



Market Commentary

4TH QUARTER 2011

Economic Summary

Despite continued concerns over the U.S. economy and the European currency and financial crisis, the last three months of 2011 produced the best quarter for U.S. stocks in more than two years with the S&P 500® Index up 11.7%. After twelve months of gut-wrenching volatility, stocks ended 2011 just modestly ahead of where they started the year.

CHART 3 on page two highlights the major events of the tumultuous past year.

The market's resilience was evident in the first four months of the year. U.S. stocks largely shrugged off a spike in oil prices following an outbreak of revolutions across the Middle East and North Africa, which was then quickly followed by the Japanese tsunami and earthquake. But massive debt levels in the major Western economies proved the market's undoing. After touching a three-year high in late April, the S&P 500® churned throughout the summer in which investors fixated on the European debt crisis and congressional infighting over the U.S. debt ceiling. In August, the Standard & Poor's downgrade of the U.S. credit rating helped set off the wildest swings of the year. The rest of the year, stocks bounced around as encouraging news on the U.S. economy was offset by nervousness over the European debt crisis. One measure of the heightened volatility in the stock market during 2011 is shown in CHART 1.

The barrage of bad news and the resulting volatility contributed to another year of investors pulling money out of equity funds and shifting it into bond funds (CHART 2).

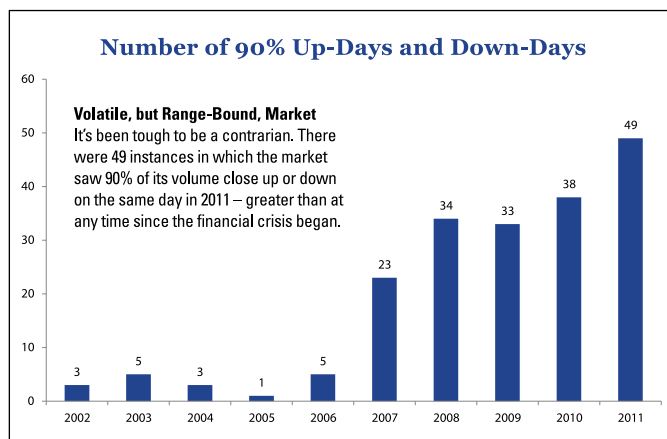


Chart 1

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS", JANUARY 3, 2012

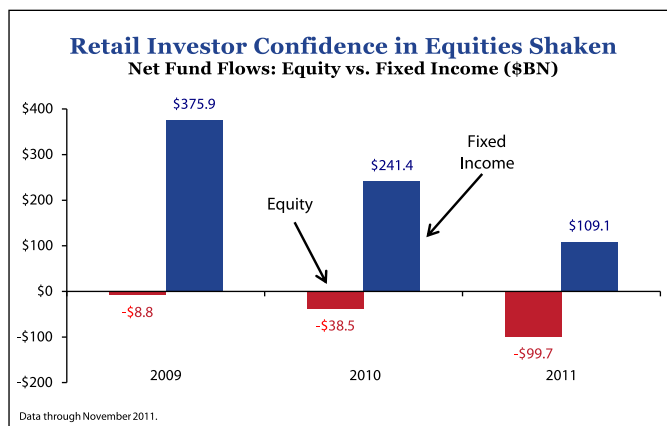


Chart 2

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS", JANUARY 3, 2012

Past performance does not guarantee future results.

