

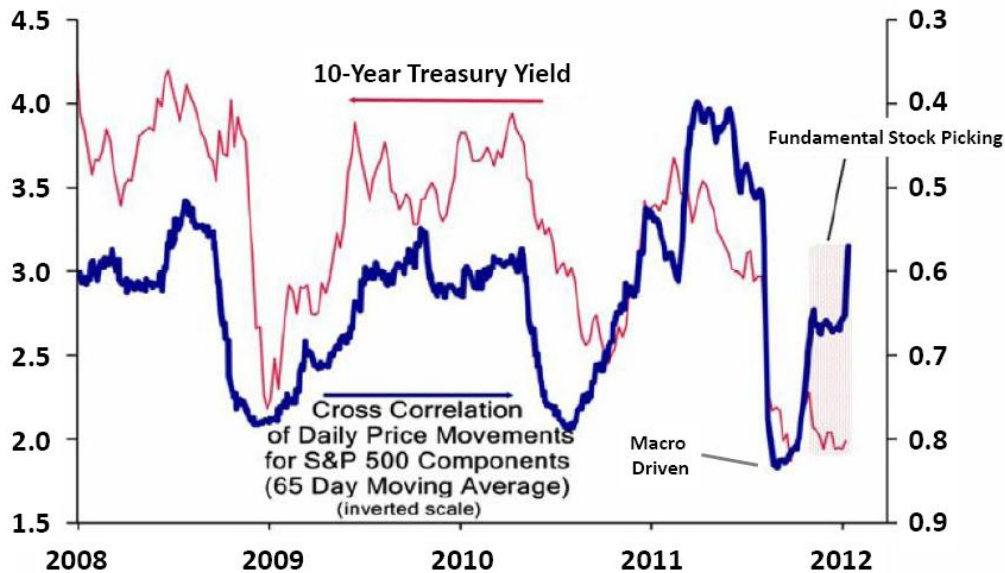
Investment Outlook & Strategy Commentary

OUTLOOK FOR 2012 AND BEYOND

2011 was a challenging year due to unusually wild, manic-depressive market swings and record cross correlations reflecting a series of extreme global shocks. At the beginning of last year we expected above-consensus U.S. corporate profits, cash flow and dividends to drive undervalued U.S. equities higher. After a sharp 9% rally in the first four months of 2011, Europe's economies weakened in mid-May and its sovereign debt crisis escalated, concerns increased about the risk of a China hard landing, the U.S. government experienced its first ever debt downgrade and political paralysis characterized the U.S. debt ceiling fiasco. These macro events trumped improving U.S. fundamentals as the dominant driver of equities. Correlations of stocks within the S&P 500 reached record highs and investor confidence eroded, making 2011 a particularly difficult year for stock picking strategies.

Continued improvements in U.S. economic data and diminished risks of a hard landing in China have trumped Eurozone issues since the October market lows. Cross-correlations in the S&P 500 have declined (shown inversely in the chart below) and decoupled from the trend in U.S. Treasury yields, with correlations at levels that favor fundamental stock picking.

