MARKETFIELD
ASSET MANAGEMENT

MARKETFIELD FUND DECEMBER 31, 2011

FUND OVERVIEW

OBJECTIVE

The investment objective of the Fund is capital appreciation. We endeavor to accomplish this by seeking low-volatility absolute return in excess of broad equity indexes.

STRATEGY & PROCESS

The Fund attempts to provide returns on capital substantially in excess of the risk-free rate rather than matching any particular index or external benchmark. The Fund has a broad investment charter that allows it to utilize equity securities, fixed-income instruments, commodities, futures and options. Additionally, with respect to 50% of the Fund's net assets, the Fund may engage in short sales of index-related and other equity securities to reduce its equity exposure or to profit from an anticipated decline in the price of the security sold short.

FUND FACTS

FUND STATISTICS

Ticker Symbol..MFLDX
CUSIP.. 89833W865
Minimum Investment...$2,500
Inception Date..7/31/07
Benchmark ....S&P 500 Index
Net Assets as of 12/31/2011 ....$889M
Number of Holdings 90

TOP TEN LONG HOLDINGS (AS OF 12/31/11)

IShares Russell 2000 Index ETF 2.99%
W.W. Grainger Inc. 2.57%
Costco Wholesale Corp. 2.36%
McDonald's Corp. 2.35%
Google Inc. 2.29%
International Business Machines...........................1.90%
Hershey Company 1.89%
IShares MSCI Mexico 1.84%
Union Pacific Corp. 1.84%
Colgate-Palmolive Co. 1.83%
TOTAL: 21.86%

PORTFOLIO ALLOCATION

Equity Portfolio Long...83%
Equity Portfolio Short 26%
Futures Short .... – 3%

Futures allocation reflect notional value (the value of the futures' underlying).

★★★★★ OVERALL MORNINGSTAR RATING™
AMONG 73 LONG-SHORT EQUITY FUNDS AS OF 12/31/11

Ratings are based on risk-adjusted return. The Overall Morningstar Rating for a fund is derived from a weighted average of the performance figures associated with its 3 year Morningstar Rating metrics.

FUND PERFORMANCE

AS OF QUARTER-END 12/31/11

	Cumulative			Annualized		
	1 Month	YTD	Since Inception*	1 Year	3 Year	Since Inception*
MFLDX	+2.41%	+3.70%	+40.53%	+3.70%	+15.83%	+8.00%
S&P 500	+1.02%	+2.11%	– 4.71%	+ 2.11%	+14.11%	– 1.09%

*Since inception date 7/31/07

Gross Expense Ratio 2.43%
**Net Expense Ratio 2.54%
***Operating Expense Cap 1.75%

Source: U.S. Bancorp ©

***The net expense ratio includes dividends and interest expense on short positions, & the recoupment of previously waived expenses.*
**** The Adviser has agreed to waive its management fees and/or to reimburse expenses of the Fund to ensure that total Annual Fund Operating Expenses (exclusive of taxes, leverage, interest, brokerage commissions, expenses incurred in connection with any merger or reorganization, dividends on short positions, acquired fund fees and expenses and extraordinary or non-recurring expenses, such as litigation) do not exceed 1.75% of the Fund's average annual net assets, at least through August 31, 2012 and for an indefinite period thereafter.*

Performance reflects the reinvestment of dividends and other earnings and is net of advisory fees. Performance data quoted represents past performance; past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost. Current performance of the Fund may be lower or higher than the performance quoted. Performance data to the most recent month end may be obtained by calling (888) 236-4298. The Fund imposes a redemption fee of 1.00% for shares held less than 60 days. Performance data quoted does not reflect the redemption fee. If reflected, total return would be reduced.

TOP FIVE SECTORS — NET

Consumer Discretionary...25.64%
Industrial...17.54%
Consumer Staples..10.30%
Technology...8.59%
Energy..7.58%

Fund holdings and/or sector allocations are subject to change at any time and are not recommendations to buy or sell any security.

