Ferguson Wellman

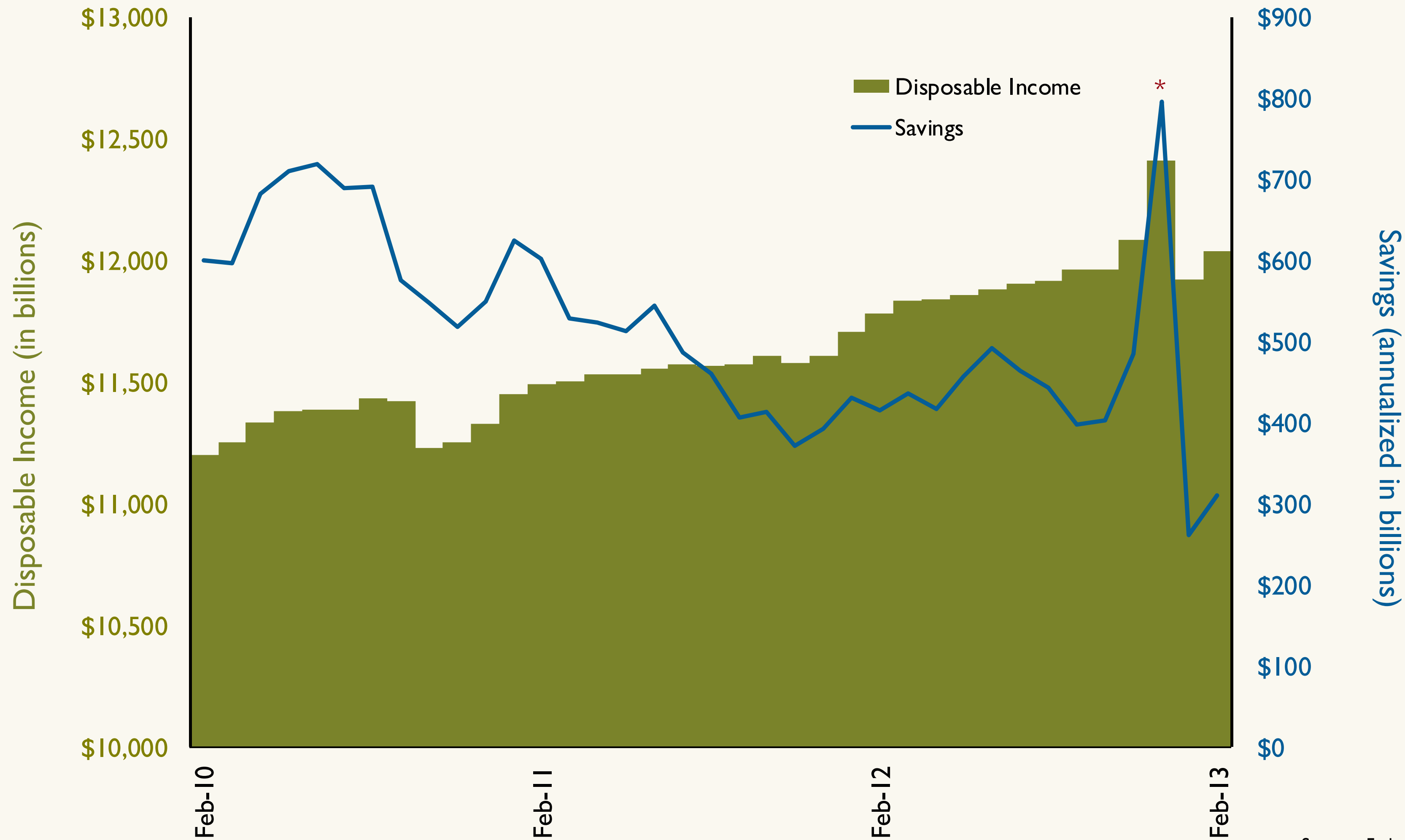
Capital Management

Climbing the Wall of Worry

Investment Outlook Second Quarter 2013

- Recession in Europe, re-acceleration in China and slow economic improvement in the U.S.
- The consumer has seemingly "shrugged-off" higher taxes and sequester cuts
- Net equity fund inflows join an improving economy to fuel capital markets
- Housing, energy and manufacturing are positives for the domestic economy
- Though overdue for a market correction, we remain constructive on equities

