RETURN ON TRUST

July 15, 2013

Dear Clients, Colleagues, and Friends,

Thank you for your support of Clark Dodge Asset Management. We are pleased to present our updated views and commentary on the economy and global capital markets.

"It is better to be approximately right than precisely wrong"
-John Maynard Keynes

Financial Markets Update

To say it's a confounding economic environment is an understatement. GDP continues to grow in the United States but unemployment has not improved meaningfully. Germany's economy had experienced some of its best performance in recent history but its European partners, at best, remain stagnant. The US equity markets are having a strong year while other – but not all – major non-US equity categories are languishing. Sanity about risk is finally returning to the bond market. Unfortunately, those who went yield shopping with the thinking that the bond market rally could continue forever experienced short term losses.

United States

Equity Market
The mid-year investment results of the US equity market, as measured by the S&P 500, are very strong – they have almost matched 2012's total return, with a 14% + return. Leading sectors within the S&P 500 Index, a basket of large capitalization companies, are health care (+19.4%), financial services (+18.9%) and consumer discretionary (+18.9%). Lagging, though still positive were utilities (+7.7%), technology (+6.0) and materials (+2.1%). Small capitalization companies as measured by the Russell 2000 Index have also had a strong showing with a +15.9% result as of June 30, 2013.

Theories abound regarding the stock market's continued strong performance. One frequently discussed is that investors are becoming less risk averse and have rotated into equities. According to data from the Investment Company Institute, $76.8 billion flowed into equity funds and $32.4 billion flowed into bond funds as of June 26, 2013.

Another theory is that the stock market has resumed its role as a leading indicator for a stronger US economy. According to the US Department of Commerce, gross domestic product expanded 1.8% on an annual basis in the first quarter. This positive growth was

derived primarily from increases in inventory investment, personal consumption expenditures and investment in residential real estate. The housing market continues to improve. Broad evidence supports the conclusion that the domestic economy is improving. Historically, a strong rise in the stock market precedes a period of economic expansion; we believe that this pattern will continue.

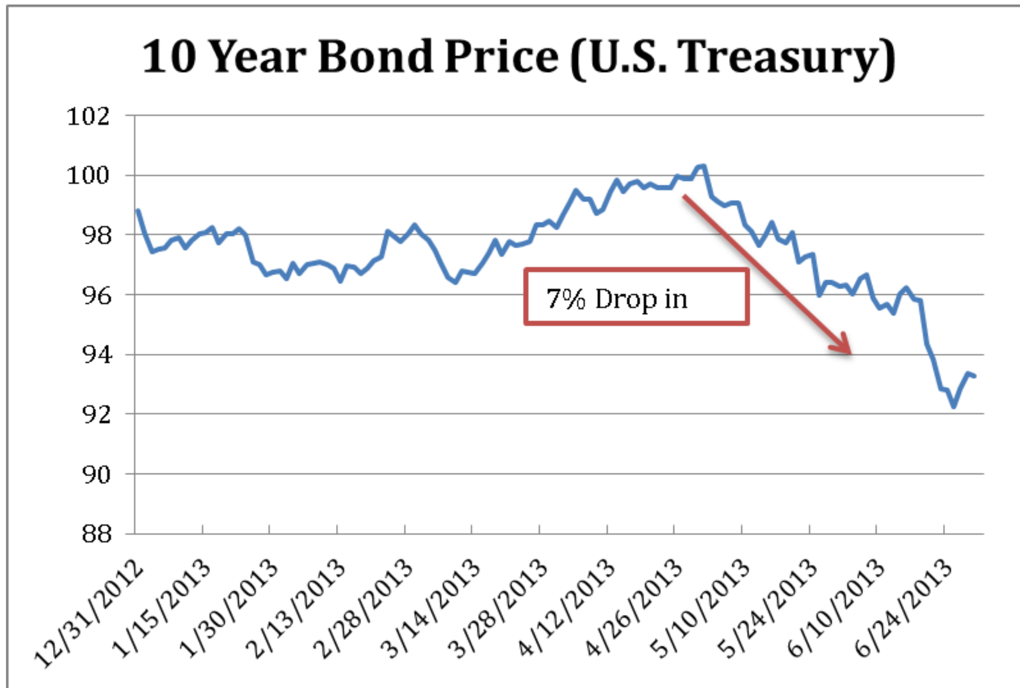
Investment Results of Major Global Equity Indices ***Ending 6/30/13***