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MARKETFIELD
ASSET MANAGEMENT

MANAGEMENT TEAM

Michael C. Aronstein
President, Chief Executive Officer,
and Portfolio Manager

Michael C. Aronstein is Portfolio Manager of the Marketfield Fund. He is also Chief Investment Strategist for Oscar Gruss & Son Incorporated, a NYSE member firm that provides research and investment advice to institutional managers. Prior to joining Oscar Gruss in 2004, Mr. Aronstein was Chief Investment Strategist at Preservation Group, a provider of independent macroeconomic and strategic advice to professional investors. Mr. Aronstein began his investment career in 1979 at Merrill Lynch, serving positions as Senior Market Analyst, Senior Investment Strategist, and Manager of Global Investment Strategy. Mr. Aronstein spent six years as President of Comstock Partners, a diversified investment advisor, and left to found West Course Capital, a discretionary commodity management firm. Mr. Aronstein graduated from Yale College with a Bachelor of Arts in 1974. His views on macroeconomic and strategic issues are regularly sought by and disseminated through the financial print and visual media. Mr. Aronstein manages $889 million in MFLDX and $406 million in The Marketfield Fund, Ltd.; total assets under management are $1,295 million.

Myles D. Gillespie
Chief Operating Officer

Myles D. Gillespie joined Marketfield Asset Management as Chief Operating Officer in 2007. Mr. Gillespie is a graduate of The Hotchkiss School and holds a Bachelor of Arts degree from Franklin and Marshall College (Class of 1983). From 1983 to 1986, he worked as a stock index futures trader with Henderson Brothers and in 1986 became a NYSE Specialist at Quick & Reilly. He was appointed Executive Vice President of JJC Specialist Corp., the successor firm to Quick and Reilly, in 1989. In 1999 he became President of Fleet Specialist, Inc., the successor firm to JJC Specialist Corp., retiring from this position in 2004. During his time at the NYSE, Mr. Gillespie served as a NYSE floor Official (1993-1999) and NYSE floor Governor (2001-2004).

Michael Shaoul
Chairman

Michael Shaoul also serves as Chief Executive Officer of Oscar Gruss and Son Incorporated, a position he has held since December 2001. He joined Oscar Gruss in 1996 as Chief Operating Officer. Between 1992 and 1996, Mr. Shaoul ran Park Square Associates, a Manhattan-based real estate investment and management company. He was awarded a Ph.D. in Accounting and Finance in 1992 from Manchester University (UK). Mr. Shaoul has written articles on behalf of *Barron's* and has been regularly quoted in *The Wall Street Journal* and *Dow Jones Newswires* regarding his opinions on the investment markets.

David C. Johnson, Jr.
Director of Research

Mr. Johnson joined Marketfield Asset Management, LLC as Director of Research in April 2011. Mr. Johnson is a graduate of the University of North Carolina at Chapel Hill. He received his MBA in 1984 from Darden School of Business, University of Virginia. Prior to joining Marketfield, Mr. Johnson was an investment analyst, portfolio manager, and head of business development at Wilkinson O'Grady & Co., Inc. He spent the first ten years of his career in the fixed-income department of Salomon Brothers, where he managed one of its primary sales groups. Mr. Johnson was president of Preservation Group, where he worked closely with Mr. Aronstein.

Mutual fund investing involves risk. Principal loss is possible. The Fund invests in smaller companies, which involve additional risks such as limited liquidity and greater volatility. The Fund invests in foreign securities which involve greater volatility and political, economic and currency risks and differences in accounting methods. These risks are greater for investments in emerging markets. Investments in debt securities typically decrease in value when interest rates rise. This risk is usually greater for longer-term debt securities. Investment by the Fund in lower-rated and non-rated securities presents a greater risk of loss to principal and interest than higher-rated securities. Investments in asset-backed and mortgage-backed securities involve additional risks such as credit risk, prepayment risk, possible illiquidity and default, and increased susceptibility to adverse economic developments. The Fund regularly makes short sales of securities, which involves the risk that losses may exceed the original amount invested, however a mutual fund investor's risk is limited to the amount invested in a fund. The Fund may also use options and futures contracts, which have the risks of unlimited losses of the underlying holdings due to unanticipated market movements and failure to correctly predict the direction of securities prices, interest rates and currency exchange rates. The investment in options is not suitable for all investors. Investments in absolute return strategies are not intended to outperform stocks and bonds during strong market rallies. ***The Fund's investment objectives, risks, charges and expenses must be considered carefully before investing. The statutory and summary prospectuses contains this and other important information about the investment company, and may be obtained by calling (888) 236-4298. Read carefully before investing. Diversification does not assure a profit or protect against a loss in a declining market.***

