B|T WEALTH MANAGEMENT, LLC

Quarterly Review and Outlook – Fourth Quarter 2011

As we entered 2011, we believed we would continue to face numerous challenges and headwinds for the markets and our economy. This view was not at all unique, but it focused us on the fact that investment returns would prove challenging. We believed that the situation provided an environment where we needed to "grind out returns" for our clients and grind we did. Market volatility was a significant influencer that made earning returns all the more difficult. One of our managers illustrated this volatility by pointing out that the S&P 500 traveled 3,240 points during 2011, but ultimately ended right where it started.

To wrap up the year as succinctly as we can, treasuries, municipal bonds and gold were the few winners during the year. Stocks were flat to down high teens depending on the geographic representation. Bonds performed well during the year in several areas but the standout was long-term treasuries with the 30yr up approximately 30%. It paid to have duration as rates declined substantially in 2011.

Market returns are often a harbinger of what will come next and with traditional safe havens leading the way, we are mindful to respect the message. So, we believe that with stocks flat to down, bonds up, and gold up we must proceed with caution in 2012. We are sure that this view surprises few.

Rationalization of Debt

Taking a look at the big picture, we repeat a refrain of what we believe is the most significant investment factor for consideration for the coming years….the world has too much debt with too little income to support it. The events of 2008 were the tipping point where this reality was exposed. The inability of policymakers to create a "normal' recovery gives merit to the belief that the markets are facing a new rationalization of debt levels around the world.

There has been much written about how we got into this predicament, but we have little precedence to suggest the best way through the process of deleveraging. The causes are simple: a flexible global financial system, a fiat currency system, and monetary and fiscal policy responses. In essence, our global financial system became very adaptive to a baseless money system that allowed more and more debt to be accumulated to allow for smooth economic growth. Our monetary and fiscal policy further exacerbated this by being a steamroller for any bump in the economic road.

This has been the playbook for over three decades and it has led to a perception of great prosperity. But, as we all know, trees do not grow to the sky and it is no different for our global economy. There appears to be limitations to the amount of leverage that can be embedded in our markets and the effectiveness of policy responses. We must adjust to this reality in our own lives and what we expect from the financial markets. We expect that we will be repeating this refrain for years to come and we wish it were more melodic.

We believe we are in the beginning stages of a rationalization of debt around the world. In our view, the real crisis involves sovereign debt levels, and the financial crisis that began in the U.S. exposed the weaknesses of overlevered government balance sheets. This realization began in Iceland in 2008, moved to Ireland, is now in Greece and soon will face the other PIIGS (Portugal, Ireland, Italy, Greece, and Spain). After dealing with Europe, Japan and China will be in the crosshairs followed by debt troubles in the United States. Our timeline ends in the United States because this is a problem partially caused by a baseless money system. Since we manufacture the world's reserve currency, the market will save us for last, but this is more uncertain and does not mask the reality that the world is on a new path of lower debt and lower growth.

In our opinion, this process will take years, but we have heard valid arguments that the process is accelerating and will continue to accelerate until we reach the next phase of the financial crisis. Policy responses around the world are focused on prolonging the adjustment to ease the pain from a deleveraging cycle by "kicking the can down the road." Those that believe it will happen much more quickly see policymakers running out of road.

While the timing is uncertain, both have serious implications for investors. It is only logical to assume that a deleveraging process will result in lower economic activity and lower investment return opportunities. If we accept this process and understand it, then we believe that we can adapt and thrive.

Europe

What we describe above is an environment that plays out over years, but we need to be mindful of what is transpiring as we speak, so let's start with Europe. Europe is a mess. The countries of the Eurozone are desperately seeking a "Nash Equilibrium" to determine the solution to their problems, but with imperfect information and concentrated power, the process reminds me of the "prisoner's dilemma." The "prisoner's dilemma" exposes a situation where two parties may not cooperate even if it is in their best interest. If Europe does not cooperate and cobble together a realistic solution, then the butterfly effect that began in Iceland will soon overwhelm this part of the world.

As the Eurozone policy makers, led by Angela Merkel, Nicolas Sarkozy, and Mario Draghi, mightily attempt to resolve the "Euro Crisis," it appears that Europe has entered another recession and it could be quite severe. Depending on the policy responses to stem the crisis (which are impossible to predict at this point), the recession in Europe could actually make the crisis worse.

As we write this, we are awaiting an agreement with respect to Greece's Private Sector Initiative ("PSI") to determine how much of a haircut the private debt holders of Greek bonds will take. It appears they will be forced to agree to a 50% haircut and an extension of their maturities. What troubles us most about this is the "P" in PSI. Under the agreement, only the publicly held debt will be subject to this agreement. The debt held by the European Central Bank will be left alone, which is a clear offense to the concept of property rights and a free market.

As we discussed, we see a multitude of unsavory outcomes for the Eurozone. We believe that it is a flawed system and unlikely to be resolved positively until the Euro nations agree to both fiscal and monetary unions. Right now we are far from that outcome, and the outlook remains dim. We have not joined the rebirth of the decoupling crowd. We believe what happens in Europe will impact the rest of the world economically and at a minimum, will provide unwelcomed volatility for our markets.

China

China has clearly been an important engine of global growth and opportunity for multinational companies over the last two decades. The Chinese government has managed a remarkable period of growth without many interruptions. The consensus of market observers and economists suggest that China is implementing policies to affect a slowdown which will ultimately be successful without any unpleasant outcomes.

The probability that China will slow more dramatically than policymakers intend is higher to us than currently appreciated by the market. Noted economist Gary Shilling is projecting growth will be in the 5-6% range, well below the 8% growth that is required for employment of the increasing labor force. If

unemployment rises, it may trigger events that would result in a "hard landing" in China. In addition, with a weakened Europe the impact in China may be more significant.

