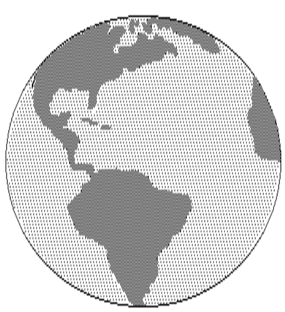
MOSAIC FINANCIAL PARTNERS, INC.
a Wealth Advisory firm

Market Watch
1st Quarter 2012

Summary

- The past quarter was the best performing first quarter since 1998.
- U.S. large and small stocks were both up about 12%, on average, during the quarter.
- International stocks were up about 10% generally, but with a weakening dollar, rose about 11% for the U.S. investor.
- Emerging markets were up 11% in their local markets, but again thanks to a weakening dollar, U.S. investors saw these investments grow by about 14%.
- Global REITs were up almost 13.5%.
- Alternatives had mixed results, but were led by timber, which as a class, was up 12% for the quarter.
- Bonds also were mixed, broadly suffering from rising interest rates during the quarter. Short and intermediate maturity bonds still produced minimally positive returns generally. High yield and emerging market bonds produced better results.
- Three year returns will show very positively this quarter, as we are now past the low point of the 2007-09 recession.



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Strong Returns from Stocks

The rally that began in the final quarter of last year, continued in 2012. This was the best performing first quarter for the stock market since 1998. The 1st quarter posted strong gains across the board. Large and small U.S. stocks rose about 12%. Overseas returns were similarly positive. Bonds generally produced modestly positive returns, while alternatives were mixed.

As of the end of March, U.S. small cap stocks have risen 37% while the S&P 500 index (large companies) is up 30% from the lows of October, 2011. The S&P 500 index is now up 122% from its low on March 9th, 2009 (less than 1% below its all-time peak, which occurred in October, 2007). Large growth stocks have actually passed the 2007 market peak by 12%.

Source: JPMorgan Asset Mgt

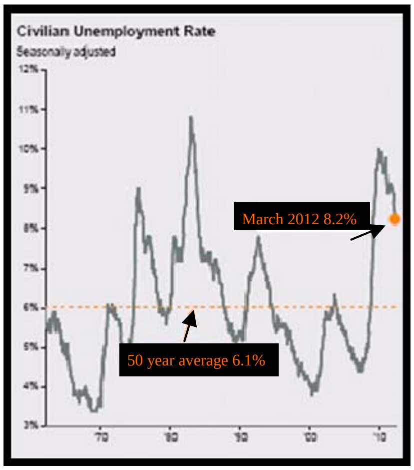
The stock gains reflect increased confidence in the U.S. economy and perceived improvements in Europe and elsewhere (both Europe's and China's improvements have come under question in April's markets.)

Interest rates seem to have begun their long-awaited move to higher ground. This has reined in most bond returns.

U.S. Economy

While the economic recovery from the 2007-09 recession has been subnormal, the U.S.

economy continues to get stronger. The U.S. gross domestic product (GDP) grew in the 4th quarter of 2011 (the most recent available) by 3.0%, up from 1.8% in the prior quarter. U.S. employment numbers are improving, consumer spending is staying steady thanks to improving consumer confidence, businesses have experienced record profits, manufacturing activity remains strong (improving last month for the 32nd consecutive month), housing has stabilized and interest rates remain low.



Source: JPMorgan Asset Mgt

The U.S. still has employment problems. Some 14.5% of the working population is either unemployed or in a part-time job, down from its peak but still high. Those out of a job and still looking fell to 8.2% in March. Significant differences in unemployment rates also exist among education levels, where the rate for those with less than a high school degree is almost 13% versus college graduates, for whom the unemployment rate is a bit over 4%.

Housing continues its sluggish recovery, but we are seeing encouraging signs. Existing home sales in February were up 8.8% over a year ago. Building permits rose to their highest level since October 2008. Housing remains extremely affordable based on historical levels (27% more affordable than the November 2005 peak), although the difficulty of getting a new mortgage in this environment has slowed the demand. Mortgage rates have moved slightly higher lately, which perversely may boost demand as the prospect of higher rates may push potential purchasers toward action. In addition the sharp increase in the demand for rental housing, has triggered increased construction of multifamily units.