The S&P 500 Index (SPX) is a broad-based unmanaged index of 500 stocks, which is widely recognized as representative of the equity market in general. The securities holdings and volatility of the Fund differ significantly from the stocks that make up the SPX. You cannot invest directly in an index. Japan's Nikkei 225 Stock Average is comprised of Japan's top 225 blue-chip companies on the Tokyo Stock Exchange. Cash flow is a revenue or expense stream that changes a cash account over a given period. *Correlation is the mutual relation of two or more things.*

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The Marketfield Fund is advised by Marketfield Asset Management and distributed by Quasar Distributors, LLC. Quasar Distributors is not affiliated with Sincere & Co., LLC.

COMMENTARY

For the full year of 2011, Marketfield Fund provided a total return of 3.70%, slightly higher than most domestic equity indices. The greatest specific contributors to our returns were short positions in emerging market indices and global financial stocks. A substantial long position in long-term U.S. Treasury bonds also contributed to our results, and acted as an effective hedge against the long side of the equity portfolio during the worst of the summer turmoil. Given that the markets generally adhered to the thematic outcomes that we expected a year ago, the results were somewhat disappointing.

When all was said and done, most popular expectations of market and macroeconomic conditions over the past year proved mistaken. Directional correlations across markets that arose on a daily basis did not, as suggested by much of the commentary, result in a simple sorting of all assets into either "risk on" or "risk off" baskets. In actuality, the annual dispersion of results among asset types that appeared correlated on a short-term basis was as wide as anything we have seen in decades. The erratic distribution was reflected in the results of professional money managers, particularly in the hedge fund and unconstrained categories.

The U.S. markets, widely touted as the most dangerous a year ago, provided returns that ranged from acceptable to, in the case of treasury bonds, spectacular. Emerging markets, high on nearly everyone's list of favored venues, ranged from disappointing to disastrous. Commodities were mixed, with gold holding on to good annual gains while broad commodity indices were generally disappointing.

The difficulties presented by the investment environment are, in many ways, unique to this age. Speculation appears to have eclipsed football (both sorts) as the new international pastime. Every bit of news from every corner of the Earth is seized upon as a crucial piece of some puzzle that requires resolution by the time the day's broadcast slot ends. Markets are being driven into a constant state of frenzy, and participants are right behind.

The noise to signal ratio has gone through the roof, and the general response among investors has been to trade more ardently on the basis of short-term noise. The availability of unlimited, real time data flows has given rise to a sense that there is significance in the day-to-day or moment-to-moment dislocations. In fact, these are simply a function of regulatory changes that have made markets less liquid. We believe the random, daily disorder in market prices has little to do with the fundamental state of business.

The signals that show some longer-term persistence are largely ignored. That has a great deal to do with the transformation of financial news into a 24-hour reality show, one that needs a story a second to keep ratings up. Long-term themes that persist in their influence become nothing but boring reruns. Where no new story exists, one can easily be invented in response to the thousands of data points that appear each day. "Full of sound and fury, Signifying nothing", is as apt a description of the daily media and market environment as we have come across. In the interest of media relations, we omit Macbeth's preceding line.

Our response to the carnival of news, data, opinion and volatility is to try, as best we can, to maintain a perceptual framework that allows us to keep our distance from the disorder. In the absence of adequate separation and perspective it is too easy to be pulled into action on the basis of random fluctuations. With the lack of liquidity resulting in greater and greater local displacements, changing one's mind according to the market's most recent twitches can become extremely expensive.

The persistent macroeconomic themes that constitute the basis of our long-term framework are not too different from those that we set forth last year. We see a structural under-allocation to liquid, domestic assets and an over-affection with alternatives to U.S. equity ownership. The typical large institution has spent the last several years diversifying away from traditional equity strategies toward increasingly exotic, illiquid and opaque venues. This is an ex-post response to two serious bear markets within one ten-year period and equity returns, which, in the clarity of a rear view mirror, have been terrible.