Consumers Have Spent Savings to Offset Higher Taxes



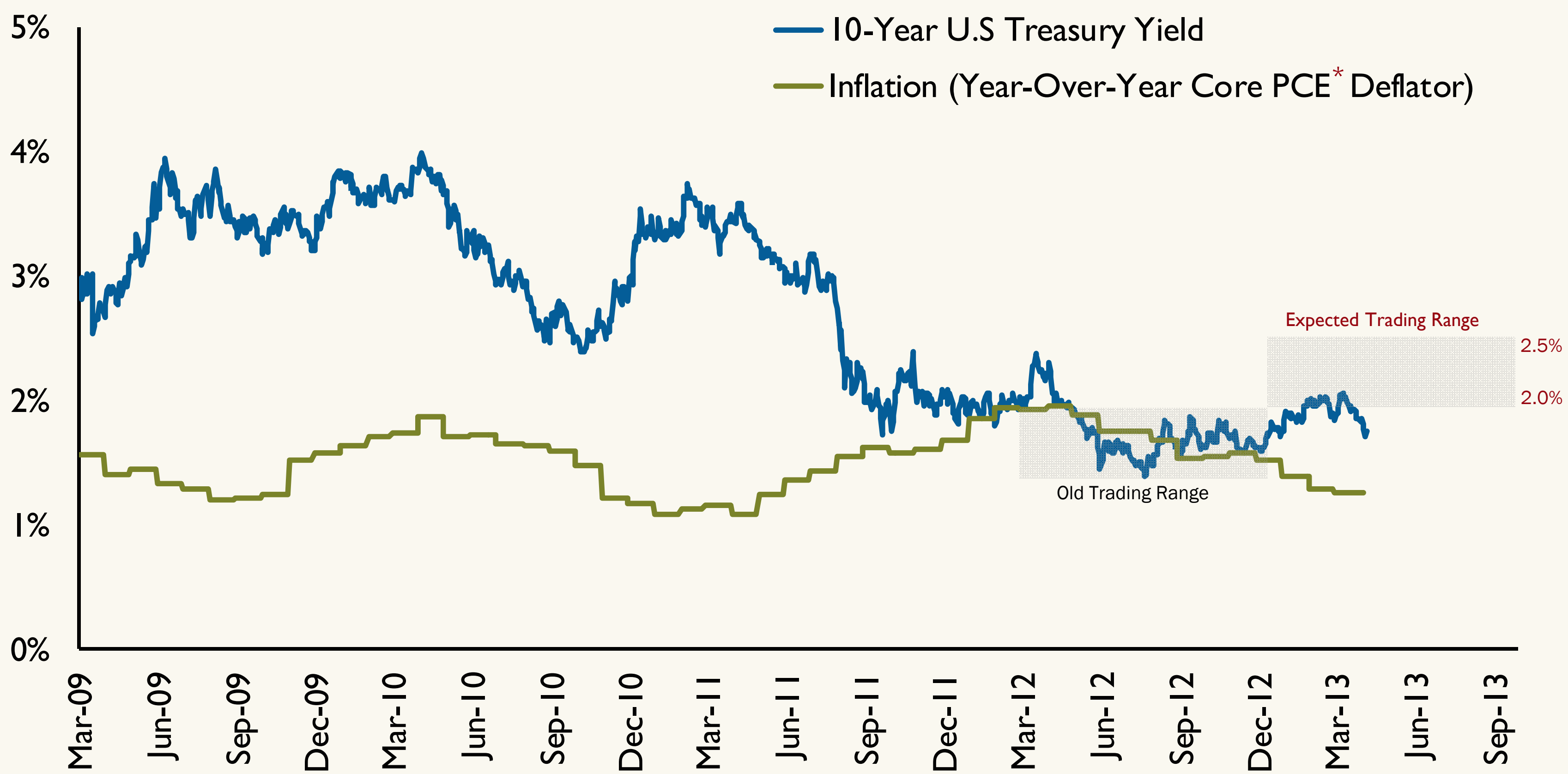
Source: Federal Reserve

- Thus far, the consumer has continued spending through tax hikes by utilizing their savings
- Tapping savings is *not* a sustainable strategy

* Personal income in November and December was boosted by accelerated and special dividend payments, accelerated bonus payments and other irregular pay in private wages and salaries in anticipation of individual income tax rates changes.