Americas	Index Value	Div Yld %	% Change (U.S. Dollar)
DOW JONES (US)	15135	2.42	15.50%
S & P 500 (US)	1631	2.11	14.42%
NASDAQ(US)	3479	1.5	15.23%
TSX (Canada)	12134	3.21	-8.43%
MEX IPC (Mexico)	40623	1.42	-8.57%
IBOVESPA (Brazil)	45210	4.66	-32.43%
Europe			
FTSE 100 (UK)	6375	3.8	-0.99%
CAC 40 (France)	3753	3.74	0.22%
DAX (Germany)	7806	3.46	-0.32%
IBEX 35 (Spain)	7868	5.1	-6.36%
AEX (Netherlands)	352	3.93	-0.01%
OMX STKH30 (Sweden)	1167	4.42	0.55%
SWISS MKT (Switzerland)	7781	3.04	8.20%
Asia/Pacific			
NIKKEI (Japan)	14467	1.45	19.26%
HANG SENG (Hong Kong)	20598	3.6	-9.14%
ASX 200 (Australia)	4829	4.5	-9.55%

Source: Bloomberg

Bond Market

In our last quarterly letter, we projected that interest rates would inevitably begin to rise. However, we did not anticipate such a rapid reversion to historical norms. According to the Investment Company Institute, there was a $60.4 billion outflow from bond funds in June alone. The outflow represents roughly 30% of all new flows to bond funds this year! Remarkably, $28.1 billion flowed from funds during the final weekly period ending June 26, 2013.



Source: Bloomberg

In response to the rate change, the price of longer-term bonds fell. Shorter-term bonds, while not immune to the drop in prices, did not lose as much value as did their longer-term counterparts. If we examine duration – a first-order measure of a bond's pricing sensitivity to changes in interest rates – we see that the portfolios with the greatest duration fared the worst. The larger the duration statistic, the more sensitive the portfolio or bond is to a change in interest rates. Our recent strategy of focusing on short & mid-term bonds certainly helped us manage through this period of abnormally low interest rates.

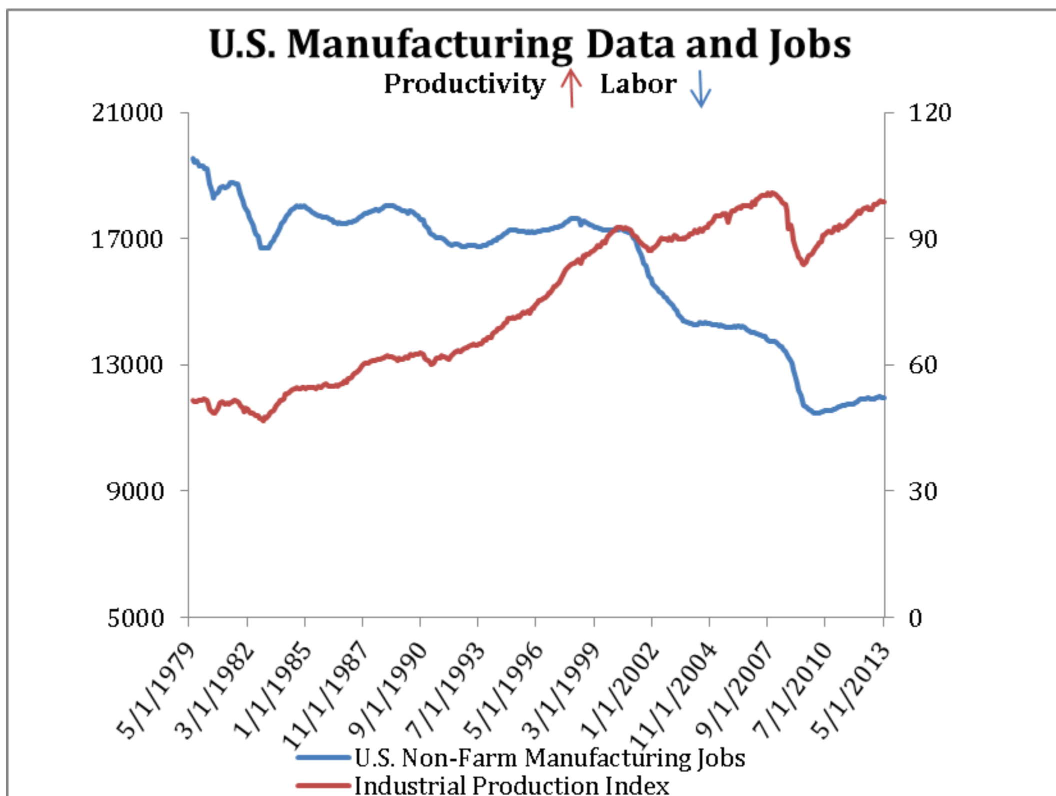
Recent Fixed Income Returns *Period Ending 6/30/13*

