Investment Update

January 2012

M I D D L E T O N & C O M P A N Y, I N C.

2011 Fourth Quarter Update and 2012 Outlook

Review:

Stocks ended a volatile year strongly, rallying 11.9% in the quarter, virtually erasing the sharp decline of the third quarter. For the year, the S&P 500 finished up a modest 2.2%. Bonds were up 1.1% in the quarter and 7.8% for the year as investors sought safety.

Quarters	***4Q11***	***3Q11***	***2Q11***	***1Q11***	***4Q10***
S&P 500	***11.9%***	***-13.9%***	***0.1%***	***5.9%***	***10.8%***
Barclays U.S. Aggregate Bond	***1.1%***	***3.8%***	***2.3%***	***0.4%***	***-1.3%***

Domestic Economy:

Our economy continues to be resilient. Fourth quarter retail sales were surprisingly strong, up more than 5% over last year. Auto sales ended the year up a robust 10%. For nine of the past ten weeks unemployment claims have been below 400,000, indicating an improving labor market. The Bureau of Labor Statistics reported that 412,000 new jobs were created in the quarter, exceeding expectations. The December unemployment rate fell to 8.5%, the lowest rate since February of 2009. Housing starts have improved steadily from the recent low of 518,000 units in February to 685,000 in November.

The ISM indices for both service and manufacturing businesses are signaling improvement in the business outlook. In 2011, corporate profits, as measured by S&P 500 earnings, exceeded the pre-recession peak year of 2006 by 9%. Despite concerns about slower growth in Asia and the Eurozone financial crisis, exports have remained fairly strong.

International Economies:

The international economic picture is more complex. Europe will probably be in recession for the first half of 2012 due to the sovereign debt crisis. Japan should see modest growth as it recovers from last year's earthquake. Exports from emerging economies have been affected by the slowdown in the Eurozone. However, central banks in the emerging world are cutting rates to boost their economies. As a result, we expect emerging economies' GDP to grow at a healthy 5-6% rate, although lower than the 7-8% of last year. More of the growth will come from internal sources, such as increasing minimum wages, leading to more consumer spending.

Financial Markets:

The U.S. stock market is appealing for several reasons:

- Our economic recovery is showing staying power, having weathered the crises of the past year.
- Valuations are attractive based on modest growth assumptions. The S&P 500 is trading at less than 13x our conservative 2012 earnings estimate.
- Corporations are in excellent financial condition. One result is that dividends have been rising. The prospect is for additional increases in 2012, making stocks competitive with bonds as income producing vehicles.
- The U.S. is appealing to International investors as a haven from the risks of Europe and the volatility of emerging markets.

Risks:

Despite our positive outlook, there are significant risks.

- The U.S. faces a potentially large drag on the economy as Congress wrestles with cutting deficits while not damaging the recovery.
- Although the Europeans have made significant progress in addressing the sovereign debt crisis, much more must be done. The necessary measures will not be politically popular, and could be difficult to implement, rattling the markets.
- Emerging markets, notably China, have to overcome several challenges to maintain growth. Exports, a main engine of growth will be hurt by slower growth in the developed economies. Higher levels of domestic consumption will have to be encouraged to bolster growth. At the same time, inflationary pressures caused by rapid urbanization will need to be contained. These are not easy tasks.

Strategy:

Since our last Update, the economic data have been favorable, reinforcing our conviction that the U.S. economy is on a slow but sure road to recovery. Our portfolios are constructed accordingly, emphasizing attractively valued companies that have the strength to grow in a modest recovery.

Bond yields are at historic lows. Because we believe fixed income yields will rise gradually over the next year as the economy improves, we do not find bonds to be attractive. Therefore, bond weightings should be at the low end of the appropriate range.

The U.S. has the best-positioned developed economy and should be well represented in portfolios. Emerging economies where central banks are easing to re-invigorate growth are our preferred international investment.