Interest Rates Up and Inflation Down

10-Year Treasury Yield and Inflation (Year-Over-Year Core PCE Deflator)

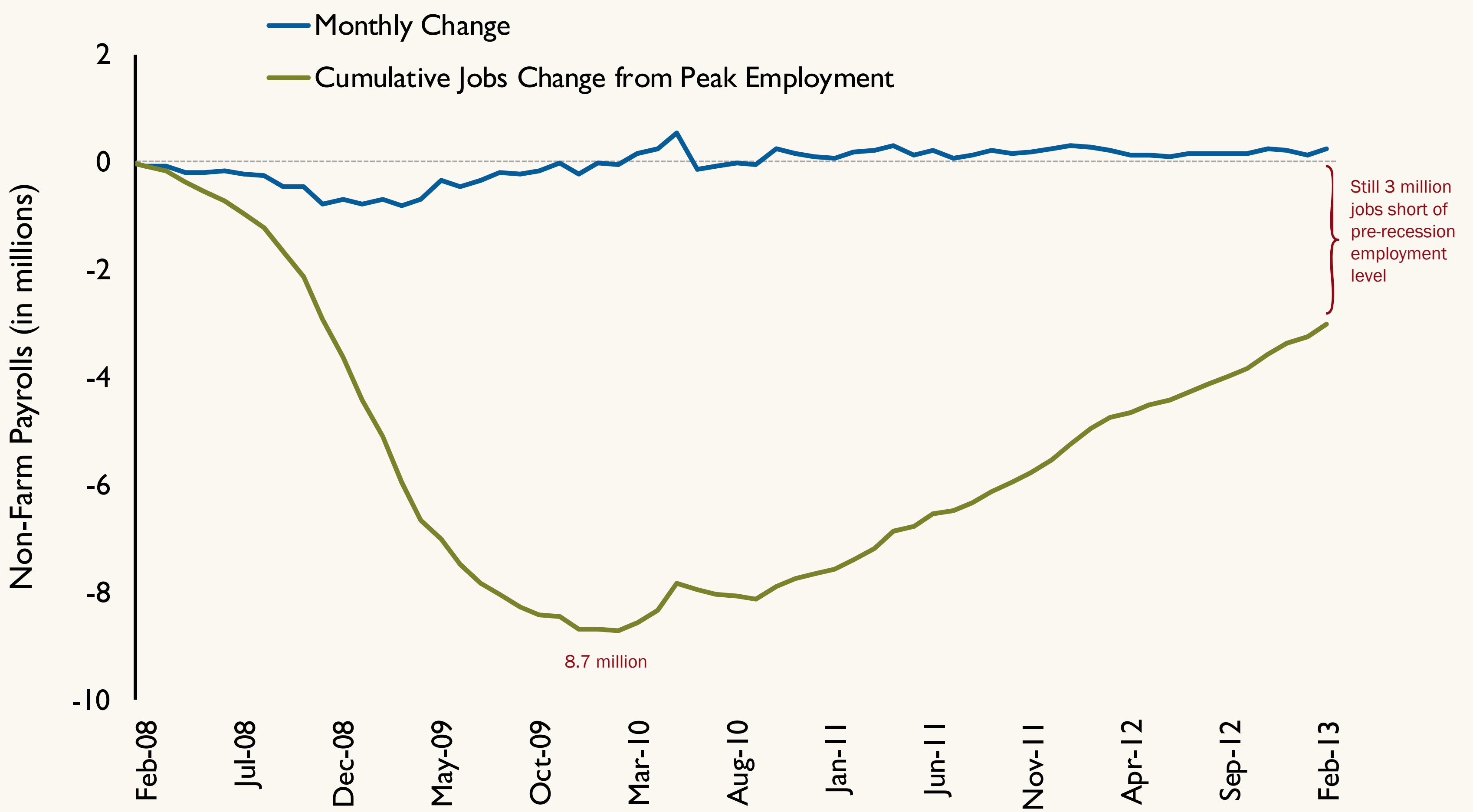


Source: Bloomberg

- Quantitative easing (QE) has kept a lid on interest rates
- With a targeted upper limit of 2.5 percent inflation, the Fed has a lot of room for continued quantitative easing
- Forecasting for a strengthening economy, we expect the 10-year U.S. Treasury yield to creep up into a higher trading range

* "PCE" – Personal consumption expenditures is the component used for consumption in GDP as calculated by the bureau of economic analysis. It measures goods and services consumed by individuals.

