

Baldwin Investment Management, LLC

PREDICTIONS FOR 2011

- 1) World growth will pick up steam from 2010 as the developed world joins the developing world in growth
- 2) Inflation in some important emerging economies (read Brazil, China & India) will trend higher
- 3) Commodity prices will rise
- 4) The Chinese renminbi will appreciate
- 5) Corporate merger & acquisition activity will be strong
- 6) U.S. treasury & municipal bond prices will be soft
- 7) U.S. unemployment will decline
- 8) The dollar will be weak vs. emerging economy currencies
- 9) The U.S. stock market will have another good year
- 10) Foreign equity markets will appreciate

COMMENTS

- Yes – The world did grow in 2011 – but not evenly & not without worry. Emerging economies grew strongly, U.S., Eurozone & Japan sluggishly.
- Yes – Inflation was a worry. However, steps taken by central banks to slow economies would seem to leave some scope for loosening monetary policies in 2012.
- Yes, then No – Commodity prices were strong in early 2011. Then fears of Eurozone “meltdown” & spread of “contagion” depressed prices through year-end.
- Yes – Still not fast enough for some, but the renminbi did appreciate.
- Yes & No – Again early year strength, followed by last half weakness due to European economic fears.
- Yes & No – Depending on time of year. Prices soft if investors unafraid (“risk on” trade); Prices up if investors afraid.
- Yes
- No – Fear ruled the marketplace & investors fled to “the familiar”.
- No – The U.S. market was better than just about every other market in the world simply by being flat.
- No – See number 8 above.

SOME ISSUES ON OUR MIND.....AND PERHAPS ON YOURS

They are all “the talk”. They are at the “top of everyone’s mind”. They are the concerns which have captured the most press and according to writers have been singularly influential in shaping investor outlook for the past year and will be consequential at least for the start of 2012.

I. The Eurozone, China and World Economic Growth for 2012

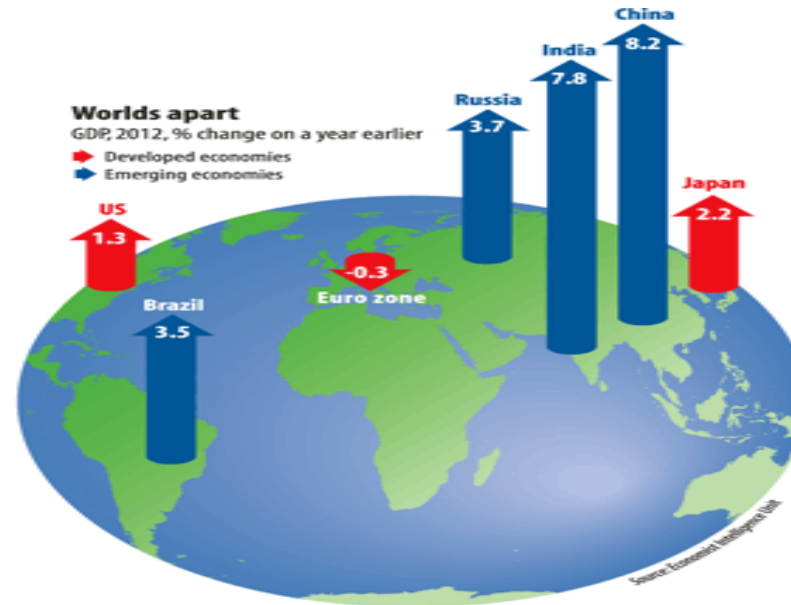


Chart 1

COMMENT: Obviously, there is a stark difference in anticipated GDP growth rates between the Developed and the Emerging economies of the world, continuing a pattern which has existed for several years and a trend which looks to continue for several more years. Europe will struggle, perhaps suffering a mild recession. We do not believe that it is inevitable that Europe’s problems will spill over onto the rest of the world. Especially, since the world has been discussing Europe’s “problems” for the better part of two years and has had that time to prepare for and ward off the “European contagion”. Japan should do better in 2012 simply because the odds of another catastrophic earthquake and tsunami are slim. The U.S. is ending 2011 with renewed economic vigor – unemployment down, the housing industry looking better, leading economic indicators up and corporate America strong. U.S. growth in 2012 will not be robust, but it should not be recessionary, i.e. no “Double Dip”. The Emerging economies should power ahead as they have done. While growth rates may look a little low as compared to past rates, economies were intentionally slowed via tighter monetary policies in order to dampen inflationary pressures which had built up in Brazil, China and India. Those pressures have been relieved and

several pundits think that monetary and fiscal policies in these countries will now be tilted towards growth. So there could be positive surprises in the Emerging economies in 2012.