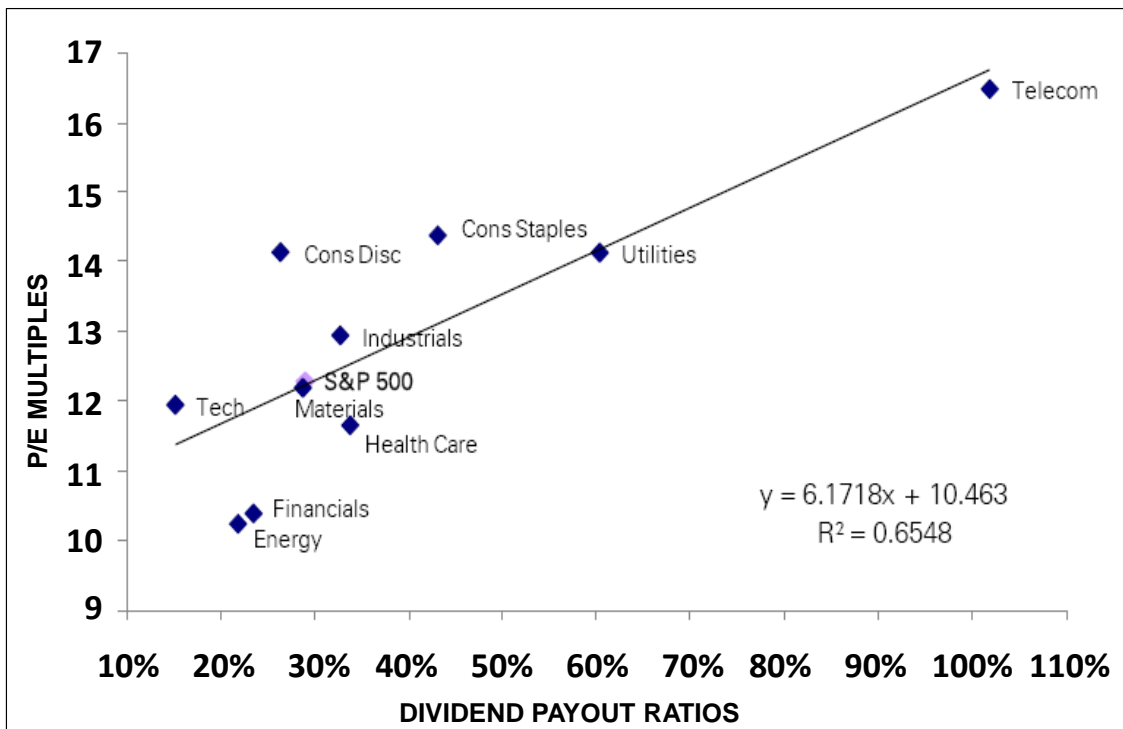
S&P 500 CORRELATION VS. TREASURY YIELD



Source: ISI International Strategy & Investment

Last year the best market performers were defensive, high-yielding utilities and telecom stocks. These sectors generally have limited growth in earnings or dividends due to their high dividend payout ratios. Now they trade at premium multiples despite lackluster growth potential because investors fled to them for their high dividend yields and safety.

DEFENSIVE TELECOM, UTILITIES & STAPLES HAVE HIGHEST DIVIDEND PAYOUT RATIOS & P/E MULTIPLES



Source: Compustat, IBES, Deutsche Bank

We believe the best returns in stocks will come from undervalued quality equities with low current dividend payout ratios that will provide attractive growth in both earnings and dividends (e.g., energy, healthcare, technology). S&P 500 dividend payout ratios remain near record lows of around 27% of earnings and we expect dividends for most stocks which we own to rise in line or at a faster rate than earnings as these cash-rich growing companies pay out more in dividends.

Macro worries, flights to safety, high volatility and excessive focus on short term trading are providing selective exceptional opportunities where price is disconnected with fundamentals. Intermediate and longer term market trends will again reflect fundamentals and valuations (rather than macro factors which drive short term swings). With meager yields on government

bonds and historically low P/E ratios for equities, the “earnings yield gap” of 5.7% (7.7% earnings yield less 2% Treasury yield) is close to a record wide spread, which favors equities. Predictably, five- year U.S. Treasury yields will return 78 bp annual returns to maturity and ten year U.S. Treasury bonds bought today will return 1.85% annually if held to maturity -- both are likely to result in a zero or negative real return after inflation. Equities are less predictable, but the long-term growth of earnings and dividends should be a good indicator of potential returns, especially now when valuations are reasonable. Thus, if 2% dividend yields (which should grow at least in line with earnings) are added to earnings growth of 5% per year, the U.S. equity market would return 7% over the next ten years (matching their 7.2% annual return since 1950), assuming unchanged price-earnings ratios (which are low on a historical basis).

Market volatility should be considered as an opportunity to increase equity allocations, where they are below target allocations. Active equity management should be a key part of portfolio allocation because markets will become more selective and there are compelling opportunities in equities (and other alternative investments). Investors are currently ignoring real returns because inflation is currently benign, but in order to earn returns in excess of future inflation (which is likely to exceed current ten year Treasury yields) equities and other alternative investments are necessary return drivers.

TUG-OF-WAR IN 2012

The following positives and negatives will pose a tug-of-war and keep market volatility high in 2012:

Positives:

- 1) Stocks are historically cheap based on most valuation metrics.
- 2) U.S. real GDP should continue its historically moderate recovery and increase by 2-2.5% in 2012, with moderately rising corporate earnings, dividends and cash flow.
- 3) With subdued inflation, interest rates should remain extremely low in the U.S. while the Fed remains totally committed to supporting the expansion. Monetary reflation or printing money will be a positive for equities and other risk assets.

