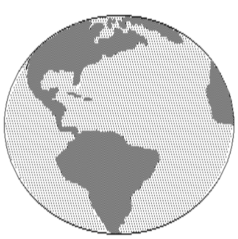
MOSAIC
FINANCIAL PARTNERS, INC.
a Wealth Advisory firm

Market Watch
4th Quarter 2011

Summary

- The broad U.S. market had a strong 4th quarter with gains of almost 12%. The S&P 500 ended the year with a return of 2.1%.
- U.S. Small Cap outperformed Large Cap for the quarter, while underperforming Large Cap over the full year.
- For the quarter, Value outperformed Growth in both Large and Small cap equities. Growth outperformed Value over the full year.
- Returns for International equities were notably weaker than those in the U.S. Emerging market equities experienced the steepest declines over the full year.
- Bonds were the best performing asset class for the year. Long Term Treasury bonds gained nearly 30% over the last twelve months.
- U.S. REITs and Alternatives, such as Timber and MLPs, rose more than 15% during the quarter.
- Monthly inflation has recently slowed. Annualized inflation for 2011 is estimated at 3.4%.



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Recovery with Continued Volatility

During the 4th quarter the financial markets recovered nicely from the 3rd quarter declines. The S&P 500, which tracks the largest U.S. companies, finished up almost 12% for the quarter and just over 2% for the year. Since the market's low point on March 9, 2009, the S&P 500 has gained 97% and ended the year only 12% below the October 2007 peak.

The MSCI EAFE Index (the mostly widely used index to track non-U.S. stocks in developed countries) gained 3% during the quarter but fell almost 12% over the year. Emerging markets were up nearly 4.5% for the quarter but fell just over 18% for the year. Because of the rising value of the dollar, all these international returns were better for local investors than for American investors.

A look back at 2011

As we head into 2012, it's worth taking a moment to look back at 2011 and consider some of the major market trends that led to the disparity of returns across asset classes.

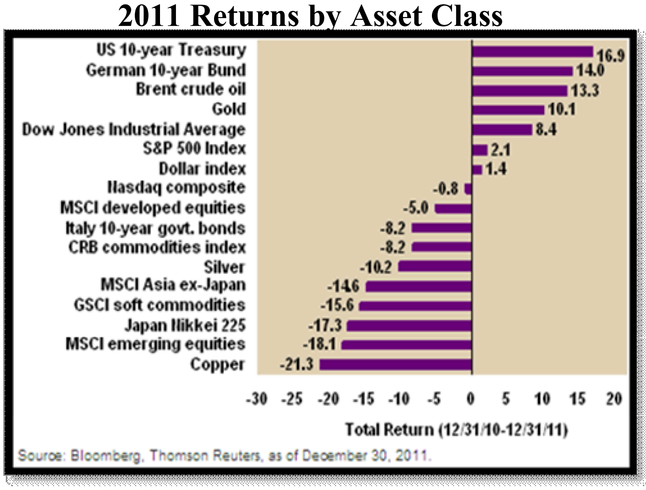
- U.S. stock prices were certainly volatile in 2011, but in the end, prices ended up close to where they began. Dividends contributed to positive total returns.
- International stocks fell in response to the Euro zone difficulties as countries struggled to resolve their fiscal excesses.
- Emerging market equities and commodities both suffered from investor anticipation of slowing global growth and negative currency effects.
- Despite macro concerns, alternative asset classes like U.S. REITs and Master Limited Partnerships (MLPs) posted strong year end gains, while providing important diversification benefits.
- Fixed income had a strong year, with returns coming from interest and price appreciation attributable to still falling interest rates.

From the U.S. perspective, the 4th quarter brought a steady flow of positive economic news. Profitable business activity, strong balance sheets, and high corporate cash levels suggested a coming U.S recovery. At the same time, the European debt contagion continues to trouble the markets, keeping them from responding to the positive domestic news.

Last year was a see-saw for the markets. From the start of January through the end of April, the S&P 500 Index rallied nearly 10%

(based on the expectation that the economic recovery was picking up momentum). Then over the next five months it plunged nearly into bear-market territory (-20%) due to weak economic reports. August and September were most unkind to investors, thanks to a dysfunctional Congressional debate about the debt ceiling, a subsequent US credit-rating downgrade and the re-eruption of the Eurozone debt crisis. During this time, uncertainty plagued the market and volatility levels doubled their "normal" range. This last quarter, the market soared in October, fell in November and jumped again in December.

2011 Returns by Asset Class



Source: Bloomberg, Thomson Reuters, as of December 30, 2011.

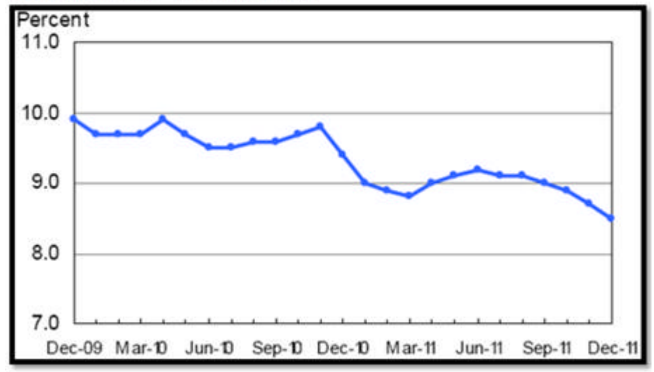
U.S. Economy

Despite what you may have heard, the U.S. economy is on the mend. The economy, as measured by real gross domestic product *(GDP)* grew in the 3rd quarter of 2011 by 1.8%, up from 1.3% in the 2nd quarter. When the 4th quarter numbers are released, most expect them to be even stronger.

