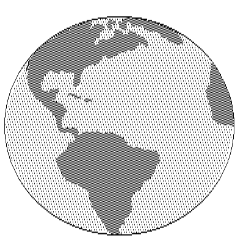
MOSAIC FINANCIAL PARTNERS, INC.
a Wealth Advisory firm

Market Watch 1st Quarter 2013

Summary

- U.S. stocks enjoyed an especially strong quarter to start 2013. Large company stocks were up 10.6% and small stocks were up 12.4%.
- Non-U.S. stocks also had a good quarter, although not to the same extent as U.S. stocks. Large foreign stocks rose by 5.2% while small foreign stocks rose more than 8%. The Japanese stock market rose 11.7% during the quarter.
- Emerging market stocks were the only major equity asset class experiencing a decline during the quarter—falling almost 1.6%.
- Global real estate enjoyed another positive quarter rising 5.9%. The category is up 21.1% over the last twelve months.
- Among our other alternative categories, timber was "on fire" with quarterly returns of 15.5%. Master Limited Partnerships (MLPs) rose even more with a 20.1% quarterly gain. In contrast, commodities were slightly negative. The other alternative holdings generated modestly positive gains during the quarter..
- Bond returns were mixed with most bond categories generating modest returns. Long bond returns were negative for the quarter.



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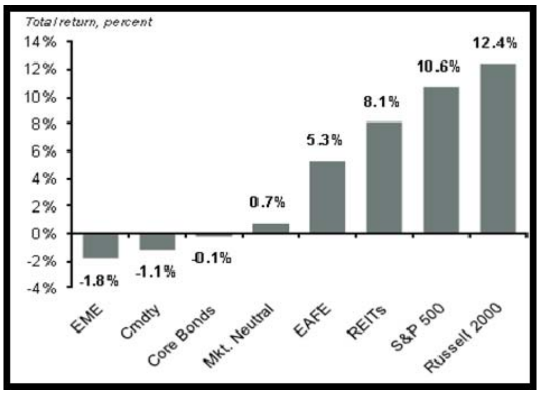
A Strong Quarter for Financial Markets

Following a strong 2012, the U.S. equity market again enjoyed stellar returns during the 1st quarter of 2013. The S&P 500, which tracks the largest U.S. companies, finished up 10.6% for the 1st quarter and has risen almost 14.0% over the 12 month period, ending March 31st. Since the market's low point in March, 2009, the S&P 500 has now increased nearly 153% and is 13.2% above its October 2007 peak. Small U.S. stocks have done even better and are now 21.6% above their prior high and 193.0% above their 2009 lows.



The MSCI EAFE Index (the most widely used index to track non-U.S. stocks in developed countries) gained 5.2% over the first quarter and 11.8% over the preceding twelve months. In contrast, concerns about slower growth and rising inflation in the emerging markets resulted in weak performance from emerging market equities (declining 1.6% for the quarter but gaining 2.3% over the last 12 months).

Fixed income was virtually flat for the quarter in most sectors. With record low yields of 1.9% for the 10 year bond, yields are now just half of where they were just two years ago. Although bond investors typically seek safety, the low interest rate environment has led many bond investors toward higher risk, higher yield fixed income. This worked in the 1st quarter as the high yield bond sector rose 2.9% and is up 13.1% over the last year.

Despite fiscal headwinds in the U.S., slower growth in emerging markets and a continued recession in Europe, risk assets provided positive returns in the 1st quarter of 2013. Master Limited Partnerships set the pace with a quarterly gain of 20.1%. Timber was also particularly strong, rising 15.5% during the quarter. U.S. equity—both large and small cap—also enjoyed significant quarterly returns. In perhaps another case of being late to the party, retail investors added substantially to their equity holdings this quarter (after pulling money from the category for several years). According to Lipper, "In January Equity Funds Experienced Their Best Monthly Net Inflows in at Least Six Years."

U.S. Economy

The US economy continues to garner strength from the improvement in the housing market. Housing contributes in numerous ways to the US economy; impacting jobs, wealth, confidence, mobility, financial stability, and overall economic growth. We think the positive trend in housing will continue as lending standards become a bit more liberal, economic conditions help buyers re-enter the market and the balance between supply and demand continues to move toward a more

normal state. New home starts are up, building permits are rising, and existing home sales have been expanding faster than in three years. As importantly, home prices are generally higher (The S&P/Case-Shiller 20 city home price index was up over 8% from a year earlier).