Employment Is Improving … But Still a Long Way to Go

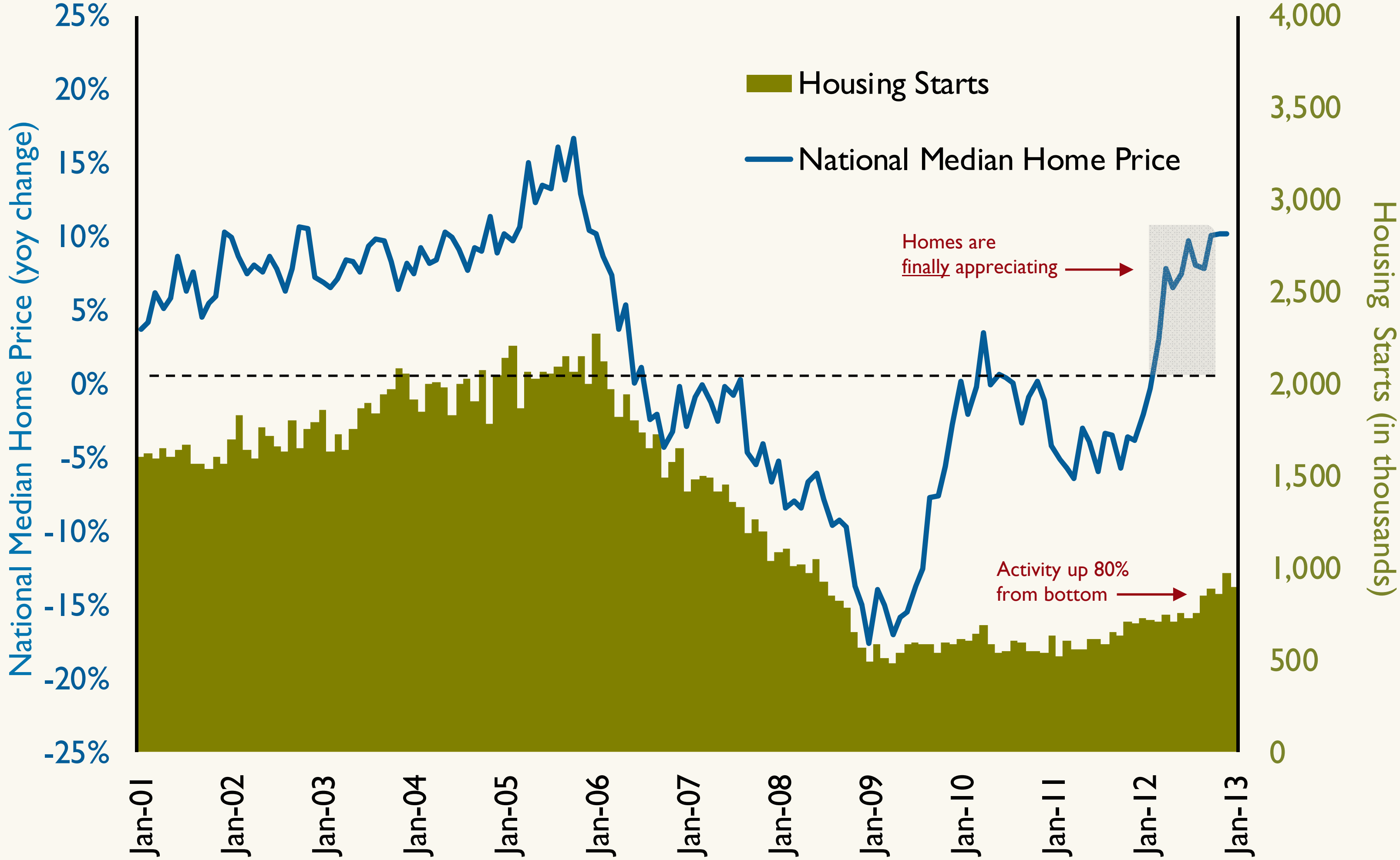


Source: Bloomberg

- At the current pace of payroll gains, it will take another 18 months to return to pre-recession levels of employment
- The end of quantitative easing (QE) by the Fed is still months away
- The Fed is targeting 6.5 percent for an unemployment rate that is now 7.6 percent
- Recent "gains" in the unemployment rate have come through reduced participation