II. U.S. Government Dysfunction

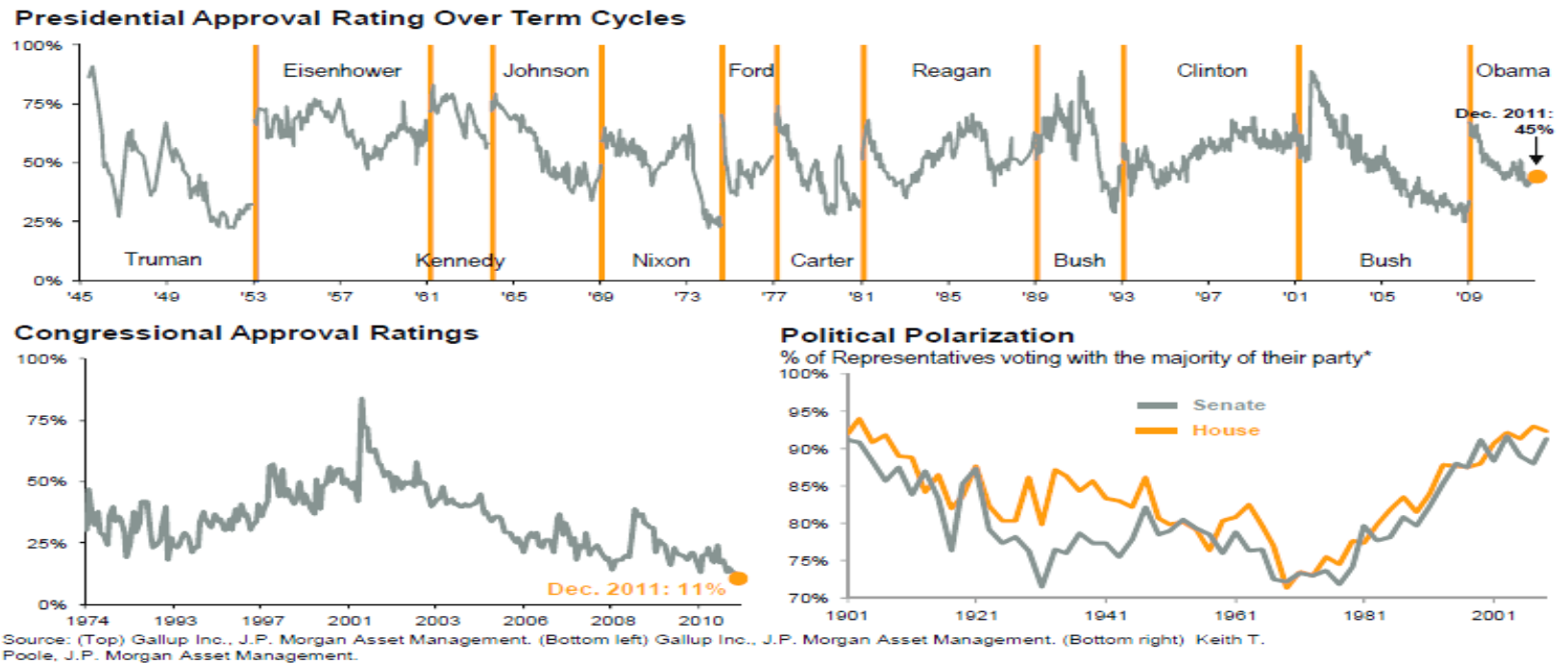


Chart 2

COMMENT: The bottom left chart speaks volumes about the very low level of esteem held by the American public with regard to our Congress. The bottom right chart demonstrates how often members of Congress simply vote along party lines. Now, as can be seen, voting along party lines is not unusual – but it is at levels not seen since 1901. In other words, “reaching across the aisle” and compromise are not part of our political language right now. So stasis has set in and little of “the people’s business” is getting accomplished. A Presidential election is coming with all of the House and one third of the Senate up for election. So a lot of “electioneering” will be going on over the next few months. Incumbents will try to make things look good and challengers will try to make things seem bad. We are not hopeful that the political polarization through which we have had to suffer will improve much until November. After the election, we think the House will still be controlled by the Republican Party and that the Senate will also be with the Republicans. If Mitt Romney