generation increasing leverage. The burden of this debt has made for a slow pace of recovery. The good news is that consumers and corporations are deleveraging. This is healthy, and this should continue, albeit at a gradual pace. Slow deleveraging is a good thing. In 2008 the Financial Sector deleveraged very rapidly and it was an awful experience. This snail’s pace makes for steady progress with little instant gratification. Traders and the guys that write the headlines can’t stand slow, evolutionary improvement. However, it sure beats sudden destruction.

(Continued on page 2)

Strategy Update: The Pendulum Always Swings (continued from page 1)

The Really Big Picture—continued

In the aftermath of 2008, it became common to hear about “Black Swan” events. These are the unforeseen, improbable outcomes that portend great risk. Today, it is the “White Swan” event that has become the improbability. What is a “White Swan” event? It is the huge area, the middle of the bell curve between the “tails” on either end. It is the muddle, the messy unresolved, work in progress, “average”. Today, the middle of the bell curve outcome is seen in the marketplace as the improbable event. Today, saying that the improbable is improbable is out of fashion.



In no environment is there such a thing as “one size fits all” investment advice. Each investor has differing needs and it is critical to customize strategy to fit personal objectives.

For conservative investors: the bond market continues to build a dangerous asset bubble. Despite record low interest rates, we believe conservative investors should keep maturities short to play defense. Think Tealwood’s *Defensive Fixed Income* portfolio.

For moderate risk takers: a balanced approach emphasizing both offense and defense worked well in 2011 and certainly looks well positioned for 2012. Dividend paying stocks offer a unique combination of robust yields and attractive risk adjusted total returns. Think Tealwood’s *Strategic Income* Portfolio.

For investors seeking longer term capital appreciation: While investor patience was tried in 2011, it will be rewarded in 2012. The combination of modest valuations and continued profitability holds the potential for double digit gains amidst a continued backdrop of 2% U.S. GDP growth, deleveraging, politically induced mood swings, and (just) the “3rd inning” of the Eurozonia financial drama. Think our equity strategies, *Large Cap Value* and *Value Growth* portfolios.



For everyone, do not expect any of the following: clarity, a simple fix, the end of ambiguity, a silver bullet, a double dip recession, the worst case scenario, a political outcome that resolves anything (quickly), or that “they lived happily ever after” feeling.

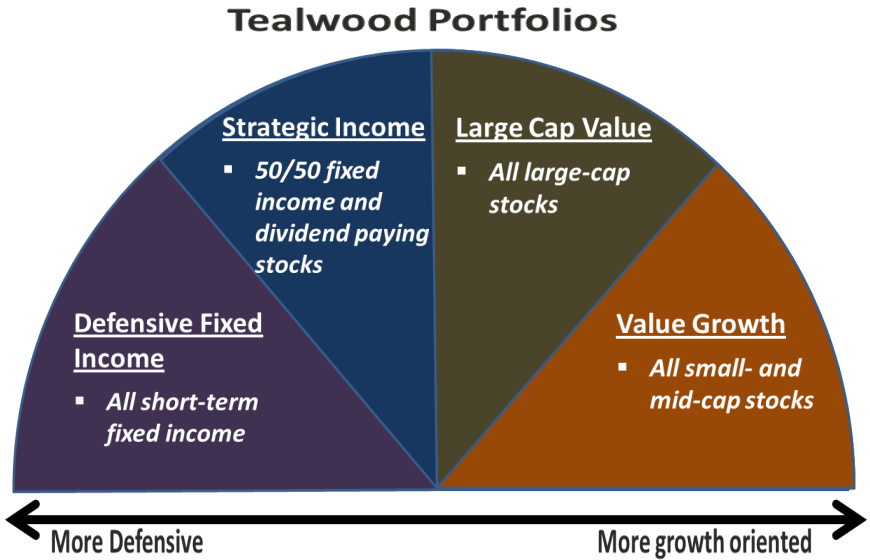
Do expect: record profits, historically low valuations, grumpiness, political frustration, domestic progress on housing and employment, ongoing anxiety about the European financial system, Central Bank accommodation, productivity gains, inflation worries, and kicking the can further down the road.

(Continued on page 3)

Strategy Update—The Pendulum Always Swings *(continued from page 2)*

Ensure your personal asset allocation is right for you:

balance offense and defense appropriately, take a risk adjusted approach to your offense making a priority of dividends, defensive businesses, bargain valuations and exceptional quality. Expect ambiguity and create an appropriate margin of safety. Stay patient with long duration assets, and benefit from the opportunity that the pendulum has provided. Lastly, remain alert, because the pendulum ***always*** swings.



Tealwood Celebrates its 25th anniversary!

2012 marks 25 years for our firm! We have planned a series of articles and events over the year ahead to properly recognize this significant milestone. In particular, our Annual Investor Conference in the fall will include a special anniversary celebration. The very best part of the past 25 years has been the privilege of working with you. **THANK YOU** for bringing so much meaning and happiness to our work together.



Charlie Mahar



Jodi Halbert



David Neal



Bruce Langer



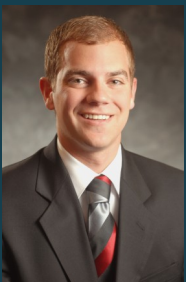
Dan Aronson



Woody Kingman



Ward Johnson



Steve Richter



Wendy Bennis



Connie Peppin



John Zevnick



Michelle Steingas

Tealwood Events

Special Events

Tealwood's Special Events offer our clients and friends unique experiences that can be fun, educational and inspiring. Please be sure to register/reserve your place with us in advance as space is often limited.

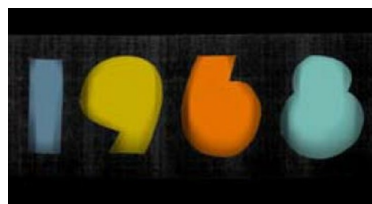
Thursday, January 19, 12:00 — 1:30p. SPECIAL CHINA REPORT

Private Strategy Briefing Luncheon

Location: Thom Pham's Wondrous Azian Kitchen

533 Hennepin Avenue South, Minneapolis

Charlie Mahar, Tealwood's Chief Executive Officer and Chief Investment Officer, presents an update on the January 2012 Deutsche Bank Investor Conference he will have just attended in Beijing, China.



Wednesday, February 8, 4:30—7:30p.

MINNESOTA HISTORICAL SOCIETY 1968 EXHIBIT

Private reception, presentation and tour.

Location: Minnesota History Center

345 Kellogg Boulevard West, St. Paul.

Tealwood is taking over the Minnesota History Center! Join us for this exclusive, private event, including reception, a special introduction to the exhibit by Bill Dinan, Museum Supervisor of the History Center, then enjoy taking a self-guided tour of this featured, traveling exhibit. The History Center will be closed to the general public during our event.

Private Strategy Briefing Luncheons, 12:00-1:00p at Tealwood

Learn more about Tealwood, presented in an informative and lively format. Hear overviews of our methodologies, performance, market insights and research findings. We will also delve into portfolio specifics. Held throughout the year, upcoming luncheon dates are:

Wednesday, February 15 · Wednesday, March 7 · Thursday April 19

Tealwood holds special events throughout the year. Visit our website often for schedules, updates and details.

www.tealwood.com To RSVP: cpeppin@tealwood.com or 612.340.0181.

Tealwood Asset Management

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