Housing Recovery Is Real and Getting Stronger

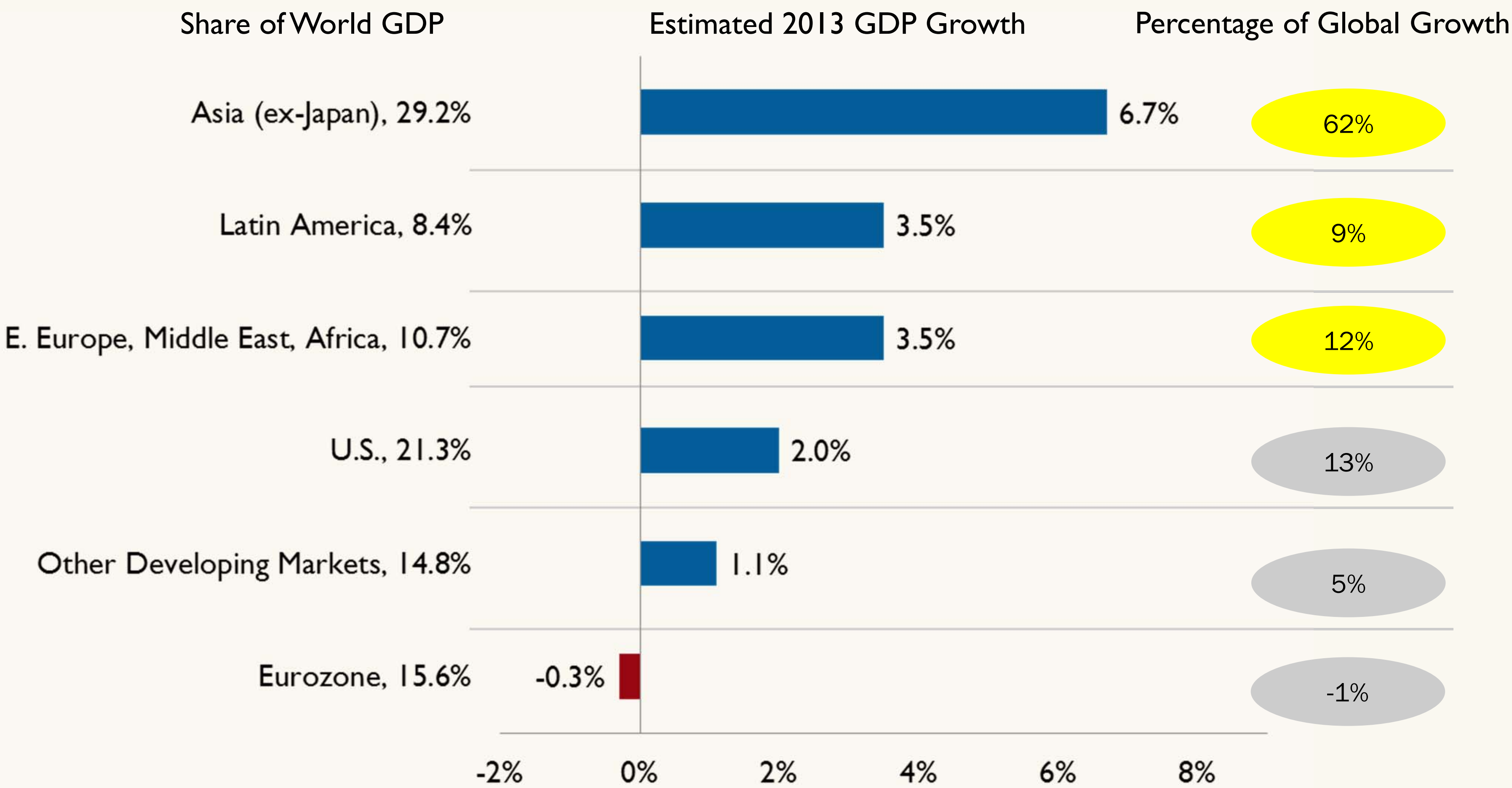
Housing Is Now Adding to GDP Growth



Source: U.S. Census Bureau

- Benefiting from record-low mortgages and affordable prices, the housing recovery is an investable theme
- Housing could nominally add between 0.5 percent and 1.0 percent to GDP growth in 2013
- Fed purchases of mortgage-backed securities should keep mortgage rates low for some time