Further impelling the flight from U.S. stocks has been their heightened short-term volatility, which has been mistakenly conflated with increased risk. Illiquid assets have the apparent benefit of not being marked to market on a regular basis, thus eliminating the emotional pressures arising from short-term volatility. The fact that most of the popular, illiquid alternatives like forest land, commercial real estate, farms and energy properties are trading at substantially higher multiples of cash flow than the broad equity indices has not deterred the inbound flows.

COMMENTARY CONT.

The rear view mirror approach to navigation is particularly widespread in the case of emerging markets. Their ten-year returns have dwarfed those of nearly all other broad asset categories, and popular enchantment with their secular prospects remains in place despite terrible results in 2011. This strikes us as the most glaring and potentially dangerous disparity between performance and perception that we see as 2012 begins.

Our concerns about the stability and performance of emerging market assets derive from macroeconomic and market related factors which, when taken together, have the potential to provoke declines on the order of technology stocks from 2000-2002 or real estate related securities from 2007-2009. What is most striking from the standpoint of sentiment is the degree to which the intermediate declines have been excused by a widespread belief that the long term is so unequivocally promising that any immediate weakness can be ignored. In the experience of this writer the belief that the long term can justify stubborn adherence in the face of any results to the contrary has been a characteristic of every important, secular peak in the past 40 years.

The "nifty fifty' leaders of the early 1970s were described as "one decision stocks" right up to the decline that saw them give up 60-90% of their values in 1973-1974. Oil stocks were a third of the entire weighting of the S&P 500 when they peaked in 1980 with the widespread belief being that oil prices could only rise over the long term. "Japan Inc." was widely regarded as the apogee of human enterprise when the Nikkei was peaking at 40,000. The first 30% down did nothing to change the consensus view that the long-term story was so compelling as to allow one to ignore any cyclical declines.

Technology and growth stocks began their declines in 2000 amidst a chorus of long-term cheers. At the same time a popular hypothesis arose, explaining that over the longer run, there was no risk in buying and holding an S&P index fund, since (as of 2000) there were no examples of ten year periods during which there were negative or inadequate total returns. Buy and hold conquered all. Until the ensuing ten years.

Few readers need to be reminded of the long-term belief in HPA (house price appreciation, later Negative HPA) that prevailed in the middle of the decade past, and persisted well into the ensuing decline. By the time it was conceded that there could be something more than a short-term problem, there were no bids.

When an asset type has offered a lifetime worth of investment returns over the course of a decade or less, the popular, institutional and academic responses invariably turn to long-term extrapolation. After all, one needs a good, thorough and unassailable rationale to advocate allocations to something that has already appreciated by eight or ten times and is beginning to show poor intermediate term results. Investors' perceptions of emerging markets appear to have reached the stage of extrapolation ad infinitum in response to poor relative and absolute results in 2011.

The institutional pressures to whistle past the graveyard of an aged uptrend are considerable. They result from the tendency of global financial service companies to build elaborate and extensive marketing and delivery mechanisms around the assets or strategies that have been the most popular. It is nearly impossible, from an institutional standpoint, to begin talking down prospects for markets that have so many recent positives to emphasize, markets in which the most money has been made, spent, and where one's highest paid and most powerful employees work. Imagine the internal debates that would arise should a major investment bank, having just spent tens of millions of dollars to establish an all-star presence in some important EM region, began hearing its strategy team state publically that said region was looking like a potential long-term problem. The disincentives to such skepticism would be even greater in a country where a part of the risk had to do with government corruption and where the leaders, who personally controlled which firms could and could not enter their markets, did not take kindly to criticism.

A dangerous sentiment background, in which opinion seems to remain bullish in the face of market action to the contrary is compounded by rapidly deteriorating fundamental and monetary conditions in many developing economies. These have their roots in the aftermath of the 2008 crisis, which involved very few real economic dislocations in emerging markets (EM). The fundamental problems centered on U.S. and European property manias and credit instruments linked to them. As the Federal Reserve addressed the liquidity crisis resulting from the forced liquidations of margined assets and the collapse of Lehman Brothers, the stabilization of world markets allowed for a prompt recovery in emerging market assets, where there had been little fundamental disturbance to work through.