Risks:

- 1) The secular deleveraging of massive sovereign debt at a time of fiscal restraint will continue to leave the global economy and financial markets at risk.
- 2) Europe is likely to deteriorate further, with a recession of unknown proportions underway and bank deleveraging and the resultant credit crunch on the periphery likely to continue.
- 3) A major geopolitical disturbance, i.e., the escalating conflict over Iran’s nuclear weapons program.

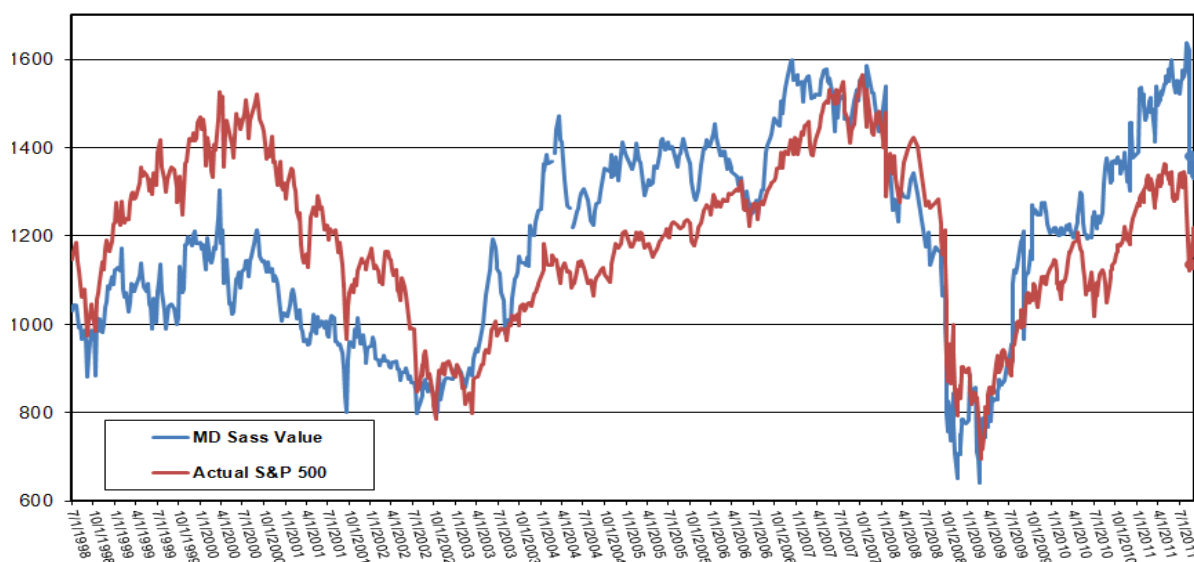
The catastrophic risk of a Lehman-style crisis in the Eurozone or a breakup is still a concern because of the lack of an imminent resolution. Over the long term there needs to be a U.S. –

style fiscal union with strong oversight to reduce government debt relative to GDP, and a Eurobond.

If our base assumption is correct that we will muddle through without these two tail risk catastrophes, investor sentiment should improve over time and provide support for equities and other risk assets. Although we are not counting on them, there is also potential for positive surprises. Earnings expectations are generally for a modest increase in 2012 but with recent firming U.S. economic growth stronger than most anticipated, increased hiring intentions and improvement in resource input prices, corporate profits could again surprise on the upside.

We believe that there is a good chance that a significant stock market bottom occurred in September when the VIX and cross-correlation spiked in the face of the intensifying Euro crisis. Using a conservative earnings increase to roughly \$100-\$103 per share in 2012, our equity valuation models show an upside of 6% over the next 12 months to 1392 for the S&P 500.

S&P 500 VS M.D. SASS EQUITY VALUATION MODEL AS OF 1/19/2012



Market Theoretical Value based on MD Sass estimates					
Scenario	Theoretical	(undervalued) /	estimated S&P 500 EPS		
	S&P Value	overvalued	2011	2012	2013
EQVAL	1,392	-5.9%	\$96	\$100	\$106

*Theoretical Value is based on interest rates, corporate earnings, discounted future dividends and asset prices.

**The discount rate of 3.48% is based on a blend of 10yr Corporate A / BBB bonds.

***Each 0.5% change in the long term EPS growth rate assumption (positive or negative) effect the theoretical value by ~4%.

