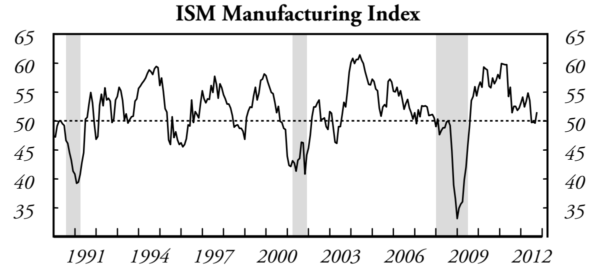
WHV INVESTMENT MANAGEMENT

REVIEW AND OUTLOOK - FALL 2012

Since the end of the "Great Recession" in June of 2009, the United States economy has expanded for 39 consecutive months through the end of September 2012. For an historical perspective, there have been eleven economic expansions following recessions in the post-World War II period. The average length of economic recoveries in this 67-year period is 58 months, the longest being 120 months and the shortest being 12 months. The current economic recovery has averaged an annualized growth rate of 2.2 percent, less than half of the growth rate of prior expansions of the same duration.

Economic growth in the United States remains tepid.

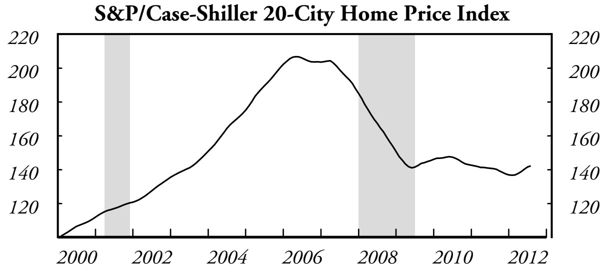
ISM Manufacturing Index



The various surveys released in September and to date in October indicate a U.S. economy growing at an annual rate of between 1 and 2 percent. Gross Domestic Product (GDP), the total output of goods and services within the U.S., grew at an annual rate, after adjustment for inflation, of 1.3 percent in the second quarter of 2012. Estimates for the third quarter center on a growth rate of about 1.4 percent. The ISM Manufacturing Index rose to 51.1 percent in September following three months of contraction. A reading below 50.0 percent signifies a contraction. The Index of Leading Economic Indicators, which provides a reasonable forecast of economic trends for the next six to nine months, has declined in three of the past five months, suggesting little promise of a significant acceleration in economic output in the period ahead.

The housing market appears to have bottomed and is gaining strength.

S&P/Case-Shiller 20-City Home Price Index

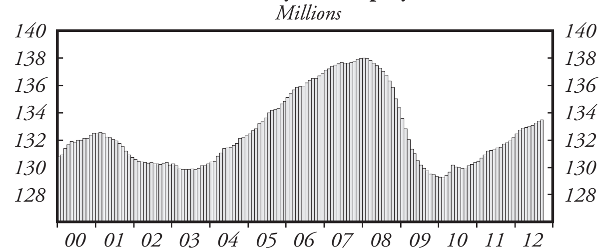


The housing market appears to have bottomed and a modest recovery is underway, albeit from a very depressed level. New home sales, existing home sales and home prices have all experienced an upward trend over the past several months. Foreclosures have leveled off, the inventory of unsold homes has declined and housing starts are exhibiting an irregular upward trend. The affordability index that measures home prices, personal income and mortgage rates is the most favorable since records have been kept. The 30-year fixed rate mortgage published by the Mortgage Bankers Association is at a record low of 3.63 percent. The Case-Shiller 20-City Home Price Index has risen for six consecutive months following 20 consecutive months of decline, although prices remain 31.2 percent below their April 2006 peak. This recovery is likely to continue into next year. However housing, as represented by residential fixed investment, is not going to be a major contributor to GDP as it accounted for only 2.4 percent of GDP in the second quarter, down from a peak of 6.3 percent in 2005 and the post-World War II average of 4.8 percent.

The economy is adding jobs but at a pace well below past recoveries.

Nonfarm Payroll Employment

Millions

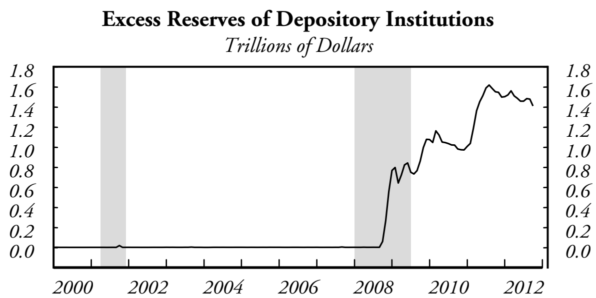


The labor market remains depressed. While non-farm payrolls have increased in each of the past thirty-one months, the rate of gain is well below normal for this stage of an economic expansion. In September non-farm payrolls advanced by 114,000 and the unemployment rate fell to 7.8 percent. The drop in the unemployment rate recently and from the peak of 10 percent in October 2010 is largely due to people dropping out of the labor force. There are 12.1 million people officially unemployed, an additional 6.7 million who say they want a job but are currently not looking, and another 8.6 million who are working part-time but would like to work full-time. Total employment remains 4.5 million below the peak of January 2008.