Fixed Income Strategy	MTD	1 Year	YTD	Duration	Avg. Credit Quality
Govt Short Term Floating Rate	-0.1%	2.0%	0.3%	0.1	A
Govt Short Term	-0.1%	0.5%	-0.1%	0.7	AA
Muni Short-Term	-0.2%	0.2%	0.0%	1.6	AA
Govt Short/Intermediate Term	-0.1%	0.2%	-0.1%	1.8	AA
Corporate-High Yld	-1.7%	6.1%	-0.1%	4.0	B+
Asset Backed Securities	-1.1%	-2.0%	-3.9%	5.0	AA
Govt Intermediate Term	-1.5%	-1.6%	-2.2%	5.1	AA
Total Bond Market	-1.6%	-1.0%	-2.5%	5.2	A
Govt Tsy Inflation Notes (TIPS)	-3.8%	-5.0%	-7.2%	8.1	AA

Source: Clark Dodge Asset Management and Bloomberg

Analysts have proposed many theories for the decline in the bond market. One leading idea is the fear of the Federal Reserve's sudden closure of the spigot of dollars gushing into the US economy. Realistically, the Fed will have to do so eventually, but not until there is greater improvement in the employment market. Do we take this in a positive light - perhaps the economy doesn't need the crutch?

Unemployment and "underemployment" continue to strain the economy. Neither has changed much since February 2013, remaining at 7.6% and 14.3% respectively. The changing nature of employment in the United States may challenge any quick statistical boost. US industrial production (see chart below) has been rising from the late 1970s while employment in this area continues to decline. David Rotman, editor of MIT's Technology Review, states that advancements in technology have resulted in an increasing number of tasks performed by computers and machines. He further asserts that technology is altering staffing needs in areas historically reliant on workers with highly developed skills such as education, law, financial services and medicine. An interesting example is Memorial Sloan Kettering Cancer Center's adoption of IBM's Watson system. The computer, loaded with research on clinical approaches for rare cancers, analyzes many possible courses of action, and produces possible treatment models for a disease. The time saved is vital for patients and health care professionals alike.[1]



Source: Clark Dodge Asset Management and Bloomberg

[1] http://www.voanews.com/content/us-hiring-advances-jobless-rate-unchanged/1695685.html

Given the sluggishness in new employment, we do not expect the Federal Reserve to abruptly stop quantitative easing; nor do we expect the program to continue indefinitely. As we previously commented, there are many other market forces that may affect interest rates. We asserted in April that the financial markets themselves had the potential to re-price risk in fixed income instruments, and support the theory that such a mechanism is at work today. Bonds have enjoyed a 30-year period of good returns. No asset class can rise continually in price, and it appears as though such a correction is occurring in the fixed income market. The 10-year yield on Treasuries is currently rising from a low of 1.38% last July. Interestingly, the 5-year Treasury has returned 5.3% from Jan 1926 – May 2013, so there is still ample space for further increases in interest rates. While unpleasant in the short term, such events, which some call "reversions to the mean," create a pathway for more normative future returns for the asset class. Where possible, we seek to mitigate further effects of rising rates, by managing bond portfolios to moderate durations and look forward to higher bond yields whenever they become a reality. Higher rates have a sunny side – increased interest rates for savers.