Manufacturing activity was at a six month high in December and reflected positive growth. Eleven of the eighteen non-manufacturing industries also reported growth in December, including Retail Trade, Professional Services, Finance and Insurance.

Since employers are more active, it makes sense that employment is also improving. The December labor report showed the U.S. unemployment rate fell for a fourth consecutive month to 8.5%, its lowest rate since February 2009. A reasonably robust 200,000 new jobs were created in December. Over the past year, the U.S. economy has added 1.6 million jobs, versus only 940,000 added in 2010.

Unemployment rate(seasonally adjusted)
December 2009 – December 2011



Consumer confidence rose in December, adding another positive signal. The Conference Board Consumer Confidence Index ® (CCI) increased 9.3 points over the November levels to 64.5.

Housing remains a primary area of weakness in the economy. Home prices continued to fall in 2011. With housing prices weak, banks have slowed foreclosure activity but have maintained very tight lending standards. Despite low interest rates, home loans remain very difficult to get for many consumers.

In the absence of Congressional and Presidential leadership, the Federal Reserve continued its efforts to boost the economy by keeping interest rates low, encouraging banks to lend and, in a new twist, being more public about its plans to minimize uncertainty. However, the impact of this efforts hasn't been clear.

Inflation hasn't been a concern for some time but did climb to a worrisome 3.4% for the year through November. With our portfolios' exposure to TIPS (inflation bonds), real estate, commodities and timber, we think Mosaic portfolios are well protected should we experience future higher future inflation.

The U.S. dollar gained 11% over other currencies during 2011. With the Euro in difficulty and the global economy slowing, investors sought the relative safety of the US dollar. Once the Euro stabilizes, this relationship will likely reverse strengthening international returns.

Investments – U.S. Equities

All U.S. equity sectors experienced strong gains during the 4th quarter, reflecting the more positive economic news. During the quarter, small stocks outpaced large (gaining over 15% versus 12% for large caps) while value stocks outperformed growth stocks. For the year, however, both of these recent trends were reversed. Large caps gained over 2% while small companies dropped 4%. And in both large and small caps, growth outperformed value.

Since the market low in March 2009, large and small company stocks have gained roughly 97% and 124%, respectively.

The particularly noteworthy element of the 2011 markets were their volatility. In the extreme, from August 5 through August 30, the S&P 500 Index averaged a 2.5% move (up or down) every day. This level of market movement turned out to be more than the whole market changed over the entire year.

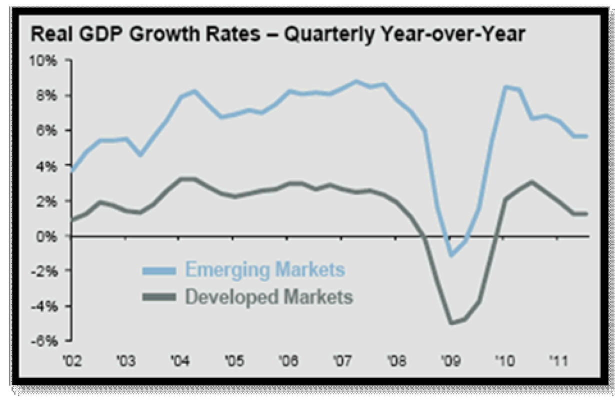
Most large companies continue to show strong results. After tax profits as a percentage of GDP is at an all time high (10.3% vs. a 50 year average of 6.1%). S&P 500 earnings are at $25.29 vs. the prior high of $24.06 which occurred in 2007. Corporate cash is at a record level of 27% (as a percentage of current assets). Inevitably, companies will either begin to spend their profits and cash or they will distribute it to shareholders, either of which would be good for the economy.

Things bode well for stocks, we believe. The U.S. stock market seems attractively priced, which could bring a rise in prices if the economy continues to grow. The S&P 500's forward P/E (current stock price divided by forecasted 2012 earnings) is now at 11.8 times forecasted earnings, versus its 15 year average of 16.2. In addition, dividend yields (2.2% for the S&P 500) are now higher than Treasury yields (1.9% on 10-year treasuries), which typically drives investors to stocks.

World Economy

Confidence in the Eurozone continues to be undermined by the ongoing European debt crisis. A full implosion in Europe seems to have been temporarily avoided, but real solutions remain elusive. The risk of a significant economic pullback remains strong. European banks have traditionally financed their national governments—it was considered risk-free business. With many of the countries now caught in a debt squeeze, the viability of the banks are now being threatened. Solutions are necessary not only for governmental fiscal discipline, but at the same time finding ways to recapitalize the banks. Deferral offers time, which is valuable for banks as they raise money and retain profits and for governments as they move their citizens toward accepting some harsher measures.

