

January 30, 2012

Dear Friend,

The past year was a decidedly idiosyncratic one for many investors. While both our China Growth Strategy and our Global Growth Strategy continued to outperform their relative benchmarks, a closer look at our absolute results illustrates what was, in hindsight, a most unexpected investment climate.

Contrary to what many - including ourselves - had predicted, the U.S. market vastly outperformed Emerging Markets in 2011. Our investment results in China and the U.S. followed suit. Although both our U.S. and China investments outperformed their benchmarks, it is cold comfort to those invested in our China Investment Strategy. It posted a negative return of 18% net of fees which, as unpleasant as it sounds, was better than the MSCI China Index which declined 20% for the year. To put 2011 results in perspective, for the past three years, our China Investment Strategy has returned of 27.6% net of fees, compared to 9% for the MSCI China Index.

Our Global Growth Investment Strategy, which has 60% of its assets invested in U.S. companies and 40% in Chinese companies, was down 1.87% net of fees, compared to a total return of 2.11% for the S&P 500 Index and -7.19% for the blended index (S&P 500 and MSCI China). That means the U.S. portion of the Global Growth Investment Strategy was up 13.4% net of fees.

The S&P 500 price was actually down 0.0027% for the year. Its total return of 2.11% was comprised primarily of dividends. The essentially flat return for the year masks what was a volatile ride, with Q1 up 5.42% and Q4 up 11.15%. It was a market of extremes, buffeted by the now familiar waves of anxiety about the U.S. funding crisis, the direction of China and U.S. growth, corporate governance in China and, of course, the European sovereign debt crisis.

Outlook

The most recent economic data for the U.S. and China is encouraging. It supports our optimism that the U.S. economy continues to recover and that growth in China will not collapse. More importantly, the long-term trends that we focus on, such as the growth of consumerism in China, have become even more robust. At this point, we see the European sovereign debt crisis as the single biggest risk. Although signs are emerging for a potentially orderly solution to problems in Greece, we cannot say that the crisis is behind us. At a minimum, we should expect Europe's growth to slow dramatically with some countries posting declines in GDP. This will most likely lead to an overall lower rate of growth for

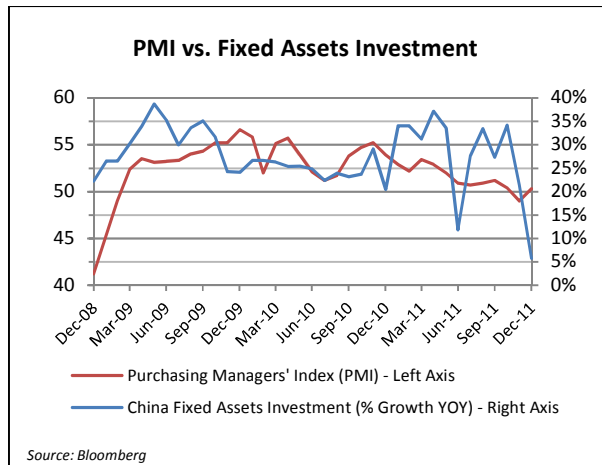
global GDP. Although the possibility for more European driven market volatility is cause for concern, we believe that the U.S. and China will be bright spots in terms of global growth.

What follows is a description of why we (absent a crisis in Europe) are optimistic about returns in the U.S. and China.

China

The biggest question facing investors in China is how the deflating real estate bubble will impact China's growth rate in 2012. Chinese GDP data shows that growth slowed during 2011, ending the year with a rate of 8.9% in the fourth quarter, after having grown 10.1% in 2010. This slowdown is partially self-inflicted, as the government worked to combat inflation by tightening monetary policy and increasing restrictions on buying real estate. Part of the slowdown also relates to lower exports because of sluggish growth in developed economies. We don't expect GDP growth to return to the double digit rate seen in 2010 but recent data should give investors a more positive outlook.

For example, the most recent economic data suggests that the slowdown in fixed asset spending is contained. Chart 1 shows the change in Fixed Asset Investment plotted against the Purchasing Manager Index (PMI). Although PMI has declined slightly during the year, it has remained relatively stable and in fact has recently increased. The data suggests a much more stable economy than you might infer from media reports.



One of the reasons for this is that the government stopped tightening monetary policy this past summer and actually began loosening this fall. Inflation has started to come down, giving the government room to ease monetary policy. The government has also stated that it is concerned about the impact a crisis in Europe might have on China. Now with inflation declining they have more room to act.

Strong consumer spending is another factor behind economic stability. The long, gradual transition to consumerism and internal consumption in China is one of the most important trends for investors to grasp. In spite of slowing GDP growth this year, retail sales were very strong, up over 18% in December. Chart 2 shows the monthly trend for retail sales in 2011.



Clearly Chinese consumers don't share the same fear as foreign investors about China's future. Are they naive and complacent? Why do they keep spending when the economy is slowing? The answer is that their personal wealth and spending power is increasing. Wages are rising, as China is now transitioning its economy to consumption, from being driven by fixed asset investment. This necessary yet slow moving evolution of China's economy will significantly extend the duration of its growth - but at a lower rate. This change will not be kind to all investors or businesses. In fact, we have already seen many export companies close their doors. But those focused on the growing consumer are in the very early stages of what promises to be an extended period of growth.

U.S.

Recent economic data in the United States suggests that our economy is also recovering. During the past few months, employment and industrial production have improved. Still, the housing market remains a mess, a drag on already tepid job growth. Silver lining theory: Slow job growth can actually be good for stock market returns. Slow growth and low inflation will allow the Fed to keep monetary policy loose and interest rates low. Indeed the Fed just announced they plan on keeping interest rates at the current low level through 2014. More often than not, accommodative monetary policy has been good for the stock market.

The low interest rate environment coincides with a period of very reasonable-to-low valuations for many companies, many of which are below their long-term averages. When you combine such attractive valuations with a dividend yield of over 2% for the S&P 500, we struggle to understand the long term appeal of owning U.S. Treasuries. In fact, in this environment, we are able to buy well-run businesses with strong balance sheets and reasonable growth prospects with dividend yields approaching 4%.

Not only are dividend yields high on some of America's household names but valuations are very low on some of our strongest growing companies. For example, as we write Apple is being valued at a price to earnings (PE) ratio of only 10x analyst's estimates for next year earnings. Google is at about 13x. We believe both of the companies are too cheap relative to how fast they are growing.

We can't promise that the market ride of 2012 will be any less rocky than last year's road. But we like the car we're in and look forward to steering a clear course.

Sincerely,



Nels Wangenstein



Dan McCarthy

Performance Disclaimer:

The performance prior to the inception date of May 31, 2008 for the Chinese Consumer Composite and the All Cap Opportunistic Equity Composite, is based on accounts managed by Nels Wangenstein at another Investment Advisor. The accounts were subject to a lower fee schedule. If the current fee schedule had been charged in periods prior to May 31, 2008 the returns would have been lower in such periods due to the higher fee schedule. Both the accounts and the Composites are managed for growth and preservation of capital using substantially the same strategy. Performance is shown net of expenses for the accounts (including a management fee) and reflects the reinvestment of all dividends and other earnings. Past performance is no guarantee of future results. Any investment program has a potential for loss as well as profit. The results achieved by individual clients will vary. Comparisons to the MSCI China index, S&P500, and other indexes are for tracking performance and are for informational purposes only, as the Account and the Composite are not intended to track the indexes and may hold or have held positions not included in such index. These results are not intended to be AIMR/GIPS compliant. A current fee structure and composite summary are available upon request.