Commodities and Gold

Commodities prices declined over 10.5% year-to-date as of the end of June, as measured by the Dow Jones UBS Commodity Index. There was a significant difference between winners and losers. WTI Crude (Oil) increased by over 15% while silver declined by 33%. Agriculture staples had similar movements; corn declined by 22% and orange juice increased by 24%.

Through June 30th, Gold, which serves as a hedge against statistically unlikely economic events (popularized as "black swan" events), experienced a steep decline (negative 26%). We believe that funds have flowed from gold due to improved strength of the US dollar and general perception that the US economy is improving. Foreign governments such as China and Japan prefer to hold US treasuries as reserves; further dampening near term demand for the metal. We shall continue to hold gold as a hedge and will take advantage of lower prices as we routinely rebalance portfolios. Experience has taught us that the time to hold gold is well before one must rely on it as a hedge.

The Rest of the World

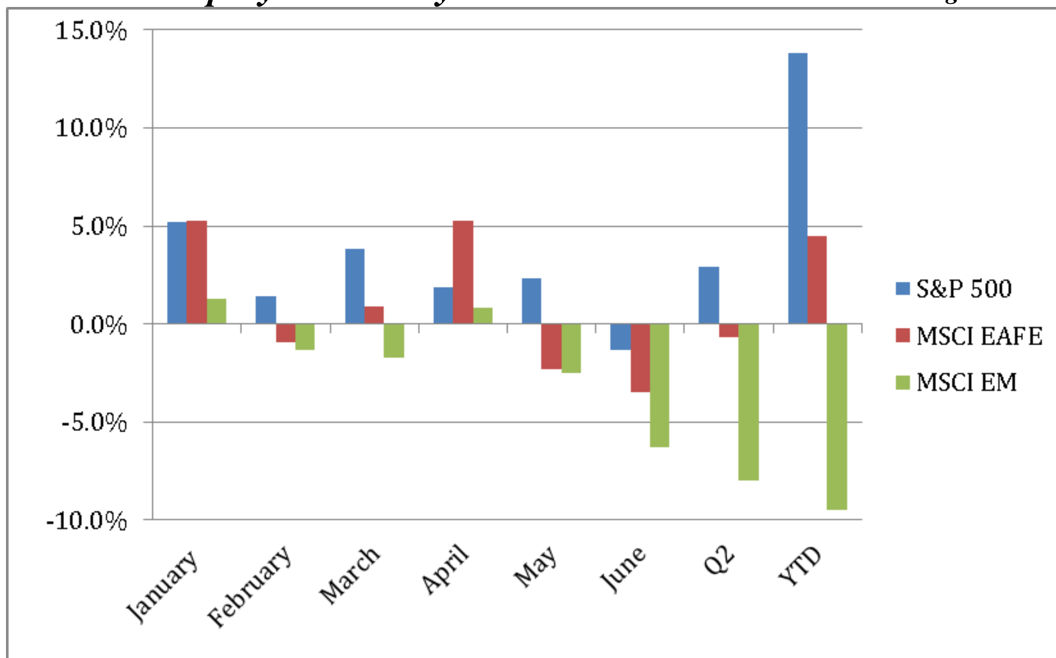
Developed Economies

The table of equity market results (see page 2) provides a useful snapshot of the wide differences in the global investment picture.

The broad index for developed economies, "EAFE," ("Europe, Australia, Far East") has returned +4.5% year-to-date (graph on next page). The key component in 2013 is Japan, whose stock market has risen dramatically. Even with the effect of the US dollar, the Nikkei still produced a +19% return in US dollar terms. The current Japanese Administration under Prime Minister Shinzo Abe is providing both monetary & fiscal support, similar to the US Federal Reserve's Quantitative Easing (QE) policies. These programs have increased the Japanese money supply, flooding the domestic economy

with yen, devaluing the currency to some extent and stimulating domestic consumption and foreign demand. The policy appears to be working for now. Europe, however is still muddling through the policy problems of the Eurozone, which has delaying the economic recovery of the area, especially in Southern Europe. One bright note is the UK's recent Producers Purchasing Index, which has shown higher spending for order fulfillment; it seems that the UK's economy is finally gaining some strength.[2]

"Global Equity Dichotomy"* Index Performance** ***Period Ending 6/30/13



Source: Clark Dodge Asset Management and Bloomberg

Developing Economies

A common argument during the late 1990s to hold emerging markets equities was that their relatively weaker correlation to US equities could provide a stream of investment returns not related to the activity of the developed world's equities. As we can see from the area's results in 2013, such weaker correlation contributed to a period of negative results while other stock markets rose sharply.