****Each 0.5% change in interest rates effects the theoretical value by ~8%.

U.S. ECONOMIC GROWTH

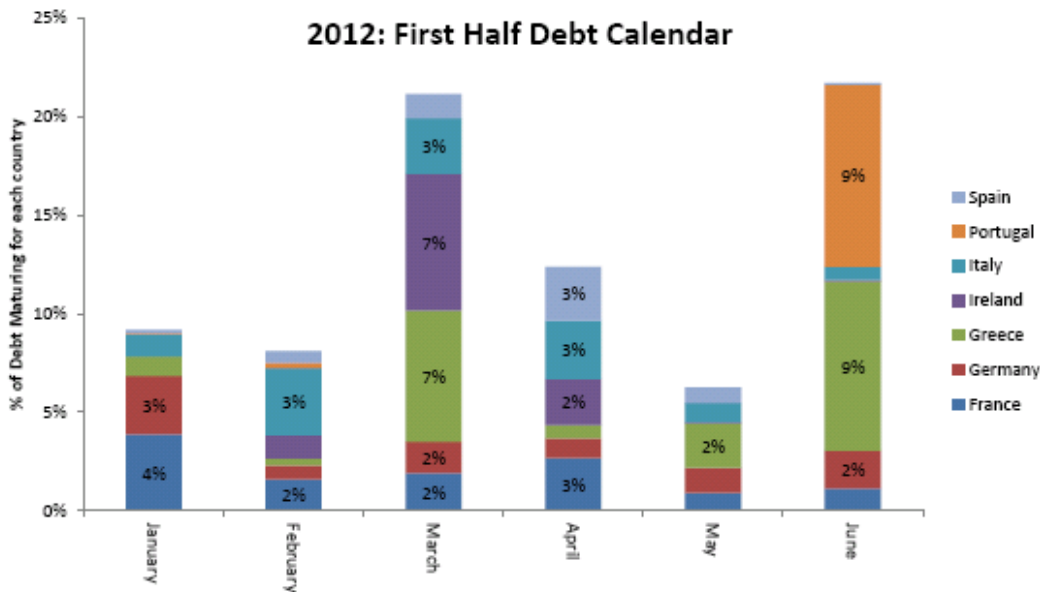
Despite the macro shocks U.S. GDP growth improved each consecutive quarter in 2011 with real GDP likely to be up around 3% in 4Q11. With improving employment indicators (e.g.,

jobless claims are near post-crisis low) and housing likely to be near bottom (with a gradual stabilization of home prices likely over the next 18 months aided by improved affordability) and rising consumer confidence we expect a continued self-sustaining U.S. economic recovery in 2012. Manufacturing in the U.S. is at an inflection point with factory employment rising after decades of decline reflecting improved U.S. competitiveness due to productivity growth in the past decade. Partially offsetting the positive are drags on growth from the European recession and U.S. fiscal tightening (with automatic spending cuts of \$1.2 tn), leaving us with an assumption of 2% real GDP growth in 2012.

THE EUROZONE DEBT CRISIS

Recent policy measures have contributed to markets taking bad news better based on hope that the increased credit threat to core Europe will force the ECB to become more aggressive in stemming the crisis. The ECB needs to act as the lender of last resort and support financial stability of stressed banks without creating “moral hazard” and risking government’s need to implement fiscal austerity. High real interest rates and fiscal austerity are in conflict and are exaggerating the economic downturn in the periphery.

BULGE IN MARCH & JUNE EUROPEAN FINANCING REQUIREMENTS



Source: RenMac

In the first quarter of 2012 456 bn Euros of sovereign debt will come due (the bulk in March), including almost 113 bn Euros from Italy alone. Greece needs to meet a debt payment on March 20th when a 14 bn Euro bond redeems, or it might come later. Somehow Greece's debt must be put on a path that is credibly sustainable. Overall, 1.23 tn Euros of sovereign debt have to be repaid in 2012 and the ECB balance sheet may have to grow by that amount to support sovereign governments and under-capitalized banks.

These challenges will represent a continuing downside risk in 2012, especially since the Euro area is on the verge of recession of unknown magnitude, with a sharp contraction in the periphery and flat to moderate growth in the core. There will be intensifying credit strains in the excessively leveraged European banking sector reflecting a reduction in the collateral value of sovereign debt and increased capital requirements.

Expanding the ECB's balance sheet has bought time and helped trigger a strong rally in the U.S. equity market and in commodities. ECB President Mario Draghi implemented a massive \$628 billion injection of cash into the European financial system by extending unlimited liquidity via its Longer Term Refinancing Operations (LTRO). These are repo agreements requiring European banks to submit collateral (mostly distressed debt) from 1 year to 3 years at 1% interest designed to encourage banks to arbitrage opportunities to buy troubled sovereign debt yielding 6-7%. The LTRO is a form of quantitative easing which contributes to the more than 800bn euro explosion of the ECB's balance sheet since last July. With the new LTRO program any European bank that was strained is getting re-liquefied, which eliminated the risk of "systemic failure" that the banks were facing late last year. However, the LTRO's did not remove the tail risk of a disorderly Greek debt default and contagion into Portugal (which ten year yield is worriedly at a record high) and possibly Spain and Italy.