United States

Moving on to the United States, the consensus view is calling for slow but positive economic growth; a continuation of the muddle through outlook where we keep growing but nothing feels great. In our view, the crisis in the Eurozone and a slowdown in China will undoubtedly continue to cause uncertainty here in the U.S. Consumers have proved resistant to lack of wage growth, job growth, and the impairment of their balance sheets through housing declines, but how long can this continue? We have seen modest signs that job growth is returning and housing is stabilizing for now, but is it permanent?

Our responsibility is to look at the economic outlook and prepare our clients for those outcomes that are out of the consensus. We believe the market largely discounts the consensus view, but does not provide much protection in more significant but lower probability events that occur from time to time. We see the current environment as a perfect example of the importance of this responsibility. During a global deleveraging process that will likely last years, we foresee an environment of continued uncertainty. With deleveraging in its beginning stages, a recession likely throughout Europe, a slowdown in China, and a Euro crisis that may cause numerous ripple effects, we believe a recession here in the U.S. is not out of the question. If it were to happen in Europe and the U.S. simultaneously, then a global recession is quite likely.

Adding to all this tumult, we face a Presidential election year. Whatever the outcome (and we are not choosing sides), we are in store for another four years of political divisiveness. In our opinion, the socio-economic disparities have grown to the point that political divisiveness and social discontent continues to mount. We are not suggesting we need government to help correct those economic differences. Instead, we need to embrace the reality as we seek investment opportunities.

For a Pessimist, I'm Pretty Optimistic

All of the situations that we describe are quite pessimistic, but it is our responsibility to manage risk, as well as return, in our portfolios. Positive outcomes result in positive risks that are less concerning to us, but negative outcomes result in periods like we saw in 2008, and we strive to mitigate their impact when they do occur.

We don't consider ourselves to be pessimistic. Instead, we prefer to think we are realists and the reality is that we are in a time where caution is the better part of valor, and we need to be mindful of risk, fat tails, and unintended consequences of policy. We look forward to a different time when our global economy and financial system are operating from positions of strength. Today is not that day, but we do believe it is coming. Excesses by their very nature need to be purged and we believe we will ultimately pay the price of those excesses. Upon completion of this deleveraging cycle, we envision a new period of prosperity that will lead to investment opportunities that will reward the patient investor.

In the meantime, the realist in us believes that we have to consider the current investment climate and challenge our return assumptions for portfolios. We believe this is one of the most important elements of a successful investment management relationship, but also the most difficult. We have spent a great deal of time communicating our thoughts about returns in these letters and we want to be clear about what we believe we can earn for clients. A world that is experiencing a global deleveraging cycle will have a constant headwind to economic activity. Increasing levels of debt have allowed us to expand our economies at a

faster rate than without debt over that last several decades. This is an undeniable reality so the opposite would logically create a slower rate of expansion. Slower economic growth ultimately plays into a more modest opportunity set for investments.

The second factor affecting our return expectations is valuations. In our view, valuations of equities reflect quite a bit of optimism while bonds reflect more pessimism due to the low yields. Which is correctly discounting the future is a question that only time will expose. To us, it suggests that both are priced to provide modest returns over the coming years. Bill Gross, founder and Co-CIO of PIMCO, recently suggested he believed stocks, bonds, and commodities would return 2-5% over the long-term. Rob Arnott, founder of Research Affiliates, recently stated on a conference call that he believed bonds would return 2-4% and stocks would return 4-6% over the next 10-20 years!!! His message to us was that we need to better communicate realistic return expectations as well as "think different" about ways to generate returns in this type of environment. We agree completely.

We have updated a chart that we included in a couple of our quarterly letters this year detailing GMO's view on return expectations for the next seven years. Its analysis reinforces our view that stocks, bonds, and cash are priced for disappointing returns while international stocks now offer more opportunity due to their dismal performance in 2011.

GMO 7-Year Asset Class Return Forecasts*

	March 2009	February 2011	December 2011
U.S. Equities (large cap)	7.5%	-0.1%	1.4%
U.S. Equities (small cap)	7.4%	-2.7%	-0.5%
Intl. Equities (large cap)	10.0%	1.8%	6.1%
Intl. Equities (small cap)	10.8%	-0.6%	5.0%
Emerging Mkts. (equities)	8.5%	4.7%	6.8%
U.S. Bonds (gov't.)	0.2%	0.6%	-1.3%
Int'l. Bonds (gov't.)	0.5%	-0.5%	-2.5%
Emerging Mkts. (bonds)	3.4%	1.9%	1.2%
TIPS	0.9%	0.3%	-1.5%
Cash	0.2%	-0.7%	-0.7%

*The chart represents real return forecasts. Long-term inflation assumption of 2.5% per year. Returns are annualized.

The bottom line is that 2012, and beyond, will likely continue to be more difficult to generate returns for clients. We will continue to focus on finding ways to "grind out returns" defensively until we encounter an environment that is better suited for a more offensive risk posture in portfolios. For some, this may be a frustrating time. In our experience, this very frustration often leads to significant mistakes and highlights the importance of a good investment manager. We are certain many investors have gone down this path already and are doing irreparable harm to their financial security. We are equally frustrated, but we remain steadfast in our belief that managing return AND risk over the long term is the most prudent course to achieve investment success.

Thank you for your continued trust and confidence. Please let us know if you have questions.

Best regards,

Steven P. Barth, CFA, CPA
President and Chief Investment Officer
BT Wealth Management LLC