is the GOP choice for President, we think, as we see the landscape right now, he will beat Mr. Obama. If this is the result, the U.S. could look forward to more political unity and less dysfunction, which should be helpful to markets.

III. Housing – Getting Better?



Chart 3

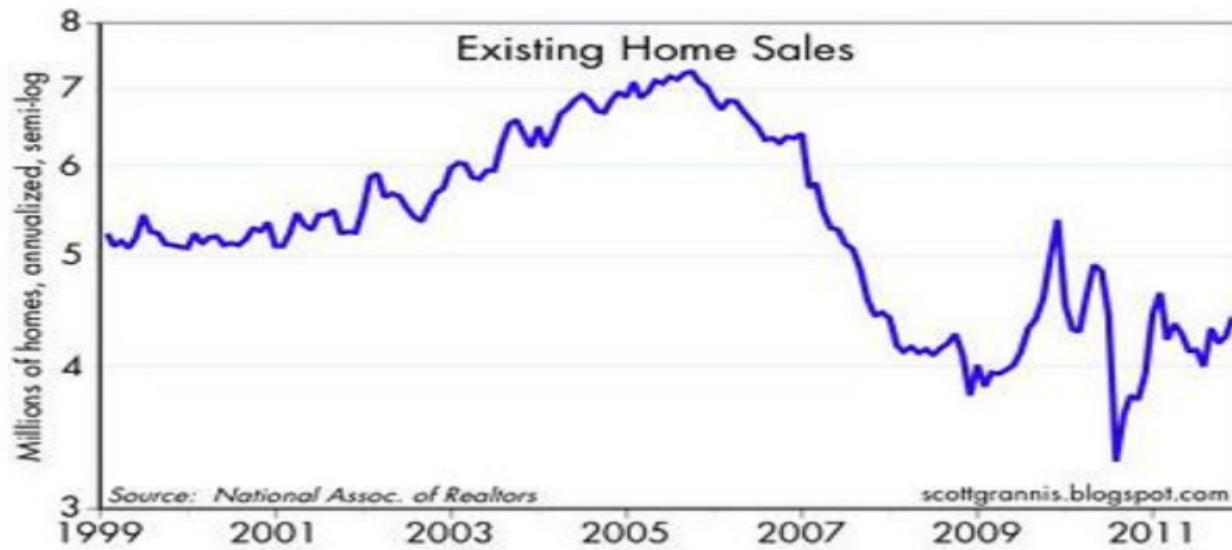


Chart 4



Chart 5

COMMENT: As we all know too well, it was the housing “bubble” that brought the world to its knees. So bad it was and has been that there are just now some signs of a sturdy bottom being put into markets. Housing starts look like they are trending up after a severe fall from 2007 through 2010 – albeit from a very low level. Existing home sales may have found their low point in late 2010. Finally, the supply of unsold homes is down considerably. There is still a considerable “shadow inventory” of unsold homes having to do with mortgage delinquencies, likely to be foreclosed and put up for sale. But even this “shadow inventory” is a lot less than it used to be. We do not believe that housing will spur U.S. economic growth in 2012 – but we think that it will not detract from growth in 2012, certainly a positive.