In the meantime, Europe continues to go about its business. Manufacturing activity has continued to grow in Germany, France and U.K and the contraction in



Italy and Spain seems to have stabilized.

As illustrated in the graph above, the growth rates in Emerging Markets continue to outpace those of Developed Markets. China and India grew in the 8% range in the 3rd quarter of 2011 (versus the major developed countries which grew in the 2% range).

Investments – International Stocks

Most foreign markets posted modest gains during the 4th quarter while returns for the year were decidedly negative. The MSCI EAFE index gained 3.4% for the quarter but declined nearly 12% for the year. The Emerging Markets Index gained almost 4.5 % for the quarter but fell over 18% for the year. Globally, regardless of region, investment returns were negative. These market declines were magnified in dollar terms as most foreign currencies fell relative to the dollar in 2011.

While less than U.S. stocks, current prices on overseas markets look attractive relative to *forecasted* 2012 earnings. The P/E ratio for the developed markets' MSCI EAFE Index stands at 10.2 compared to the ten year average of 13.4. The Emerging Markets Index P/E is 9.4 compared to its ten year average of 10.2.

Investments – Fixed Income

On August 5, Standard & Poor's announced a formal downgrade of U.S. Treasury bonds from their AAA status — arguably creating even more uncertainty in a market already struggling to reprice risk. While the downgrade seemed to negatively affect stocks, bond investors ignored the downgrade and demand for U.S. bonds actually rose (presumably a reflection of the concern about other sovereign debt).

The overall bond market, as represented by the BarCap Aggregate Bond Index, gained over 1% for the quarter and grew almost 8% last year as investors sought refuge from market uncertainty.

All fixed income sectors showed positive returns. Intermediate U.S. Treasuries gained 6.6% for the year. Treasury Inflation Protected Securities (TIPS) returned 13.5% while long term municipals rose almost 14% in 2011. The best performing bond sector was Long Term Treasuries gaining nearly 30% for the year.

Yields continue to be at record lows, falling even further from the lows of 2010. The current yield on 10-year U.S. Treasuries is somewhat less than 2.0%. The average yield on High Yield bonds is around 8%.

Investments – REITs

The 4th quarter FTSE NAREIT All-Equity REIT Index, which tracks total returns of listed U.S. equity REITs, posted strong gains of 15% for the quarter and 8% for the year. The gains for 2011 came on top of a 28% gain in 2010 and another 28% increase in 2009. International REITs gained almost 7% for the quarter but were down 8% for the year.

Investments- Alternatives

Alternative investments are intended to help dampen the overall volatility of a portfolio while still contributing to portfolio returns over time. A number of our Alternative holdings posted favorable returns this quarter.

Timber, represented by the FTSE NAREIT Timber REIT, gained almost 16% during the 4th quarter and 8% for the year. The Alerian Master Limited Partnerships Index (investing in energy transportation and storage) gained over 16% for the quarter, and almost 14% for the year.

The Dow Jones UBS Commodity Index remained virtually flat in the quarter with a gain of 0.3%, but it suffered a 13% decline for the year. Commodities include a number of sub-components (broadly: energy, precious metals, agriculture and livestock), each of which can be driven by different economic and market factors. Oil prices ended the quarter up $20 to almost $99 per barrel. Meanwhile, gold declined 5% for the quarter but gained 9% for the year.

Summary

	Yield	
U.S. Treasuries	12/31/2010	12/31/2011
2-Year	0.61%	0.25%
5-Year	2.01	0.83
10-Year	3.30	1.89
30-Year	4.34	2.89
Sector		
Broad Market	2.97%	2.24%
MBS	3.67	2.68
Corporates	4.02	3.74
Municipals	3.80	2.82
Emerging Debt	5.76	6.07
High Yield	7.51	8.36
TIPS	2.78	1.69

Last year reminded us of the importance of maintaining a long term focus *and* an appropriate strategic asset allocation for your portfolio —the right mix of stocks, bonds, real estate and alternative investments, structured in consideration of your unique time horizon, risk tolerance and financial objectives. Since these investment allocation decisions are driven primarily by your personal long-term investment needs and the historical relationships between the asset classes, few client allocations shifted during the year, despite 2011's significant market volatility, the frustrating congressional dysfunction, the US credit-rating downgrade and the Eurozone debt crisis.

As we start the New Year it is important to remind ourselves of what we can control: the focus on long term spending, savings and investing goals. Investing for your future should not be done with a short-term mindset.

Overall, we are optimistic about the progress being made on the economic front, based on increasingly heartening economic news. We believe that our diversified portfolios are well positioned to do relatively well in the variety of possible scenarios we face for 2012. Election years are usually good years for investors and we hope that will be true again this year. While market results can never be promised, it is our hope and expectation that we can continue to assist you to help you progress toward your long term financial goals. Thank you for your continued confidence.

Sources: *Morningstar, JP Morgan, Bureau of Labor Statistics, Ibbotson, The Federal Reserve, Reuters, Bloomberg, Standard & Poors, The Economist.*