The economy is strengthened when employment is strong. Although unemployment has fallen over the last few years (the March unemployment rate came in at 7.6%), fewer people are in the labor force today (as workers retire, go to school, go on welfare, unemployment, disability or just drop out). The change in labor force participation offsets much of the benefit that the declining unemployment picture would otherwise suggest. The January tax legislation—with its spending cuts and tax increases is also a key unknown likely to impact both jobs and the broader economy.

Recent activity on the manufacturing front has been mixed. The ISM Manufacturing Index is still in expansionary territory with 14 of the 18 manufacturing industry sectors reporting growth in March.

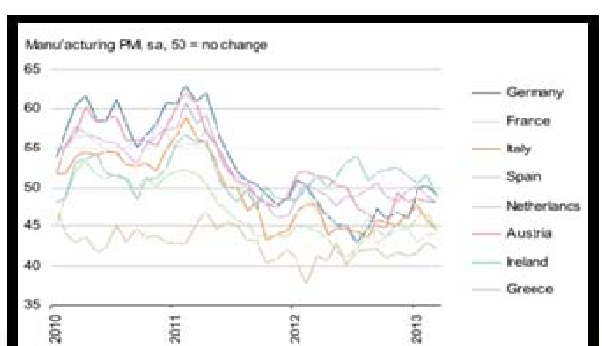
The Index of Leading Economic Indicators, a composite index of ten economic indicators designed to predict economic activity six to nine months in future, posted a rise of 0.5% in February (the latest available data). Improvements in unemployment, housing and manufacturing seem to bode well for the near future.

As measured by GDP, the U.S. economy grew at a 0.4% annual rate in the 4th quarter of 2012. This is significantly below the 2.2% rate for 2012 and the 2.5% growth rate over the last twenty-years. 4th quarter GDP was significantly affected by the largest decline in government defense spending since the 1970's (down 22% from the prior year).

As can be noted at the chart at left, corporate profits remain at record levels. This has been fueled by productivity gains, limited U.S. wage growth and increased globalization. Earnings for the S&P 500 continue at record levels ($23.16 for the quarter). After-tax corporate profits now represent 9.9% of GDP (well above the 6.2% 50 year average). Corporate cash is also at record levels. This suggest business has the financial capacity for investment and could positively offset potential economic slowing that might result from reductions in government spending. This will continue to be bolstered by Federal Reserve actions to continue to stimulate the economy.

World Economy

The Eurozone debt crisis has been a key concern for markets for more than three years. Missteps by policymakers have impacted all sectors of the region's economy. This quarter the focus was mostly on banking problems on Cyprus. Manufacturing and services have both been contracting in the Eurozone and sentiment continues to be weak. As the chart below illustrates, manufacturing activity has been down in virtually all



major European countries and recent measurements continue to be negative as well.

Different countries are experiencing these problems in their own unique ways. While consumer confidence has generally improved in Europe recently, confidence in Italy hit the lowest level on record (perhaps reflecting their inability to pick a political leader). While UK sales were picking up, Germany's business climate indicator dropped after four months of increases.

In China, the good news was that the March HSBC manufacturing index moved into expansion territory after contracting for the last 11 months. However, most economists remain concerned that the current economic rebound remains fragile and could falter if China moves to a tightened monetary policy (given China's increasing reliance on debt to finance their growth). China's retail sales growth has been weak and many new infrastructure projects, which helped with recovery efforts, have stalled. Meanwhile, with Chinese home prices rising, new regulations have been imposed that are likely to constrain property market growth. China is still growing at a fast rate, but they face an increased number of complex problems.

Investments – U.S. Equities

Stocks enjoyed stellar gains during the 1st quarter. All equity sectors experienced solid gains despite a backdrop of slower global economic growth and concerns about the impact of sequestration. As reported above, the S&P 500 enjoyed strong returns for the quarter and over the last year. The index is now 13.2% above its previous high point. Small U.S. stocks did even better—rising 12.4% in the quarter. The small cap Russell 2000 index is now 21.6% above its prior all-time high. All S&P 500 sectors had positive returns for the quarter. Healthcare led all sectors with a gain of 15.8% while technology lagged with a gain of 4.6%. Since the March 2009 market low, consumer discretionary and financials have gained 256.9% and 212.8%, respectively. Financials, which took the biggest hit in the last recession, are still 42.7% below their October 2007 market peak. Large value stocks outperformed growth stocks, during the 1st quarter, while the opposite result occurred for small cap stocks. The S&P 500 has now averaged 8.5% per year over the last ten years and 9.8% over the last 50 years.

After that kind of rise in stock prices, is now a good time to be buying/holding stocks?

