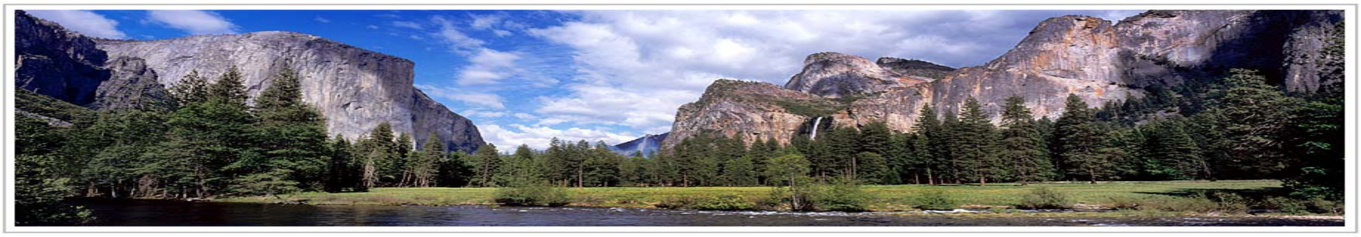

YOSEMITE CAPITAL MANAGEMENT

Second Quarter 2012 – COMMENTARY

The only function of economic forecasting is to make astrology look respectable. – John Kenneth Galbraith

The current cyclical bull market in stocks, as exemplified by the S&P 500, began on Monday March 9, 2009 and three years later has more than doubled. Along the way many pundits have predicted a decline in stocks for various reasons of various merits. Keep in mind that bull markets don't die merely because of old age or passing certain milestones, but often end because of excesses in valuation in some part of the financial markets (real estate in 2007, technology stocks in 2000, the nifty-fifty in 1969, etc.) or a systemic shock (invasion of Kuwait in 1990, stock market crash in 1987, Federal Reserve tightening in 1980, inflation in 1973, etc.). Often, but not always, a bull market ends in anticipation of the economy entering a recession.

We perceive the current bull market in stocks is still intact and the odds favor at least one more major leg upward because valuations are moderate by most measures and earnings estimates for 2012, while falling from their peak show growth over 2011. ***We also perceive that the domestic economy will continue to have positive growth, albeit slow and choppy***, and is not on the verge of recession (more about that at the end of this letter). However, we are of the opinion that ***global circumstances suggest the risks that are always present to one degree or another are simply not worth incurring because the appropriate rewards may not exist***. This means that tactical allocations to some of the more aggressive parts of the investing arena, such as emerging markets stocks, are best minimized or avoided entirely.

Europe is treating investors to what has now become a third annual event: a bout of Euro crisis consternation that causes the broad stock markets to decline noticeably in the face of bank insolvencies, sovereign debt defaults, and the very real possibility of the Euro zone collapsing into oblivion. The episodes in both 2010 and 2011 basically resulted in European politicians throwing money at the problem in hopes of preventing contagion and otherwise agreeing to plan to make a plan. Said another way, they kicked the can down the road. This year there is a noticeable difference in tone, perhaps caused by intervening elections that tossed out incumbent regimes or the numerous demonstrations in various capitals: ***European politicians are finally acknowledging at least some of the structural changes that are necessary for the Euro to survive as a viable currency***. These include openly discussing the possibility of Euro bonds, centralized banking regulation, direct recapitalization of banks, and fiscal union. While this is still just talk and much must be done in a relatively short time to enact any real reforms, these developments are far better than the attitudes of not long ago when such proposals were rejected outright.

While this is good news, the fact is that much of Europe is already in or on the verge of recession, one that likely cannot be overcome without structural reform (which could take several years). Europe as a whole happens to be the biggest customer of China. When coupled with the fact that the United States with its slow growth at best is its second biggest customer, China and other emerging markets cannot be expected to grow at anywhere near the same rates as in recent years. Then there is the whole issue of the overheated property market in China which the authorities are actively working to deflate and the impact this has on that country's slowing internal growth rate. For these reasons, we believe investors are better served now by reducing risks.

The last part of a stock market cycle still contains opportunity, but prudent investors increase their focus on risk management during that phase. While we reduce risk exposures for the present, we will continue to assess the global investing environment and will not hesitate to revisit these more adventurous areas when appropriate.

**

As mentioned earlier, we anticipate continuing positive growth for the domestic economy, albeit slow and choppy, as we do not perceive the United States is on the verge of recession. We can also guess there will be increasing talk from numerous pundits about a recession, especially any time our "choppy" scenario unfolds with a downward tic in economic measures. No doubt this talk could easily be fed by election gamesmanship, another debt ceiling charade, fiscal cliff shenanigans, perhaps some disappointing corporate earnings announcements, or new foreign developments. And should an official quarterly GDP number actually end up with a small negative value, the news media, the political class, and others could easily erupt into much wailing and gnashing of teeth about the impending end of the world. Never mind that *a negative quarterly GDP number by itself not necessarily indicative of a recession.*

Investors need to keep a major point in mind concerning predictions of recessions or assessments about the odds of entering a recession (including our assessments): ***the financial markets ANTICIPATE economic activity as opposed to REACT to an economy changing direction***. So as far as investing is concerned, it does not matter what our (or anybody else's) opinion is about the economy. The financial markets don't care about predictions and the best economic forecaster does not necessarily make for a good investor. Indeed, if the market gods gave anyone an advance look at the final GDP number for the next quarter or two or even three, that data would be of no use for determining where or how to invest today.

While we certainly are aware of the economy in general, a far more important activity on which we spend our time is assessing the markets, including valuations, corporate developments, and risk factors that affect securities.

There is an old saying on Wall Street that if anything is in the news it's likely to be already discounted by the markets, so those who react to bad news on the economy by changing their investments are often fodder for the smart money. We also urge investors not to be concerned with predictions about economic activity because they are a dime a dozen. Wonder more about those who provide the dimes.

John Kleponis, CFA
Chief Investment Officer

Paul Heckler
Managing Director