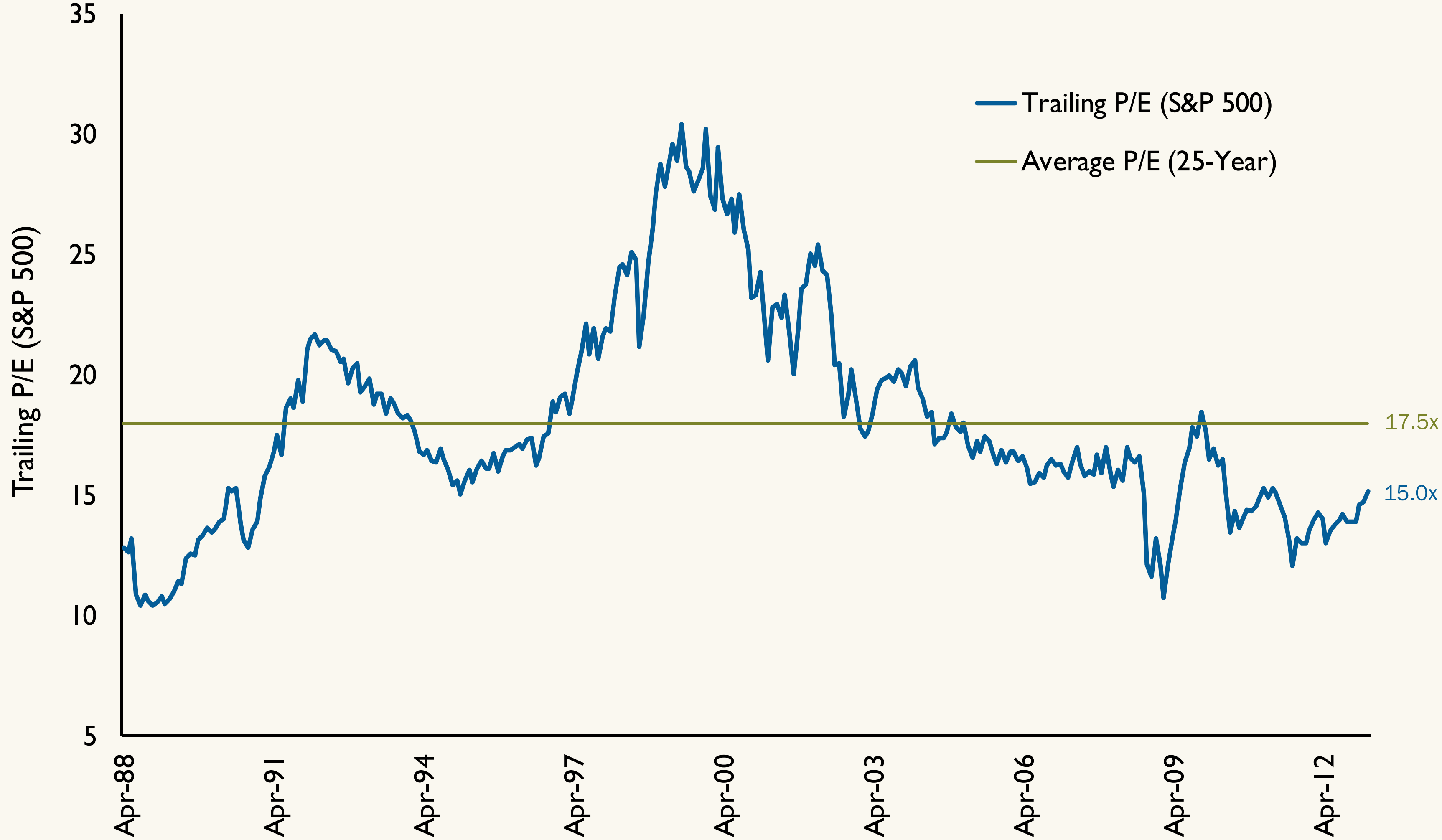
Emerging Markets Are the Global Growth Engine



Source: IMF, Deutsche Bank Research

- Global share of GDP is roughly equal between developed markets (52 percent) and emerging markets (48 percent)
- 2013 estimated total global GDP growth of 3.2 percent (5.4 percent from emerging markets, 1.0 percent from developed)