Until there is political backing for a more centralized economic and fiscal union, Eurobonds (the instruments for such a union) will not get political backing, markets will remain highly volatile and there will remain lingering problems from the Eurozone debt crisis.

Fixed Income

Our U.S. Government Agency Mortgage-Backed Securities strategies continued to perform well in 2011 by providing stable and positive returns in a very low interest rate environment. Their composites are summarized below.

Strategy	Total Returns - Gross of Fees - Period ending: 12/31/2011			
	Past 1 Year	Past 3 Years	Past 5 Years	Past 10 Years
M.D. Sass One-Year	1.88%	3.34%	4.25%	3.90%
M.D. Sass Two-Year	2.75%	4.06%	4.86%	4.38%
M.D. Sass Three-Year	6.40%	5.30%	6.49%	5.52%
M.D. Sass Core	8.49%	6.16%	7.24%	6.11%

Looking forward, we expect 2012 will continue the trend of low, but not lower, interest rates until there is evidence of a more robust economic pick up, or the credit markets become more concerned about the political process by which the U.S. eventually brings down its budget deficits to a more sustainable level

Asset Allocation

We continue to believe that diversified portfolios should continue to maintain liquid reserves to stabilize portfolios, add income and provide funds for opportunistic deployment in a volatile market environment. Below we list some of the reasons we expect continued volatility.

2012 is likely to be a very interesting year in the global economy, political environment, capital markets and technology. As we look to the year ahead, it is useful to contemplate the significant events that may shape the macro environment for the capital markets and adapt strategies that might capitalize on them and/or mitigate their risks. The world macro environment is clearly a complex, interactive and highly volatile system that is exposed to events that are not yet clearly on the visible horizon or are of relatively low probability but potent impact. For example, two years ago few (if any) prognosticators viewed Greece as a threat to the global capital markets, although the economic forces in Greece were then clearly in place to make their debt unsustainable and adversely impact the Euro, European banks and impact the global financial markets. There are trends in place now that can have major impact and need to be incorporated into investment planning. We will limit our list to 10 items. No doubt some of these will not have great impact, and others, not listed, will occur with important ramifications. That alone does not render this exercise futile. Investment decisions are made in “real time” and as events unfold, but within a conceptual longer term framework.

1. Economic Activity, Inflation and Interest Rates

Growth, but sluggish growth, in the U.S., combined with stagnation in Europe, is likely to hold down price pressures for a while longer and provide a backdrop for continued monetary stimulus and low interest rates. When and as economic growth accelerates, price pressures and interest rates for intermediate and longer term issues are likely to jump higher, independent of monetary authorities’ desires or policies. This poses a substantial risk for longer term bonds, as quantified above, to bond investors who are currently getting very little income to offset the price risk of longer term issues.

2. The Euro and the EEC

The cohesion of the European Economic Community (EEC) will continue to be stressed by the need for the large debtor nations to adopt austerity programs, necessary to regain confidence by the capital markets, that they can eventually repay or refinance their funding needs and maturing obligations at rates that are affordable. The stronger nations (Germany and France) plus the IMF do not have sufficient capital to back stop Italy, Portugal, Spain, Greece, Belgium and others without market confidence that structural changes in the debtor nations’ fiscal

policies will bring down their deficits. Nor are French and German voters' likely to want to take on out of control growing obligations for other countries. Additionally, France and Germany's electorate is unlikely to want to support the weaker nations, through higher taxes, to save their banks or send money abroad unless they see a long term economic advantage to preserving the weaker nations as export markets. This story will unwind throughout the year with no clear end point.

The 2012 election campaigns in Germany and probably France will give important insight as to the prospects for the major European banks and the more fragile EEC members. Important austerity initiatives are already underway in Greece and Italy in the aftermath of their recent elections, precipitated by the global capital market pressures forcing politicians to adopt more spending restraint and tax revenue increases.