The rapid recovery of markets and economies in the developing world from 2008 on came on top of powerful bull markets that began between 1998 and 2002. This had the effect of convincing the vast majority of observers that there was a special form of immunity inherent in developing markets.The steady stream of capital inflows grew into a flood. Local markets were inundated with capital inflows, which inflated asset prices, currencies and the

COMMENTARY CONT.

wealth of those citizens who were in the midst of the inflow streams. Central banks responded to the steady rise in local exchange rates by increasing liquidity in the hope of slowing currency appreciation and mitigating the strains on export sectors. All of the elements of a credit and asset price boom were present, along with the seeds of traditional inflation. Bank lending grew at several times the pace of economic activity, with the attendant relaxation of credit standards.

When asset price inflation finally spilled over into the consumption side of the economy, central banks found themselves between an array of rocks and hard places. The rapid rise of consumer costs in developing markets was abetted by the investment appetite for commodities as an asset class that had developed during the past cycle. As portfolio flows into commodities accelerated, partially provoked by quantitative easing (QE2) in the United States, prices followed. This had a particularly acute effect in emerging market economies, where basic commodity consumption accounts for a much higher proportion of consumer spending (and inflation indices) than in developed markets.

The net effect was to force EM central bankers to reverse course and introduce tightening measures to address the social stresses that were being fueled by inflation. These measures ranged from traditional banking and money market intervention to what have become known as "macro-prudential" approaches, where specific administrative orders were enacted with the hope of slowing particular sectors and prices.

The combination of monetary tightening, inflated asset prices and the residue of the post 2008 EM credit boom struck us as a dangerous combination. We have been writing on this topic for about a year, and we still see very little popular agreement with our position, particularly in the preferences of fund investors.

Between the market lows of 2008-2009 and the end of 2011, the most striking feature of the fund flow data has been the relentless preference for non-dollar equity funds, particularly those with emphasis on emerging markets. In 2011, a year in which the U.S. equity markets have been standouts, more than $140 billion has been withdrawn from equity funds, with all the withdrawals coming from domestic funds (funds focused on foreign stocks have seen small net inflows).

In spite of three years of flows towards EM assets, they have stopped performing and were, over the past year, one of the most disappointing components of any diversified portfolio.

The phenomenon whereby flows continue but price appreciation stops seems contra-logical at first glance. It is however, illustrative of one of our basic market theorems, namely, that all bull markets end with supply responses. Faltering demand is never the bête noir of a powerful uptrend. Human beings do not, with minor exceptions, lose their affection for something that has worked.

What sets investors and speculators on the path toward losing their enthusiasm is that the favorite asset stops appreciating. It stops appreciating in the face of continuing demand because it reaches a price at which new and expanded supplies are recruited. Part of the new supply comes naturally in the form of higher price, as the supply demand balance is expressed in monetary terms rather than physical units. The more telling increase comes from new sources of supply. This is the soundest indication that prices have reached a behaviorally important level. It is true in every bull market in all asset types. An abnormal supply response is the ringing bell.

In the instance of capital markets, the supply response to enthusiastic and persistent demand is very straightforward. New issuance of securities always rises up to absorb any incremental increase in demand late in bull markets. With securities, there is normally a larger and more prompt supply response than in less liquid asset types. Building the additional billions of dollars worth of apartments or homes to take advantage of extraordinarily high prices and profit margins takes a lot longer than putting together road shows and printing prospectuses.

The question of what price level is likely to prompt a terminal supply response in markets is difficult to address in prospect but easy to recognize when it has prompted changed behavior. The time lapse between a boom of new issuance and the beginning of the ensuing bear market is similarly difficult to predict by rule but more easily identifiable once under way. The clearest sign is a halt and reversal of prices in the face of continuing robust demand and bullish sentiment. Failed and withdrawn offerings are another good warning sign.

COMMENTARY CONT.

All of these are clearly present (or recently past) within a number of important emerging markets. A cursory look at the level of new issuance in emerging market equities and fixed income during the past year tells the supply story with extreme clarity. It is why, in the face of continuing inflows, prices have actually declined.