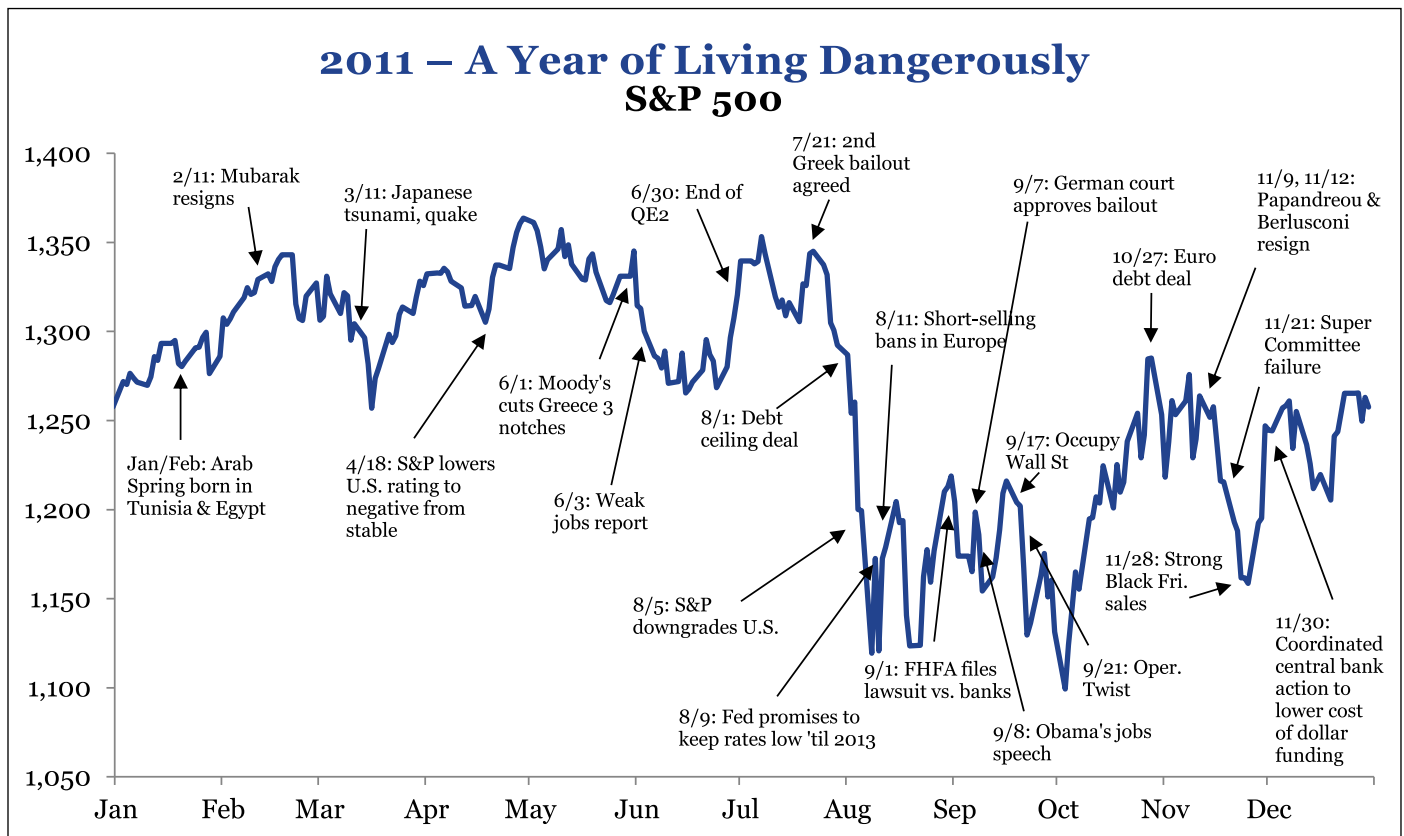


Chart 3

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS", JANUARY 3, 2012

Economic Summary (CONTINUED)

For 2012, we feel the U.S. economy is likely to crawl to a gradual upswing, and will avoid sliding back into a recession. The economic news is improving: household employment is up (CHART 5), unemployment is down to 8.5% from 9.0% as recently as September; the Conference Board Index of Consumer Confidence, which reversed course 8 times during the year, was up 9.3 points in December ending the year at 64.5 (baseline in 1985 = 100); even auto sales which fell to 9.2 million in the depths of the recession advanced to 12.8 million in 2011 and are currently running at a rate of 13.5 million.

The perennial sick child of the economy, housing, is starting to show some better numbers. Pending home sales have turned positive in recent months and housing starts, which are still well below long-term trend in demand, are creeping higher. With real GDP growth estimated at 3.1% for the fourth quarter of 2011, the entire year should sum out at nearly 1.8%. For all of 2012, we're estimating real GDP growth of 2.5%.

The recession in Europe and slowing growth in Asia will impede U.S. economic growth and likely moderate inflationary pressures, at least in the near term.

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Economic Summary (CONTINUED)

Headline inflation which had been running at nearly 4% during the third quarter, has slowed to the mid 3% range in the fourth quarter and may fall further temporarily. We are considerably less sanguine about inflation staying low over the long-term. Growth from developing nations of the world will continue to put upward pressure on commodity prices. At the same time, central banks around the world, like our Fed, have been pursuing highly stimulative monetary policy almost continuously for three years. The result, we fear, will be significantly higher inflation and interest rates in the years ahead.