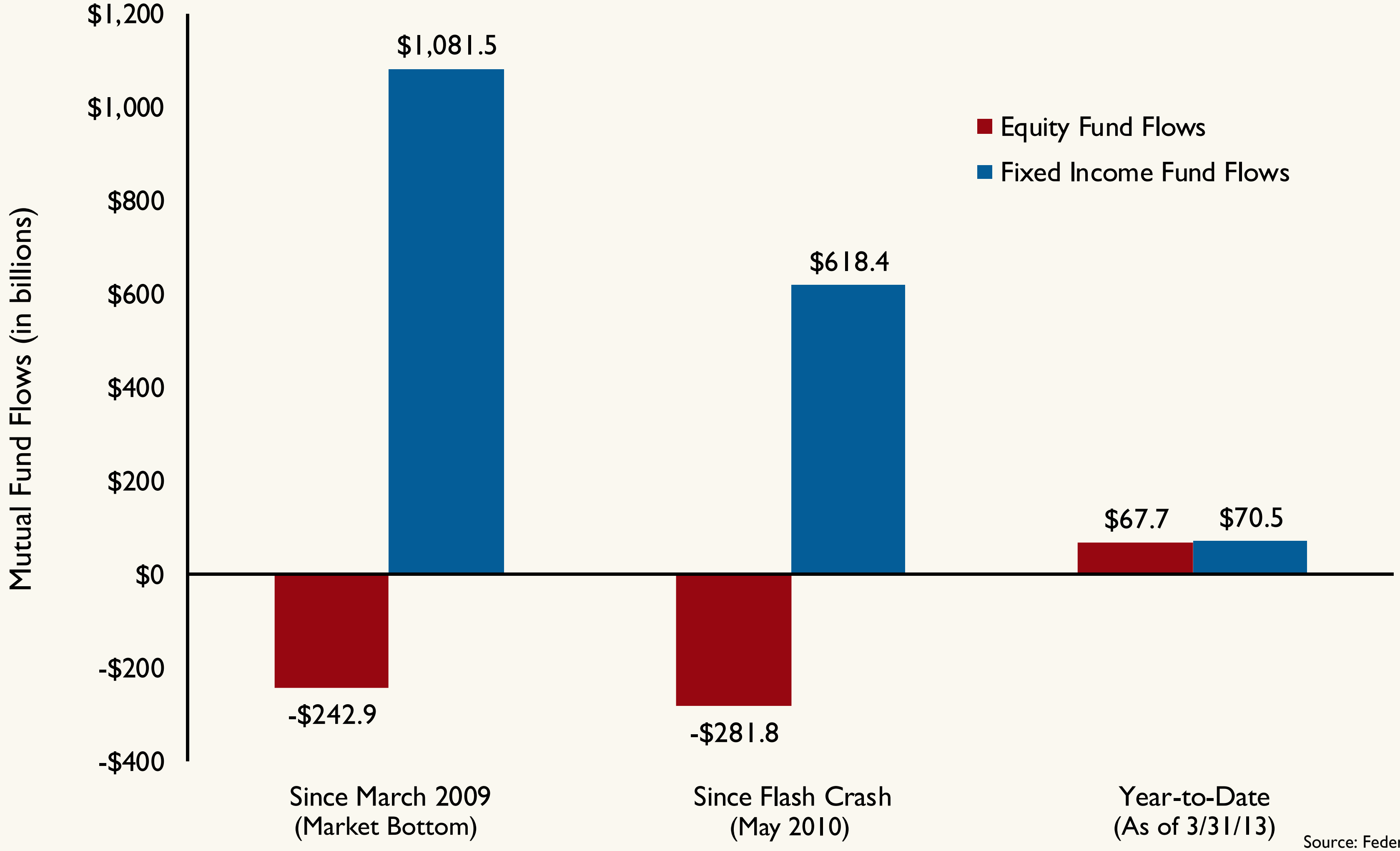
Valuation Is Not an Impediment for Equities



Source: Factset

- For the past 25 years, the average multiple on the stock market has been 17.5. Today we trade at only 15x trailing estimates
- Stocks are reasonably priced relative to other asset classes and their history
- Valuation is just one metric we consider with regard to equities