Whether the EM bear markets of 2011 will prove transitory or will mark the beginning of painful secular declines remains an open question. As long as the general level of enthusiasm remains high, we are inclined to treat the sector with the same degree of caution that we expressed with respect to financials and housing sectors five years ago.

From a timing perspective, we hear a great deal of discussion about the fact that EM central banks have now recognized the local weakness and have abandoned their tightening biases and, in many cases, have begun to ease policy. This is correct, but it has been our experience that central bank policy usually lags markets in both directions, and does not catch up until the cycle that they are trying to address has reached an extreme. Central bankers tend to start too late and stay too long, which is not surprising given the institutional and bureaucratic nature of their processes.

The continuing risks in emerging markets lead us reluctantly to a mention of Europe, which has become everyone's favorite risk factor and the presumed breeding ground for all black swans.

From our perspective, European sovereign debt problems are fairly well integrated into market expectations and should not, under any circumstances, present any sort of existential threat to the common currency.

Try as we might, we find it difficult to see why any of the heavily indebted members of the Euro region would choose to abandon the Euro and return to their previous currencies. There exists an argument that the peripheral Euro countries should revive their own currencies in order to then devalue and reduce the real burden of their external debts. This is the traditional Latin American playbook, which is simply a messy and roundabout form of default.

If Greece or Italy or Spain really wishes to default, they can do it quite straightforwardly by simply refusing to pay their debts. There is no need to go through the rigmarole of trying to convert the entire internal monetary system to a new unit of account and then pretending that the conversion of obligations from Euro terms to something new would not constitute an actual default.

The fact that the financial authorities are trying to craft a restructuring of Greek debt in a form that can technically pass as "voluntary" and thereby avoid triggering the credit default swaps written against Greek debt is just another foolish political evasion of the facts. It is, like all of the political theatre in European financial circles, simply an effort to apportion the pain of real loss that has already occurred. Whether certain banks or insurance companies are going to have to pay back credit losses to hedge funds that hold swaps against Greece is a political, not economic issue. The question of whether these institutions or others holding different sorts of sovereign debt should be allowed to fail, or be nationalized or be beaten with staves is, likewise, more a matter of politics than economic policy.

Except in the case of an acute monetary contraction brought about by European Central Bank (ECB) failure to act in the face of widespread institutional failures (as was the case in the U.S. eighty years ago), the various paths by which the consequences of sovereign restructurings are distributed will have only specific, rather than general, Euro-wide effects.

In this day and age, the Euro, like all currencies, is nothing more than a convenience. It fulfills two of the three roles of money as a unit of account and medium of exchange quite well. The third role of money, as a store of value, is a remnant of ages past, where the purchasing power of money held at money market rates of interest or produced in strictly limited quantities might reasonably be expected to maintain most of its purchasing power over time.

With money market rates at zero and global holdings of cash and near cash at record levels, the store of value function of monetary assets has been replaced by what we would broadly term "investment media". These include all assets with the prospect of providing returns that will at least maintain the purchasing power of the original capital over time. The fact that every asset type within this group involves some degree of nominal risk over and above cash makes for a very uncomfortable environment for those who are averse to the possibility of any loss.

COMMENTARY CONT.

The notion that a current member of the Euro zone would be better off reintroducing local currency volatility into its business, savings and investment formula strikes us as misguided. In fact, the elimination of exchange rate volatility is one of the few theoretical justifications in the original plan for a common currency that has worked out as planned.

Another mistaken notion that we hear a great deal of is the idea that if a country cannot live up to the fiscal standards of the stronger members of Europe and honor all of its obligations in good order, than it should be expelled from the common currency and forced to go back to seashells or wampum. This makes little sense from the standpoint of the stronger nations, given that the wide circulation of the common currency is of greatest advantage to those able to enjoy borrowing at the lowest rates. There has been little disadvantage to the U.S. in the fact that many nations, some with less than pristine financial standing, have effectively chosen to use the dollar as a unit of account and medium of exchange within their own borders. If and when California cannot handle its debt burden, it is unlikely that it will be forced to abandon the dollar. It will, however, like Greece or Italy, have to restrain government spending and beg for the support of wealthier states.