3. Japan

Japan is largely out of the news from an economic perspective (so was Greece, Portugal and Spain), but it remains, for a while, the third largest country in terms of GDP. While it has little outside debt and historically has funded its huge budget deficits with domestic savings, this is likely to change and create a new source of uncertainty in the global capital markets. Japan's stagnant economic performance due to its demographics and the increasingly competitive market environment for its high quality exports is under pressure from Korea, Taiwan, Singapore, Hong Kong and China, among other Asian producers of consumer goods. Japan is likely to have to drastically reduce its budget deficit or seek financing in the global capital markets within the next several years. This will put additional stress on the credit markets and their feedback loop into equities. As the third largest GDP, it is ultimately a lot more important to the global capital markets than the small Southern European economies.

4. China

The Chinese leadership changes in late 2012. It is also at the beginning of the first change in priorities to shift China's five year economic plan to stimulate domestic consumption and augment their export driven economy. This comes in part in response to street demonstrations, product quality issues and corruption, as well as domestic unrest from the 800 million Chinese that have yet to see a substantial increase in their standard of living. As their domestic consumer economy and infrastructure spending grows, so too will the demand for raw materials and protein. This is beneficial to suppliers of commodities and energy and will lead to increased inflation pressures in China and reduced trade surpluses.

5. U.S. Elections

The election campaigns in the U.S. will focus on economic growth, job creation, energy policy and tax policies with enormous implications for investors. We expect no major legislation in 2012 until after the election, but the stage will be set for important changes, post-election, that investors will discount as the election results become more confidently forecast or known. Major changes in entitlement programs and tax deductions will have to be made to reduce the long

term trajectory of the budget deficits. The outcome of the U.S. elections and prospects for the factors mentioned above will be a catalyst that moves the stock and bond markets to a greater extent than the dramatic swings currently associated with the EEC.

6. Volatility

The global equity markets have been unusually volatile on a daily basis. Daily moves up and down of 1% to more than 2% were common in 2011, with reversals shortly thereafter. This kind of volatility scares investors who try to relate economic and political events to the markets movements as they seek reasons for the abrupt market moves. In the context of a mere 2% 10 year Treasury bond interest rate, these movements are all the more dramatic. With low interest rates, equity investors have few ways to dampen overall portfolio volatility by earning interest income from a portion of their portfolio. This has caused them to reduce equity exposure to manage overall portfolio volatility. In the post war period, stocks have performed poorly with rising interest rates. Paradoxically, when and as interest rates go up, investors will shift money out of bonds and into stocks.

7. Military Activity

With the departure of the last U.S. troops from Iraq, increased sectarian violence and a power struggle will lead to chaos and open the path for increased Iranian influence. The U.S. response will be muted and lead to additional questions as to why the U.S. was involved in the first place. Iranian progress on nuclear arms and delivery systems will progress and thereby create increased concerns about an Israeli and/or U.S. military intervention, with implications for the oil supplied through the Straits of Hormuz. This will inject more volatility and an upward bias in the energy markets. U.S. military expenditures will increase their focus on capabilities that reduce the need for ground forces, including drones, ground based robots, surveillance technologies and cyber war. The focus will be to persuade potential adversaries of our ability to strike them with massive, non-nuclear, destructive force, but without committing large numbers of ground forces. The strategy will be to deter adversaries but not attempt to directly occupy or control them. While overall defense expenditures will be reduced, the increased emphasis on remotely controlled warfare will favor defense technology companies.

8. U.S. Energy Policy

Concerns about the available supply of foreign energy and its cost will increase pressure for wide scale natural gas and oil from domestic shale deposits. The increase in jobs from these projects will make them all the more compelling and increase profits of service and material providers. Environmental concerns will slow but not halt development and material and service providers will benefit.

9. Arab Spring

New regimes in the Middle East and Africa will continue to evolve. It is uncertain if and where more radical regimes will take hold, but it is likely that some will. This will be a continuing cause

for concern for the U.S., Israel and the Arab states that have been traditional U.S. allies and oil suppliers.

10. U.S. Capital Markets

U.S. Capital Markets will continue to experience high volatility as bits of information or forecasts on the nine factors above are extrapolated into major trends. Stock market movements of 1% or more, are now so common place as to no longer warrant much comment. With a disciplined focus on selectivity and fundamentals, active equity managers can produce attractive returns as cross-correlations are at current or lower levels. Investors will also seek sources of greater stability in parts of their portfolios to create greater confidence in achieving their longer term funding requirements and stabilizing returns. The current low interest rate environment makes this even more challenging. Accordingly, alternative investments will continue to see increased portfolio allocations, as will defensive high quality short term fixed income strategies.

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We appreciate your continued support and wish you a happy, healthy and prosperous 2012.