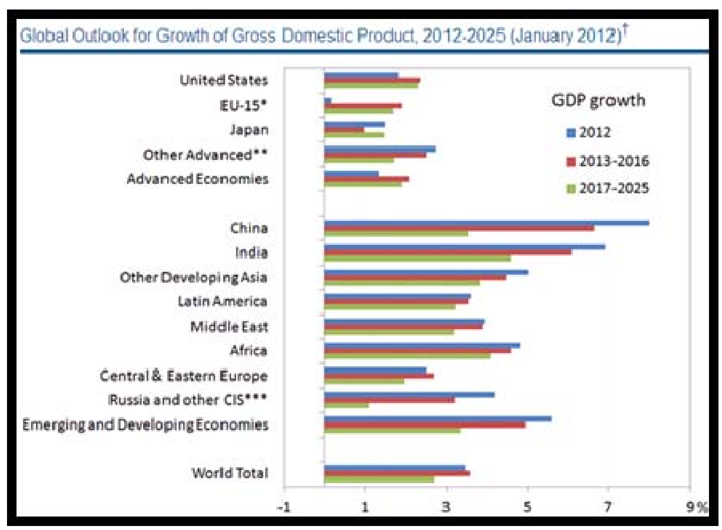
While oil prices are a concern, given their large impact on inflation and economic growth, most studies suggest that it is the degree and rapidity of change, rather than the absolute price level, that creates harm. Oil prices ended the 1st quarter at $103 per barrel, while in 2011, oil prices ranged from $79 to $114 per barrel. This suggests that neither the degree of price change nor the speed of change in prices is going to have much of an economic impact in the near term.

The World Economy

Global economic growth continues (albeit at a slower rate) thanks to several quarters of better than expected U.S. data and a milder than expected European recession. According to The Conference Board, global growth is likely to be in the range of 3% through the middle of the current decade, including a projected global GDP growth for 2012 at 3.5%, (as illustrated in the table below). While advanced economies are expected to slowly recover from their current difficulties, this positive will be more than offset by a gradual slowdown in emerging countries as they mature. The net result for global growth will probably be sluggishness.

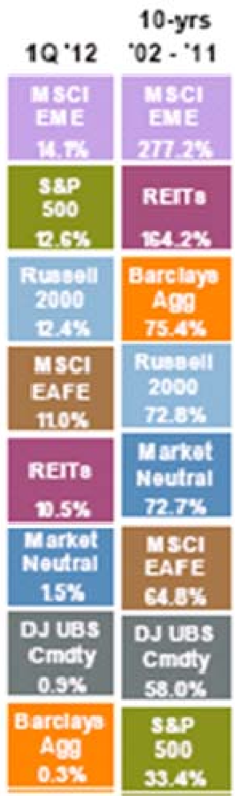
Europe is struggling now with its deficit spending and related bank and government debts as well as its unwieldy non-governmental European Union structure. Inevitably, problems will arise, and despite the difficulties and resistance, it is our guess they will be addressed, possibly moving the continent to a stronger union over time.

China has been the other major concern for the markets. Representing approximately 16% of the world economy, it makes a difference what happens there. Unlike their recent past growth of 9-10% annual growth, the Chinese economy is slowing, but it appears to still be coming in around 7-8%. That's certainly not a recession, but the lower demand will have a worldwide impact.



Source: The Conference Board

Investments – U.S. Stocks



JPMorgan Asset Mgt

The financial markets had their best 1st quarter in fourteen years. All equity sectors posted strong gains during the quarter. Large and Small Capitalization U.S. stocks rose on average in excess of 12%. Returns for large growth stocks were a bit under 15% and large value stocks were up 11%.

Stock prices ultimately reflect the relative earnings of companies and the expected growth of those earnings. Corporate earnings are today at all-time highs, so despite the general run-up of the last few months, U.S. stocks continue to appear attractively priced (i.e., there is reason to believe stock prices could rise). Using expected earnings for large companies, the S&P 500 is now priced at 13.0 times forecasted earnings (in other words, the share price is now 13 times the proportional earnings for that share), compared to its 15 year average of 17.2. Small stocks appear to be similarly attractively priced.

Given the above, the real question is whether corporate earnings can continue to grow. We believe it likely. The aggregate annual earnings of the S&P 500 companies are 12.4% higher today than they were a year ago and the economy seems to be getting stronger.

U.S. real estate stocks (REITs) continued to be strong contributors, rising 10.5% for the quarter. They are now up 164.2% over the last ten years.

Investments – International Stocks

All international countries posted strong market gains during the first quarter, enhanced for American investors by a weakening dollar. Everything else being equal, the weaker the dollar, the more attractive international stocks become for Americans.

The MSCI EAFE index, the most widely used international index, gained over 10% (in local currency) for the quarter and returned 11% to U.S. investors. Developed country returns were led by Germany and Japan, which posted gains of 18% and 19%, respectively (in local currency), translating to gains of 21% and 11% to U.S. investors.

Emerging markets as an asset class was the best performing sector during the 1st quarter; returns were almost 11% (in local currency) and over 14% to U.S. investors. As illustrated by the adjacent chart, they also led all major asset classes over the last ten years, with 277% returns. The best performing emerging countries this quarter were India and Russia with returns of 20% and over 18%, respectively, to U.S. investors.

