Dillon Capital Management
Q1-2013 Quarterly Review

Economy

The Fed's easy monetary policy, which remains in disaster prevention mode, supports growth while the administration's fiscal policy is a hindrance.

Overall the greatest impact of fed policy has been on liquidity, assisting the cyclical housing recovery, and employment growth. Low interest rates and liquidity lubricate commerce across the economy, including housing activity. Home prices overshot long-term equilibrium from 2002-2008, then undershot during the recession of 2009. Recent price growth of 7% will return housing to the historic trend line by 2015. This trend provides support to employment growth, and could lead the US to 3% GDP growth by Q4-2013.

Japan has joined the list of global central banks that have accelerated monetary easing to stimulate economic growth. The Europeans have focused more on austerity and problem countries.

Despite negative real interest rates (10-yr Gov. Bond Yield less inflation), much of the world is only succeeding at halting deflation (asset price declines), quite a ways from a return to economic growth.

Capital Markets

The US market remains the strongest as we lead the global recovery. The new-year got off to a strong start following budget and tax resolutions.

Stocks rallied in the quarter, led by the US and Japan. The S&P 500 was up 10.6% and the EAFE index gained 5.1% (strong Japan, flat Europe). Large and small cap stocks did best, and value style sub-indexes beat growth portfolios. Dividend strategies, which typically underperform during market spikes, beat the broad markets in Q1.

The Philippines, Japan, and Indonesia were the best at the country level, with returns in the mid-teens, while the BRIC countries and the emerging markets index declined over 5%.

Fixed income markets continued to be weak as investors anticipate higher interest rates in the future in the US and increased risk for debt in other countries. The high yield sector squeezed out about a 2% total return, but the broad indices declined for the first time in over 5-years. Overall, returns were flat in the US, while international fixed income declined on credit downgrades.

Capital Market Returns	Q1- 2013	1 Year
Barclays 1-3 Yr Tsy.	0.12%	0.64%
Barclays Agg Bond	-0.12%	3.77%
London Gold Fix	-3.95%	-3.86%
S&P 500	10.61%	13.96%
MSCI EAFE	5.23%	11.27%

In commodities, energy related prices rose in the low single digits, metals and mining declined, and agriculture was slightly positive. Commodity markets are experiencing the part of the cycle where inventories and capacity remain high, yet demand from a slow global environment is weak.

Strategy

Our asset allocation heading into 2013 reflected a preference for equities over bonds, US assets over foreign markets, and value over growth. This was directionally correct but our modest cash position was a drag in the strong market. An overweight to the value style and small cap was positive for performance, but the position in the weak emerging markets detracted from returns.

With the major indexes at all-time highs, and bond yields at all-time lows, caution should be taken. The economy is stabilizing but is not strong – not a good scenario for corporate profits and stock prices heading into Q2.

Better opportunities are emerging in Japan and will eventually materialize in Europe. In the mean-time, we still prefer the US, and stocks over bonds.

G. Foley -- April, 2013