Equity Market

In general, domestic stocks performed much better than foreign stocks. Domestically, performance was worst in the Materials and Financials sectors. The sectors that did well were Utilities, Consumer Staples and Healthcare. A breakdown of stock performance by S&P 500® sectors can be found in CHART 5.

Fixed Income Market

With the economic turmoil here and abroad during 2011, investors flocked to the safety of U.S. Treasury issues pushing prices skyward. At the beginning of 2011, the yield on ten-year U.S. Treasuries was 3.3%. By the end of the year, the yield had fallen to 1.9%, very near long-term historic lows. This is also true of the 30-year Treasury bond which currently yields 2.9%. At today's elevated prices, there is significant interest-rate risk undertaken by investing in long-maturity bonds, so we're avoiding them. Purchasing a long-maturity bond to get the higher current yield is like picking up nickels in front of a steam roller – very risky. Therefore, we have invested our bond portfolio with a focus on preservation of principal, and have limited the fixed-income securities to high-quality issues with short to intermediate maturities.

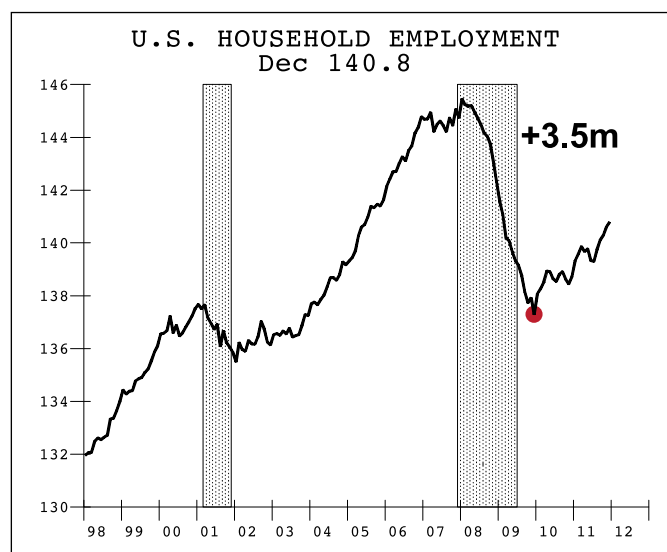


Chart 4

SOURCE: ISI, DAILY ECONOMIC REPORT: EXPANSION BECOMING SELF-SUSTAINING, JANUARY 6, 2012

Performance of S&P 500® Sectors (Total Returns)	
Sector	2011
UTILITIES	20.0%
STAPLES	14.0%
HEALTH CARE	12.7%
TELECOM	6.3%
DISCRETIONARY	6.1%
ENERGY	4.7%
TECHNOLOGY	2.4%
S&P 500 ADJ FOR DIV	2.2%
INDUSTRIALS	-0.6%
MATERIALS	-9.8%
FINANCIALS	-17.1%

Chart 5

SOURCE: STRATEGAS RESEARCH PARTNERS
"QUARTERLY REVIEW IN CHARTS", JANUARY 3, 2012

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Conclusion

In 2012, investors can expect the tug-of-war between stronger U.S. business fundamentals and macroeconomic and political worries. Successful investors always view periods of uncertainty as periods of opportunities. Our experience indicates that the best chance for protecting capital from permanent losses and compounding that capital at above-average rates is to:

- **Have a long-term investment horizon,**
- **Own high-quality, competitively entrenched businesses with fortress-like balance sheets,**
- **Own shares of companies with the ability and inclination of management to produce a growing stream of dividends, and**
- **Only buy at a discount to intrinsic value, so as to reduce risk.**

Because we follow these principles, we expect the stocks we select to generate positive returns over the next several years. In closing, we feel this quote is particularly timely:

"I think the future of equities will be roughly the same as their past; in particular, common-stock purchases will prove satisfactory when made at appropriate price levels. It may be objected that it is far too cursory and superficial a conclusion; that it fails to take into account the new factors and problems that have entered the economic picture in recent years especially those of... the movement towards less consumption and zero growth. Perhaps I should add to my list the widespread public mistrust of Wall Street as a whole, engendered by its well-nigh scandalous behavior during recent years in the areas of ethics, financial practices of all sorts, and plain business sense."

Excerpt from June 1974 speech by Benjamin Graham, printed in Financial Analyst Journal, Sept/Oct 1974

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