IV. Unemployment



Chart 6

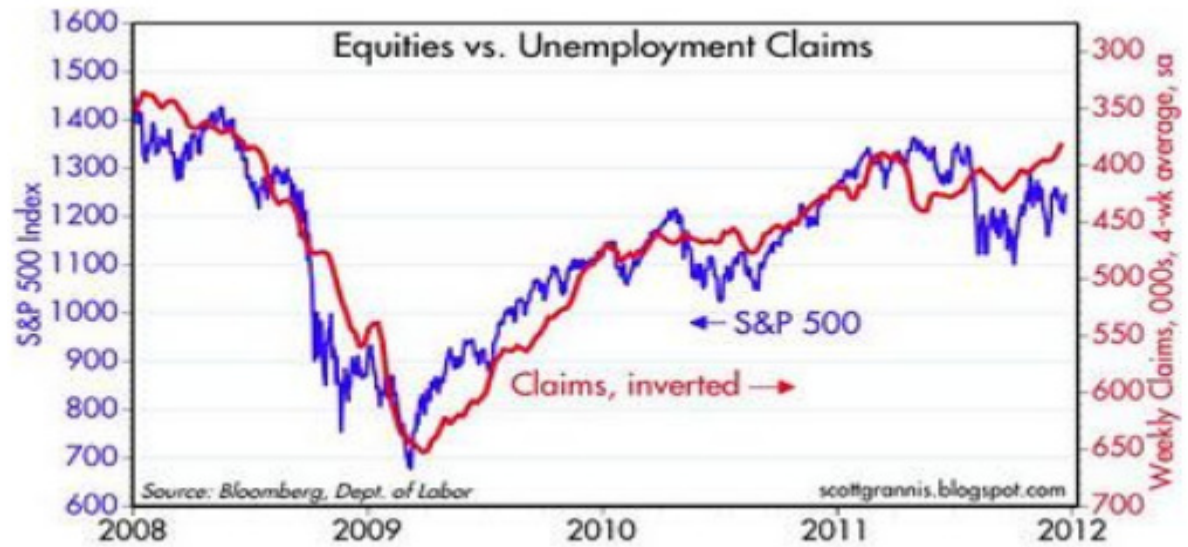


Chart 7

COMMENT: JOBS has been a WORRY and a rallying cry. Unemployment reached 9.2% in 2011. As seen in Chart #6, weekly unemployment claims have decreased sharply and have done so since late 2009. Millions of new jobs have been created in the private sector, as the American economy has recovered. Further, these commercial jobs have been created at the same time that many federal, state and local governments have been letting people go. The U.S. is still not where it wants to be with an unemployment rate of 8.6% - but it is getting better and with higher employment, people spend more and this will help the economy gather momentum (see Chart 7 with regard to the relationship between lower unemployment claims and higher equity prices).