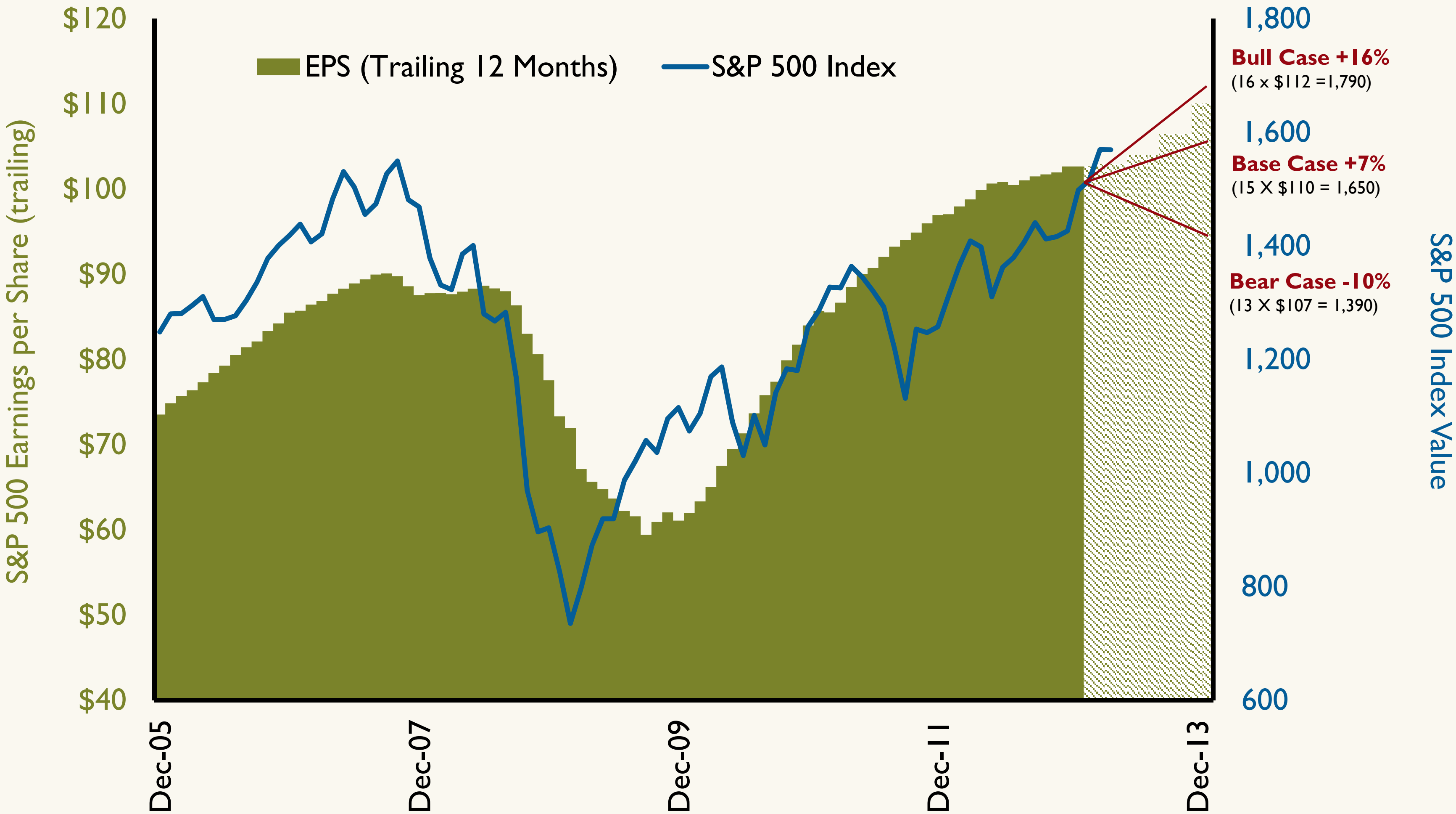
Investors Are Finally Starting to Allocate to Equities



Source: Federal Reserve

- Equity flows are now turning modestly positive
- We view bond funds as a source of funds for equity markets in the coming years
- Flows out of bond funds will not occur en masse until rates move enough to cause losses in fixed income vehicles

Equities Had a Good Year … In One Quarter



Source: FactSet

- Margin improvement and share buybacks could result in 7+ percent earnings growth in 2013
- Low rates and increased fund flows should enable price/earnings multiples to trend higher
- S&P earnings of $93.00 at previous peak (October 2007) compared to current trailing earnings of $103.00

Second Quarter Investment Outlook

Macro

- U.S. economic growth will likely accelerate in second half of year
- Expect interest rates to move up modestly
- Investor focus likely to shift from policy actions to fundamentals
- Improving macroeconomic backdrop and fund flows favorable for equities

Risks

- Impact of the sequester may impair the pace of job growth
- Continued instability in the Eurozone (Cyprus is the latest example)
- Higher taxes could adversely impact consumer spending