The Federal Reserve will keep the 0.25% fed funds rate into mid-2015.

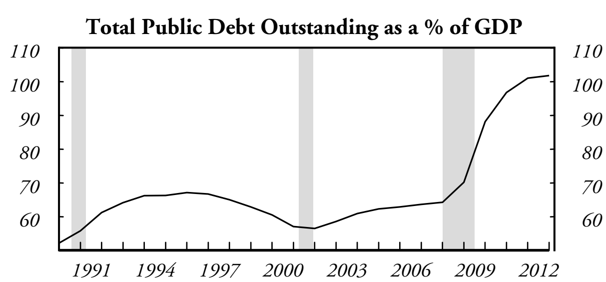
At its meeting on September 13, 2012, the Federal Reserve announced that it would embark on a third round of quantitative easing (QE3). Quantitative easing is one of the tools used by the Fed to try to stimulate economic growth and employment. It entails the purchase of bonds, either U.S. Treasury securities or mortgage-backed securities (MBS), in an attempt to lower interest rates. It is hoped that lower interest rates will spur the housing market and depress the exchange rate of the dollar thereby boosting exports. Additionally, by keeping yields low on "riskless" securities, the Fed hopes to drive businesses and investors into riskier, higher-yielding assets, whether it be new plant and equipment, equities or high-yield bonds that in turn will boost economic growth and employment. The Fed also announced that it would keep its Federal funds rate at 0.25 percent through at least mid-2015.

The new round of quantitative easing involves an open-ended program to purchase $40 billion of newly issued mortgage-backed securities every month. These securities are issued by Fannie Mae, Freddie Mac and Ginnie Mae and consist of packaged or securitized mortgages that the government agencies have bought from financial institutions. These agencies issue about $140 billion of mortgage-backed debt a month representing the funding of about 90 percent of U.S. home loans. The mortgage-backed market totals about $5 trillion.



The Fed uses its member banks as agents for the purchase of securities, paying for its purchases by crediting the reserve accounts of the member banks. The banks can then make loans of about $9 for every $1 of reserve. This process is called the fractional reserve system or the multiple expansion of bank credit. In simplest terms, it is printing money. The Fed carries these reserves and other assets as part of its balance sheet. Since August of 2007, the beginning of the financial crisis, the Fed's balance sheet has expanded from $869 billion to just under $3 trillion currently. Most of this increase represents excess reserves that can be turned into money by a multiple of nine. The potential inflationary implications of quantitative easing are staggering.

Continued large federal budget deficits and accumulating debt hamper economic growth.



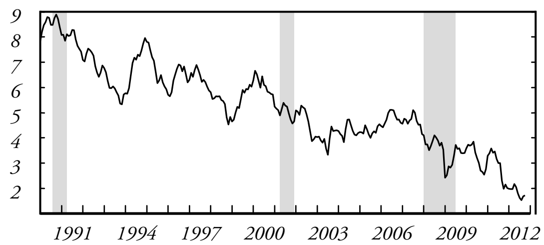
The federal government is running a deficit of over $1 trillion a year and, since the beginning of the financial crisis in 2007, the U.S. has added over $6 trillion to its outstanding debt. The Fed has financed or purchased a substantial amount of this debt through prior quantitative easing programs, QE1 and QE2. The U.S. has total debt of $16.02 trillion on a GDP of $15.6 trillion, or 103 percent of GDP. The total outstanding national debt is increasing at a rate of $3.85 billion a day. Economists Carmen M. Reinhart and Kenneth Rogoff have shown that sustained debt-to-GDP levels of 90 percent or more reduce the trend-line growth rate of GDP by a third. This could be one of the explanations for the current tepid rate of economic growth in the U.S.

Economists have labeled quantitative easing a form of financial repression. Financial repression occurs when a government intervenes in the financial markets to control interest rates to a level that would not prevail in a free or unfettered market. It enables a government to finance and service its debt at low nominal interest rates and avoid the unpopular steps of raising taxes or cutting spending. Since the controlled low interest rates are often negative in real terms (inflation adjusted), it allows the government to liquidate the real value of its debt. This is a classic way for a government to liquidate sovereign debt, debasing its currency through inflation. The lender or owner of the debt is losing purchasing power while the issuer of the debt is servicing it with a depreciating currency. Other forms of financial repression whereby governments intervene in the credit markets are bank nationalization, capital market controls, restrictions on bank withdrawals, and regulations and restrictions on cross-border capital movements.

Foreign central banks, including those in the euro zone, Britain, Japan and China, are also likely to continue easing monetary policy in order to promote growth, support asset prices, prevent sovereign debt default and fight deflation.