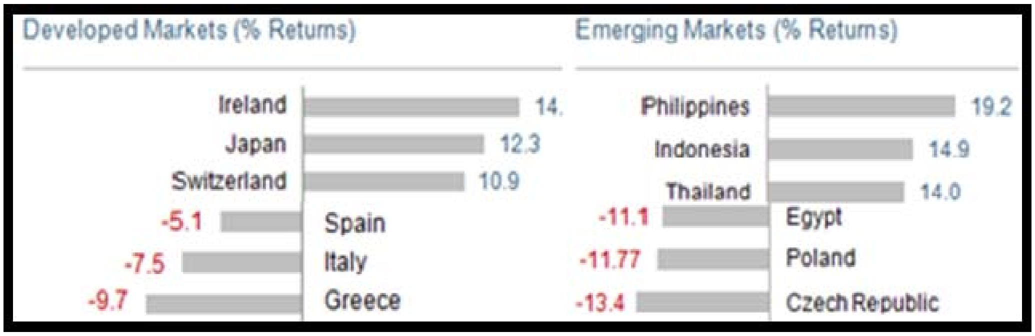
For stocks, valuation (what is a stock worth today, given all the information available about the company's likely future?) is a critical question. From a stock valuation perspective, using forward P/E (current stock price divided by estimated future earnings over the next twelve months), the S&P 500 is now priced at 13.8 times forecasted earnings. This is lower than the S&P's 15-year forward P/E average of 16.2 and suggests more room for further stock market growth. To justify higher prices, earnings will need to grow. Given all the corporate efforts of the last few years to cut costs and improve efficiency, the most likely driver for growing earnings will need to come from growth in sales, which in turn will rely heavily on the degree to which consumers increase their spending.

The second critical question for stocks is how do they compare to bonds? The current dividend yield for the S&P 500 stands at 2.0%, slightly higher than the 1.9% yield on the 10-Year Treasury bond. This relationship has generally been a boon for the stock market—contributing to higher stock prices.

Investments – International Equities

International markets posted mixed results, with most developed economies posting solid gains while developing economies, in general, lost ground.

The MSCI EAFE index, the most widely used international index, gained 9.8% for local investors and 5.2% for U.S. investors (given the dollar's strength relative to other currencies). Ireland and Japan had strong gains with both rebounding from fairly weak returns in 2012. German markets were virtually flat for the quar-



ter. The MSCI EAFE index has risen 11.8% over the last 12 months and has now gained 110.3% from its 2009 lows. In contrast to the U.S., it is still 14.8% below its 2007 peak.

Emerging Markets (the MSCI index) declined 1.6% for U.S. investors during the 1st quarter. These results reflected concerns about the impact of slower global economic growth and rising inflation. The major countries in the emerging group, China, Russia, India and Brazil (also known as BRIC economies), suffered negative returns while the Philippines, Indonesia and Thailand showed robust double digit returns. The index is up 2.3% over the last 12 months and has gained 135.9% from its 2009 lows (the index remains 14.8% off its 2007 peak). The chart above illustrates the market performance for the countries that led and lagged in the international markets during the quarter.

Using forecasted 2013 earnings, the MSCI EAFE Index has a forward P/E ratio of 12.8 times forecasted earnings, slightly above its 10-year average P/E of 12.3. It will be difficult to achieve meaningful growth in stock prices until corporate earnings start to grow. The current dividend yield for the EAFE Index is 3.3% while the Emerging Markets Index yield is at 2.7%. These are both well above the 1.9% yield on the 10-on year U.S. Treasury bond.

A Word about Fundamental Index Funds

As a client of Mosaic, you almost certainly hold in your portfolio one or more Fundamental Index Funds. To remind you, most index funds choose funds solely on the basis of the "market capitalization" of the stocks included in the index (for example, the largest 1,000 companies, etc.). Market capitalization simply multiplies the current stock price times the number of company shares outstanding. This simple approach has long been used as a measure of the market (and over the last 40 years, as a means of investing in the market).

The Fundamental Index methodology is a more sophisticated way to rank stocks using what analysts have used for years in choosing their favorite stocks—sales, dividends (ignored when companies don't pay a divided), and cash flow. We believe this is generally a better way to determine which stocks fit best in a particular category, rather than relying so heavily just on the often volatile price of a stock. Over time, the fundamental methodology has tended to generate higher returns than the market capitalization approach (on average by about 1.5% per year). This outperformance is not guaranteed and in any given time period, may disappear. Over the last year, fundamental index funds have outperformed most market price peers in the U.S. but have slightly underperformed overseas. This type of performance variation can and should be expected. It is not a cause for concern.