We find it challenging to discuss "emerging markets" because one must first reject their facile description as some kind of economic monolith by financial talking heads. We view the sector as much more advanced, with 30 nations on five continents, each with their respective strengths and weaknesses. To be fair to the talking heads, what they are really thinking about is the MSCI Emerging Markets Index, which presents one, academic way of addressing emerging markets equities that does colors investors' expectation for investment return and economic behavior.

[2] http://online.wsj.com/article/BT-CO-20130702-702687.html
http://www.bbc.co.uk/news/uk-scotland-scotland-business-23200724

The MSCI Emerging Markets Index is a capitalization-weighted index; the index's largest holdings tend to be formerly state-owned companies in telecommunications, materials and energy. Consequently, people generally associate resource booms with emerging markets equity booms. China's heavy investment in industry and infrastructure over the last decade fueled strong demand for raw materials and petroleum in large quantities. Brazilian Vale, the world's largest producer of iron ore, generated handsome returns for investors over the last five years. However, moderation in China's consumption of raw materials and the United States' increasing "self-reliance" energy policies & practices has tempered the outlook of commodity producers in emerging markets.

Milder resource demand does not indicate that emerging markets equities are doomed. With strong demographic trends, including a young population, maturing economic reforms and greater consumer power, we expect emerging nations to enjoy higher economic growth prospects than their developed counterparts. The International Monetary Fund estimates emerging and developing countries GDP to grow at 5.3% for 2013. We endeavor to make investments that address emerging markets for their complete economic potential, not just for their abundant natural resources or short term trends. As investors, we also have a chance to participate in the area's high return potential for years to come as the financial markets of major population areas such as Africa begin to mature.

One benefit of price weakness is the creation of a buyer's market. The current valuations for emerging markets are among the most attractive available to long-term investors. We will take advantage of their very attractive prices as we pursue our standard course of re-balancing.

Attractive Valuations and Yields

Index	P/E 2012	P/E 2013 (Est.)	Dividend Yield 2013 (Est.)
S&P 500 (US)	14.09	14.95	2.13
MSCI EAFE (In't Developed)	17.59	13.35	3.41
MSCI EM (Emerging Markets)	12.44	10.14	3.06

Source: Clark Dodge Asset Management and Bloomberg

While we cannot foretell the future, we will continue to hold non-US equities as key portfolio components. They have made significant contributions to our portfolios over the past decade, and we believe that they will once again do so in the near term.

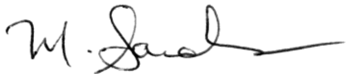
Mid-Year Assessment and Strategy

We believe that a stronger US economy will stimulate the world economy, which should mitigate some of the recent weakness in foreign equity markets. We believe there is a high probability that interest rates will continue to rise, but the effect on portfolios shall be less dramatic than that of the recent movement. We may experience some stability in bond yields for the short term as buyers act on what they perceive as more attractive bond yields.

As portfolio managers, we shall continue to follow our strategy of employing a broadly diversified base of asset classes to achieve long-term total return goals. We shall take advantage of the price weakness in some of our key "toolkits" as we rebalance portfolios. We are strong believers that as prices fall, the expected return of an asset class increases, which shall provide for capital appreciation in the future.

We thank you again for your support of Clark Dodge Asset Management. Please do not hesitate to call me to discuss any issues or if we can help in any way.

With kind regards,



Michael R. Sanders
President
Clark Dodge Asset Management
www.clarkdodgewealth.com
914-304-4766
info@clarkdodgewealth.com

The production of this material would not be possible without our team. Thanks especially to the contributions of Fred Munk, Craig Marson and John Bannan.

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