V. Corporate Health

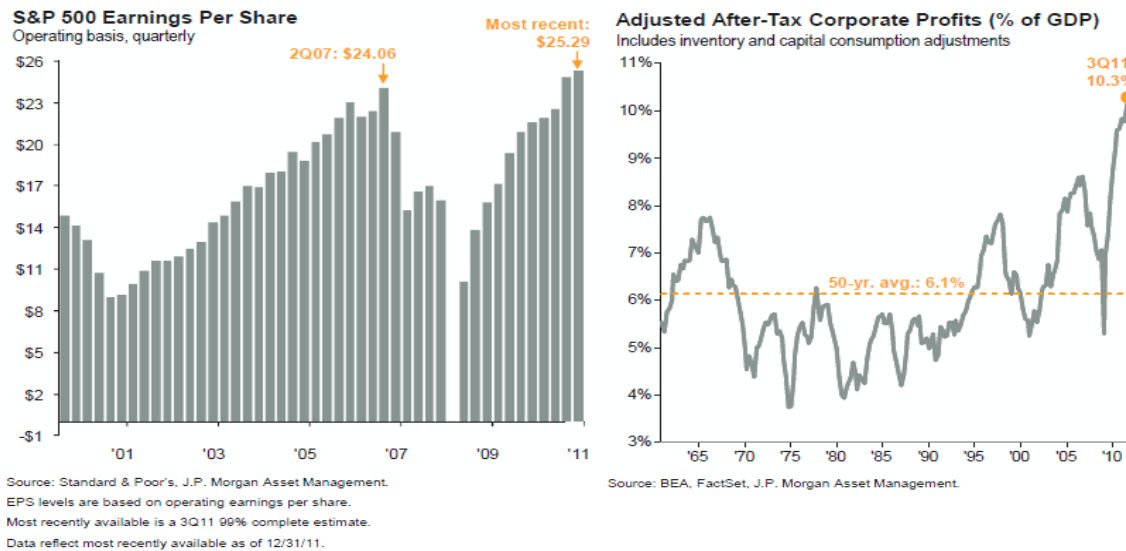


Chart 8

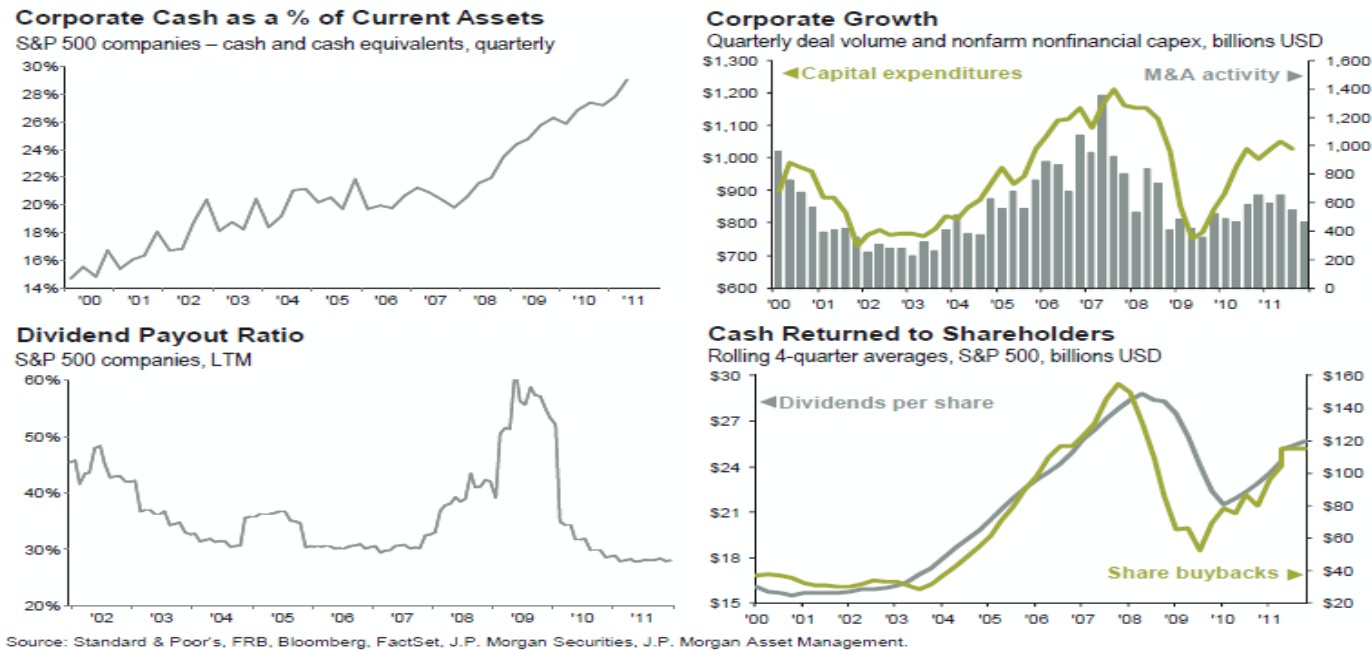


Chart 9

COMMENT: During 2011, the majority of companies around the world exceeded analyst performance expectations. Quarter after quarter managements steered their corporations around the political/economic shoals to beat anticipated cash flow levels and earnings (see Chart #8). More money has been spent on capital expenditures and on acquisitions (see Chart #9, top right panel). Balance sheets have been strengthened with cash (see Chart #9, top left panel). More cash is being returned to shareholders via increased dividends and share buybacks (see Chart #9, lower right panel), while keeping a low dividend payout ratio (see Chart #9, lower left panel) which provides the flexibility to increase dividends in the future. So, despite all the world's worries, and there have been many if you want to listen to the media, managements have managed around the problems and delivered surprisingly good returns. This is what they are supposed to do. This is why they get paid "the big bucks". This is what smart investors seek. Succinctly, corporations are being well managed, while most governments are being poorly managed. We think this will continue to be the case. Query? When will investors sell poorly performing government paper and buy high performing corporate paper? Isn't IBM or ExxonMobil really less risky than U.S. Treasuries? IBM and Exxon certainly have better balance sheets than the U.S. government.