From our perspective, European debt markets are working just as they should. Profligate sovereigns are being weaned forcibly from their borrowing habits by markets, rather than by externally imposed fiat. The German government ought to thank its lucky stars that it does not have to dictate fiscal policy to its southern neighbors. The markets are doing it for them. The best financial disciplinary mechanism involves a cap on borrowing, either de jure or de facto, that acts, in effect, like a strong version of a balanced budget law. When markets have told you that you may only borrow X amount at Y rate, the arithmetic works back into a structure of budgetary imperatives that can be addressed as each nation sees fit. If Greece wants to sell the Parthenon, raise taxes, cut the government payroll or merge with Cyprus, all of that is their business. As long as they realize that the markets have imposed a hard cap on spending that is roughly in line with their receipts plus regional charity, no further external restraints are needed.

A system whereby markets reward responsible fiscal management with low borrowing costs and rein in those unable to control their spending by cutting off access to further credit is exactly what Europe needs if it is to prosper in the longer-term. As long as markets remain awake to sovereign risks and impose discipline on the wayward members of the European Union (EU), there is no need for new treaties, rules or enforcement mechanisms.

From a practical perspective, it is our sense that the regime change at the ECB and the subsequent extension of term funding for the banking system and a cut in base rates marked a turning point in the systemic crisis. Removing the immediate threat to bank liquidity has resolved the capital market emergency within the EU. Forced liquidation of bank assets is a much less ominous threat, and money market rates have begun to reflect the diminished risk.

Countries and businesses within Europe that have behaved responsibly should be in positions to move forward. The easier monetary conditions arising from the need to save the weak members of the EU will wind up having a greater positive influence on the strongest sectors, which did not need the help in the first place but are best positioned to take advantage of it.

Monetary and credit conditions in the U.S. stand in stark contrast to those arising in emerging markets and Europe during the first three quarters of 2011. There was little or no private sector credit expansion and no central bank tightening in the United States between 2009 and 2011. This is a primary factor in the striking outperformance of dollar assets over the past year. It is a big plus in the relative performance of Dr. Bernanke against most of the rest of the world's central bankers since the crisis lows of 2008.

In addition to the restraint shown by the Federal Reserve, markets embarked on a dramatic easing path following the rate peaks of early 2011 and the economic softening that followed. It is important to remember that ten-year rates on U.S. treasuries rose to around 3.50% in early 2011. Thirty-year yields peaked at around 4.75%. At those levels, a cyclical slowing of the domestic economy followed, just at the point that many economists were raising forecasts. At the same time, long-term U.S. bonds were being singled out as the worst possible asset to hold for 2011.

After the higher rates did their tradition job of moderating the economy, long bonds turned out not the worst but the best of all liquid assets on the face of the planet. Circumstances now seem to have come full circle.

After peaking in the first quarter, long-term rates plunged for most of the year to levels that should prove highly beneficial to important parts of the domestic economy. The move in ten-year yields from 3.5% to well below 2% will rekindle the credit sensitive sectors of the economy, and should further tip the balance of return away from apparently safe assets to those that can take advantage of nearly free debt capital.

COMMENTARY CONT.

It is our sense that we are beginning another market cycle, with typical early stage leadership in credit cyclicals. These include some of the worst laggards of the 2009-2011 recovery, including financials, housing and construction related shares. We have moved the portfolio in the direction of the early cycle sectors, while maintaining short positions mainly in emerging markets.

Global markets always comprise sectors that are improving and sectors that are deteriorating over the longer term. Changing macroeconomic conditions work to the advantage of certain activities while simultaneously impairing others. The difficulty in portfolio management is a function of never knowing which side of the equation markets will embrace over the short or intermediate term. That is why we try to maintain not only thematic but directional diversification, with a part of the portfolio designed to contribute positive returns when certain sectors come under pressure.

In years like 2011, where global markets seemed to change their messages every day about whether the restorative or destructive forces were likely to prevail, a portfolio that carries some exposure on the short side allows for more measured response in the face of pressure, which, in money management and every other aspect of life, is crucial for long-term success.

January 18, 2012
Michael C. Aronstein
President

The information provided herein represents the opinion of the Portfolio Manager and is not intended to be a forecast of future events, a guarantee of future results, nor investment advice.