Compared to the U.S., overseas markets appear to be roughly fairly priced today, although the key uncertainty remains future earnings for these companies as well. Using forecasted 2012 earnings, both developed and emerging country stock prices versus earnings are approximately equal to their respective historical trends.

Investments – Fixed Income

The overall bond market, as measured by the BarCap Aggregate Bond Index, remained virtually flat for the quarter (+0.3%) but rose almost 8% over the last 12 months, largely driven by declining interest rates.

As interest rates fall (see the below chart for a sense of their 30-year history), bond values rise. The reverse is also true. For many observers, U.S. interest rates have fallen as far as they are likely to, and with our increasing federal debt and continuing deficits, it is inevitable that they will rise. When this occurs, it will be a difficult environment for bond investors. In anticipation, Mosaic portfolios hold a significant portion of bonds which will adjust their principal value to inflation, others that are more exposed to non-U.S. economies than to the U.S., and we've generally ensured that a meaningful percentage of our bonds have short maturities. These are less impacted by interest rate movements.

Historical Yields on 10-year U.S Treasuries How they have fallen over 30 years	
3/31/12	2.2 %
3/31/02	5.4 %
3/31/92	7.5%
3/31/82	13.9%

Source: U.S. Treasury

Investments – Alternative Strategies

Our alternative investment selections are intended to help dampen the overall volatility of the portfolio while still contributing to portfolio returns. Each of our seven primary alternative strategies pursues a different path to generate returns, with each less linked to the economic factors that drive stocks and bonds. A number of our alternative holdings posted favorable returns in the first quarter.

- Timber, represented by the FTSE NAREIT Timber REIT, gained 12% during the 1st quarter. Timber was down 3% over the trailing 12 month period.
- Global real estate, represented by the FTSE EPRA/NAREIT Global REIT Index was again one of the best performing asset classes, with a gain of over 13% for the quarter and +2% for the prior year.
- Energy transportation and storage (The Alerian Master Limited Partnerships Infrastructure Index) rose almost 3% for the quarter, and was up 14% for the 12 month period.
- Commodities (Dow Jones Commodity Index) finished the quarter with a gain of 1% but fell 16% for the trailing 12 month period. Global commodity prices have declined due to China's slowdown. China is the biggest consumer in virtually all commodity categories in the world and is the key factor behind the global commodity demand.

Threats to the Markets

Our concerns these days include

- Possible contagion from the European periphery to the larger European economies remains the biggest threat to global economic recovery. The Euro zone remains uneven in terms of competitiveness, currency rigidity and the region suffers from a lack of a coordinated vision for its monetary and fiscal policies. While Greece has now defaulted on their debt, which helps clear that table, more problems remain with Spain, Portugal, Ireland and Italy. The European economy can only take so much. Even the German economy has slowed significantly, and there's a good chance it will get worse, all of which would have a negative impact on the U.S. economy.
- Likely political angst and indecision during our election season (especially as we approach another debt ceiling debate later this year) creates a milieu of negativity, which expands into consumer confidence and the broader economy,.
- The federal, state and local budgets are nearly all in some degree of difficulty (i.e., in deficit and facing difficult decisions). Fixing the problem is going to require great determination. Importantly, efforts to grow the economy are likely to be offset with other attempts to reduce debt levels. Taxes are scheduled to rise (e.g., Bush tax cuts and Medicare taxes) and federal spending is scheduled to fall (as a result of the sequestration, approved last year by Congress), but much more will be needed.
- The Fed has largely used its weapons, and is unlikely to do much more to ease interest rates. Ultimately, the Fed is going to need to start to pull money from the economy and this will have a slowing effect.
- The debt/deficit problems and the pull-back from the Fed makes it likely that interest rates will start rising in the next year or two.
- The possibility of rising oil prices worries some observers, although the research suggests it really is only a problem when large percentage increases happen quickly.
- A mild slowing in product demand from China would hurt the exports and production activities of most of the world's countries.

Conclusion

The 1st quarter posted strong gains across U.S. and international stock markets, resulting in the best 1st quarter for the stock market since 1998. Most financial asset prices improved substantially and liquidity conditions across markets have eased. Global economic growth found a footing of sorts compared to last year. In the U.S., the overall trend remains positive, and coupled with a continued improvement in consumer sentiment, suggests that economic growth may continue in 2012 (although the troubling state of the Euro zone will likely prevent the US from achieving more typical levels of post-recession economic growth).

We thank you for allowing us to continue to assist you to improve your ability to reach your long term financial goals. We welcome your questions and comments.

Sources: Morningstar, JP Morgan, Financial Post, Bureau of Labor Statistics, Morningstar Direct, The Federal Reserve, Reuters, Forbes, Bloomberg, Standard & Poors, The Economist, Credit Suisse, Charles Schwab