Investments –Fixed Income

In the fixed income world, investors were rewarded for taking on the extra risk associated with High Yield, Emerging Market and Convertible bonds. High yield was the best performing sector with 1st quarter gains of 2.9% and 13.1% for the last year. In contrast, the broader U.S. bond market (BarCap Aggregate Bond Index) stayed virtually flat for the quarter, and rose a modest 3.8% for the year. Most short to intermediate bond categories along with Treasury Inflated Protection Securities (TIPS) were also flat for the quarter. Long term bonds lost 2.0% in the quarter although gaining 8.9% for 2012.

The yield on the Ten-Year Treasury ended the quarter at 1.9%. With inflation standing at 1.8%, the real yield on the Treasury is just 0.1%. In contrast, the yield on High Yield corporate bonds stood at 5.7% while Emerging Market bonds had yields of 4.3%.

Bond yields in Europe varied by country and the perceived risk seen by investors. As the adjacent chart illustrates. Government debt has stabilized recently as structural reforms have been put in place, the European

Ten-Year Bond Yields	3/31/13
Greece	10.90%
Portugal	6.26%
Spain	5.06%
Italy	4.68%
Ireland	4.40%
Germany	1.28%

Central Bank has increased purchases of sovereign debt and the Cyprus banking crisis addressed. The Cyprus deal appears likely to restrict its financial industry and will almost certainly hurt the country's status as an off-shore tax haven. Still, it saved the country from financial collapse and allowed the Eurozone to maintain its equilibrium for at least another few months.

U.S. Bonds are currently yielding near all-time lows (1.9%--compared to 6.1% twenty years ago). These low yields are largely the result of the Federal Reserve's efforts to stimulate the economy with lower borrowing costs. These low rates have likely provided a real boost to the housing recovery. They've also created greater demand for other non-fixed income investments (read equities) that can offer investors a better return on invested capital. These low rates have also helped the government manage the increasing interest costs of the of the debt it continues to accumulate. These outcomes have come with a not insignificant cost—savers have gone for years now earning virtually nothing on their savings. This has undoubtedly contributed to reduced consumer spending throughout the economy.

Investments – Alternatives

Most of our alternative holdings posted favorable returns this quarter. Each alternative strategy pursues a different path to generate returns and thus has less relationship to the returns of stocks and bonds. This helps create a more diversified portfolio. The returns for 1st quarter alternative categories (i.e., might differ from the experience of the actual funds) include:

- The Alerian Master Limited Partnerships Infrastructure Index (energy transportation and storage) had the largest quarterly gain of our alternative strategies with an increase of 20.1% for the 1st quarter and 21.7% for the preceding 12 months.
- With an improving housing market, lumber was in demand. Timber, represented by the FTSE NAREIT Timber REIT, posted strong gains with an increase of 15.5% for the 1st quarter and 41.3% for the preceding 12 months.
- Global real estate, represented by the FTSE EPRA/ NAREIT Global REIT Index, had a gain of 5.9 % during the quarter and is up 21.1% over the trailing 12 month period.

Not all of the alternative strategies had positive returns for the quarter.

- Commodities (broadly: energy, precious metals, agriculture and livestock) have continued to experience difficulty given reduced worldwide demand and modest inflation. The Dow Jones UBS Commodity Index declined 1.1% for the period and is down 3.0% over the preceding 12 months.
- Emerging market bonds declined 3.3% in dollar terms in the first quarter. For the last 12 months, the JP Morgan Emerging Markets Bond Index is up 9.7%

Summary

Risks and opportunities continue to be present as we look ahead. One of the characteristics of a more mature bull market (like the one we're currently experiencing) is that asset prices often become more susceptible to negative news. Although we're in a better position than most other countries around the world, the U.S is likely to continue to face headwinds from its slow economic growth and continuing high unemployment. This may be offset, in part, by recovery in the housing market and record corporate profits. For the past five years, stocks have been fundamentally cheap, providing a cushion against market noise and periodic setbacks. We may be transitioning to a period in which market volatility, in response to economic news, increases. Investors should be prepared for this possibility.

Although market results can never be assured, we believe that our globally diversified portfolios are well positioned for the future. Bonds and alternative strategies should help to dampen volatility while stocks are likely to provide that all-important growth. It is our hope and expectation that we can continue to help you progress toward your long term financial goals. Thank you for your continued confidence.

Your team at Mosaic Financial Partners, Inc.

Sources:

Chart 1: JPMorgan Asset Management

Chart 2: Standard & Poors

Chart 3: Markit

Chart 4: JPMorgan Asset Management

Chart 5: Russell Investment Group

Chart 6: Tullet Prebon, Facset, JP Morgan Asset Management