10 Year Government Bond Yields

Percent Per Annum



The cost of capital, whether credit or equity, is the filter for risk and an important ingredient in calculating expected rates of return on capital. When governments intervene in the credit markets to keep interest rates low, the allocation of capital becomes distorted. When the Fed lowered the federal funds rate to as low as 1 percent following the 2000-2001 recession, it was culpable in contributing to the housing bubble as investors piled into higher-risk and higher-yielding subprime mortgage loans. The current monetary policy of the Fed is setting the stage for the unintended consequences of a future bubble in some asset class.

The global economy is experiencing slower growth.

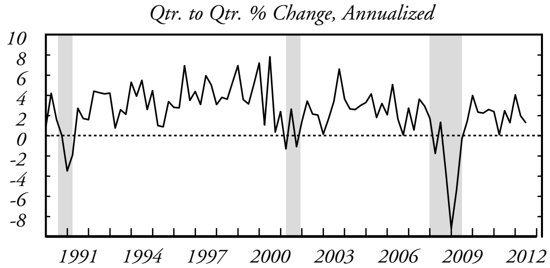
Among the mixed signals of the current state and future outlook for the economy is the slowing trend of global trade. Imports into the U.S. have slowed to an annual rate of 2.7 percent compared to 15 percent earlier in the recovery, confirming weaker domestic demand. Global merchandise trade has also slowed as the U.S., the euro zone, China and other areas of the world have experienced slower rates of growth. The World Trade Organization lowered its forecast for global trade growth in 2012 to 2.5 percent from its prior 3.7 percent forecast. This compares to the 5 percent growth recorded in 2011 and 13.8 percent in 2010.

The slowdown in U.S. and global growth leaves the world economy vulnerable to recession if shocks or an exogenous event were to occur. Such an event could be a disruption in global energy supplies as a result of an escalation of hostilities in the Middle East, a default on sovereign debt in Europe, policy missteps in China or failure of Congress to address the “fiscal cliff” in the U.S.

The sovereign debt crisis in Europe remains unresolved.

Real Gross Domestic Product

Qtr. to Qtr. % Change, Annualized



The prospects for solving the problems engulfing the 17-member euro zone continue to be elusive. The area is in a deepening and broadening recession with GDP having fallen in two of the past three quarters. Actions by the International Monetary Fund (IMF), the European Economic Community (EEC) and the European Central Bank (ECB) have proved to date to be of little help. The head of the ECB stated it would do everything in its power to protect the euro zone. The latest operation by the ECB to buy sovereign debt is dubbed OMT for Outright Monetary Transactions, similar to the quantitative easing of the U.S. Federal Reserve. These funding sources are short-term rescue vehicles. The proposed euro zone’s permanent bailout facility, called the European Stability Mechanism (ESM), was approved by Germany's highest court. This rescue vehicle will be funded by the issuance of debt authorized by the 27-member European Union but guaranteed by the euro zone. The ESM will use these funds to provide financial assistance to member states that appeal for help and adhere to the conditions surrounding the loans. The peripheral members of the euro zone that have large budget deficits and large sovereign debt relative to their GDP must pay high interest rates to attract buyers of their debt because of the risk of default. These interest rates are unsustainable given the rising proportion of interest payments to total spending.

The source of the fiscal ailments of several of the members of the euro zone, namely excessive spending and lack of growth, is not being addressed. The structural failures include rigid and immobile labor forces, excessive health care and retirement benefits, excessive regulation and taxation and a host of welfare entitlements. Attempts to undertake such reforms have met with civil unrest and political upheaval. Additionally, European banks are dealing with bad loans, made in many cases on inflated real estate, that are experiencing high rates of default. Private sector banks also own the sovereign debt of the weaker euro zone countries. In order to keep the euro zone intact, Europe needs to adopt a fiscal union, an economic union, a political union and a banking union. Germany has resisted such integration until the wayward members (Greece, Portugal, Spain, Ireland, Italy, and Cyprus) have shown that they can go beyond enacting reforms to implementing the needed reforms. This is a hurdle that appears unlikely to be cleared. Nevertheless, financial markets initially reacted favorably to the ECB and ESM announcements.

Failure to resolve the "fiscal cliff" will send the U.S. economy into a downturn in 2013.

The most immediate threat to the U.S. economy is the looming "fiscal cliff" at the beginning of 2013. Unless Congress acts, in January 2013 about $100 billion in spending cuts and $500 billion in tax increases will occur. This is equivalent to about 3.8 percent of GDP assuming individuals do not change their behavior, for example, by bringing income forward from the high tax rates of 2013 to the lower tax rates of 2012. Some estimates suggest the impact could be as much as 6 to 8 percent of GDP. That would put the economy into recession in the first half of 2013.

SUMMARY

The global economy is slowing due to a deepening recession in Europe, tepid U.S. growth and slower growth in several developing economies including China. The developed countries of the world are battling large budget deficits and expanding sovereign debt. Unless the legislative and executive branches of government in the U.S. take action, a combination of spending cuts and tax increases effective at the beginning of 2013 will likely send the domestic economy into a downturn. On a more positive note, corporate profits are near a record level, corporate balance sheets are strong and consumers are repairing their balance sheets. Central banks around the world are flooding the system with liquidity which should help support asset prices and defer sovereign default and deflation.

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