VI. Inflation and Returns

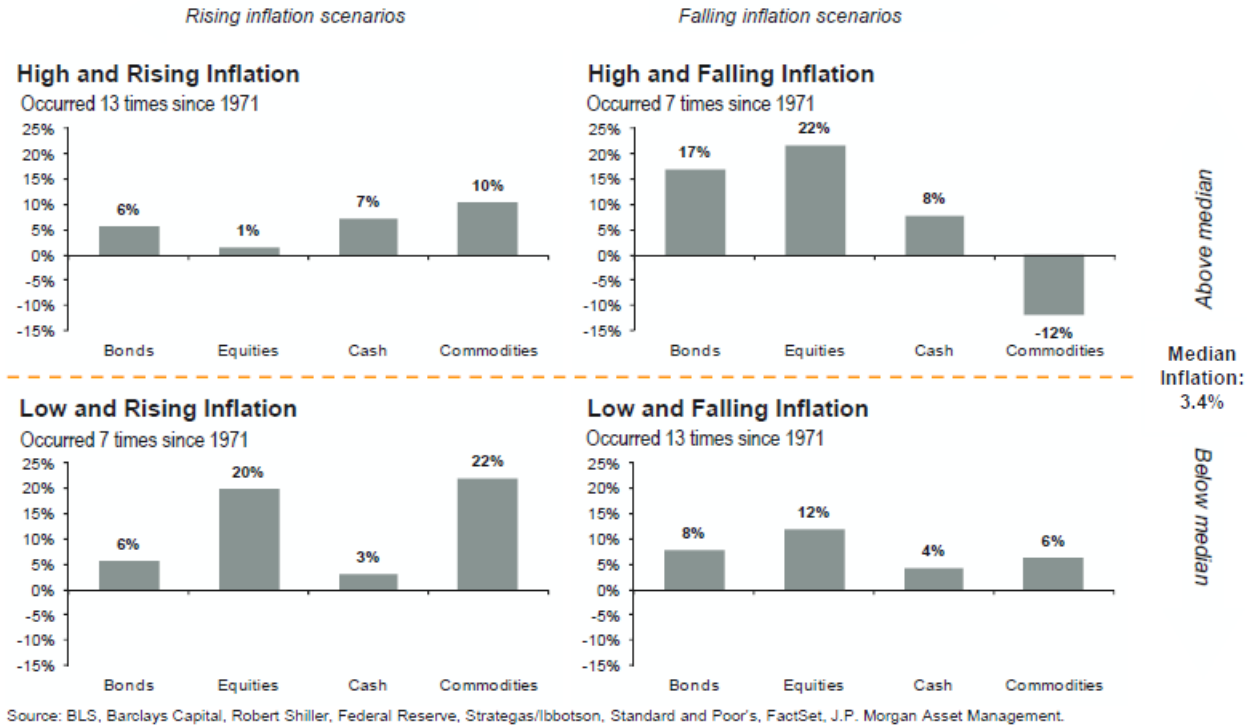


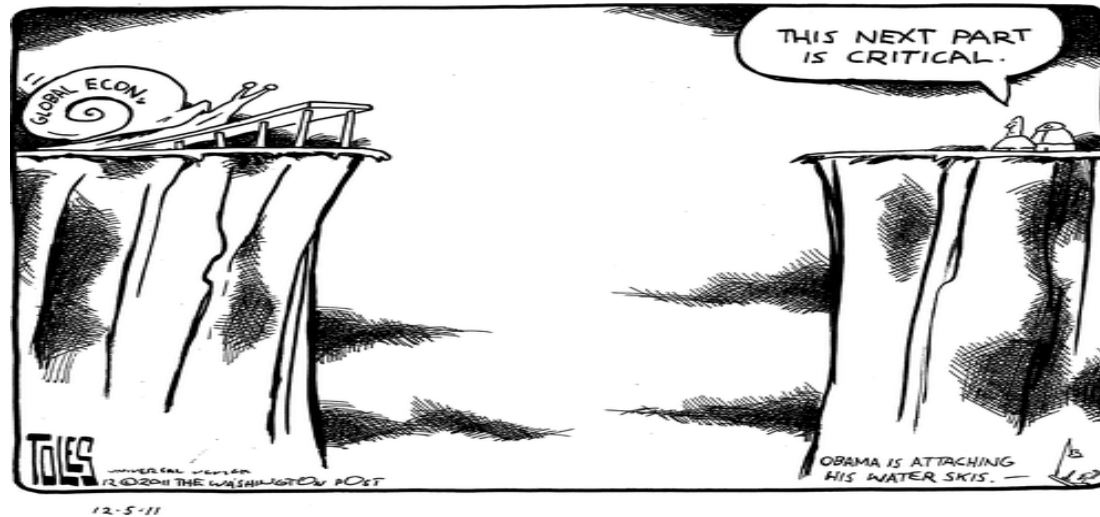
Chart 10

COMMENT: Since 1971 we have lived with inflation as a worry and a constraint on economic performance not only in the U.S. but around the world. Central banks have as one of their missions (if not their *raison d'être*) the control of inflation. So as we live with this pervasive power in its couple of different forms, we thought the above chart took an interesting look at diverse inflation environments and the effect on a number of asset classes. Please note that in only an environment of high and rising inflation did equities turn in the worst performance. In every other scenario (i.e. 75% of the projected events), equities were the top performing asset or a close second. Today the U.S. inflation is low. Over time, it will rise (our bet) and stocks will certainly do well and outperform bonds or it will fall and stocks should do well, again outperforming bonds. Again, we think that the U.S. Treasury market is in a “BUBBLE”.

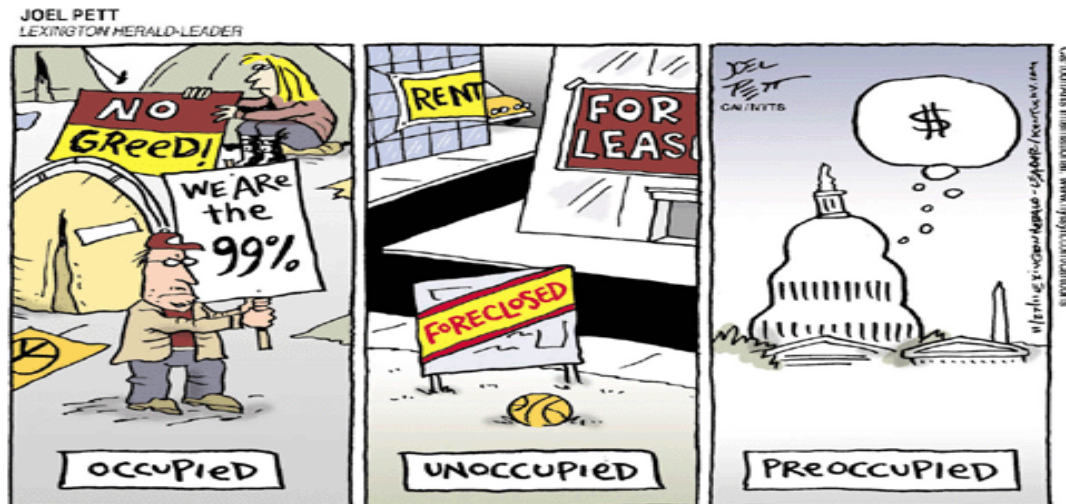
PREDICTIONS FOR 2012

- 1) U.S. housing will no longer be a “drag” on U.S. economic performance
- 2) U.S. employment will improve – but not much
- 3) U.S. business spending will rise in 2012
- 4) Municipal bond credit risk will improve
- 5) Asian consumer spending will increase
- 6) President Obama will be a one term President and the Republicans will gain control of the Senate while keeping control of the House.
- 7) Corporations around the world will continue to raise dividends and buyback stocks
- 8) There will not be a “hard landing” in China
- 9) Emerging country currencies will have a better year than in 2011
- 10) Equity markets around the globe (except the Eurozone) will go up

A FINAL THOUGHT



A FINAL, FINAL THOUGHT





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The reported numbers enclosed are derived from sources believed to be reliable. However, we cannot guarantee their accuracy. Past performance does not guarantee future results.

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A list of our Proxy voting procedures is available upon request.

A current copy of our ADV Part II & Privacy Policy is available upon request or at www.baldwinim.com/disclosure.htm

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