Schaper, Benz & Wise
INVESTMENT COUNSEL, INC.

Economic & Market Summary
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As the GRCC (Great Recession/Credit Crises) began to unfold 4 years ago, Federal Reserve Chairman Ben Bernanke feared illiquidity and deflation. In order to prevent deflation, the Federal Reserve has employed an extraordinary program to increase the supply of currency in the economy and keep prices of goods and services from falling. Empirical evidence clearly demonstrates the negative influence deflation has on an economy. If executed perfectly, inflation would settle near normal inflation expectations of 2-3%. More likely the program won't be withdrawn perfectly forcing inflation higher at least temporarily. Chairman Bernanke has also supported more aggressively than past chairmen the Fed's mandate to maximize employment, providing added justification for the extended period of monetary easing. This analysis underlies our belief that bonds, particularly long-dated Treasuries and high-quality corporates, are mispriced relative to inflation. Commodities have also risen as a result of current monetary policy as real assets, in the short-term, tend to be a good hedge against a decline in the purchasing power of paper currency. We expect the premium in most commodities to unwind as extraordinary monetary policy becomes unnecessary.

In addition to monetary stimulus, the U.S. economy has been supported by fiscal stimulus. Unless Congress takes action before year-end, tax rates on ordinary income, dividends and capital gains are set to rise significantly beginning January 1st. This risks reversing the current economic expansion as disposable income would be immediately reduced, important because consumption accounts for 70% of our economy. As the election nears, an acrimonious debate will likely depress consumer and business confidence for a short period of time. If our deficit ceiling debate in the summer of 2011 is an indication, a solution will be achieved very close to year-end or current tax policy will be extended briefly into 2013 to allow time for debate. While we continue to estimate 2012 real GDP growth at 2-3%, the economic expansion is not strong enough to handle the shock of across-the-board tax increases.

A critical component to our thesis of an improving U.S. economy is a healthy banking system. The Dodd-Frank bill mandates that the largest banks in the country submit an annual capital adequacy plan to the Federal Reserve which is tested against an extremely negative economic backdrop. The results released in March show the banking system holding sufficient capital to withstand a major economic collapse without accessing outside capital. Banks are already experiencing loan growth in both the consumer and corporate segments.

Global equity performance has been quite strong since the beginning of 2012 with many major markets increasing double-digits. The S&P 500 had a total return of 12.7% in the first quarter on the back of improving economic data, earnings growth, and an expanding P/E ratio. Although total mutual fund equity flows, which include foreign equity investments, have turned slightly positive in 2012 for the first time since 2007, domestic equity funds are extending into the *sixth* year of negative net flows. Since 2009, domestic equity negative flows have actually accelerated, despite strongly positive investment performance. It is clear that many investors have not participated in improving equity returns. This situation will reverse itself as most investors tend to chase returns. While we would not be surprised if volatility returns as the election season heats up, equities continue to offer attractive value resulting from earnings growth, reasonable valuations (S&P 500 trading at 14x forward earnings), and rising investor participation.

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To request our SEC Form ADV Part II, please contact Michael L. Wise, Chief Compliance Officer, at the address below.

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