Dillon Capital Management
4th Quarter Review

Economy

Despite a number of challenging events during the quarter, global economies and capital markets forged ahead. In no particular order, the presidential election was decided, the uncertainty of taxes and the "fiscal cliff" was resolved, and QE-3 was implemented by the Federal Reserve.

Economic growth in the US continued at a slow pace. The unemployment rate declined below 8%, and the housing market showed signs of improvement. But going forward, payroll taxes will rise and disposable income will decline.

Nearly every central bank in the world is printing money. The objective may be to reflate asset prices and support the banking system, but the immediate effects include: devalued currencies, and rekindling of inflation fears.

The EU leaders have worked diligently with great resolve to save the euro and the union while offering negotiated terms of support for the weakest players. Europe has stabilized for the time being, staving off default and subduing the demonstrations in Greece and Spain.

China shows signs of returning to growth. In Japan, a new government promises to take an aggressive approach to devaluing the yen, allowing exporters to become more competitive and turn around decades of corporate decline in the cheapest equity market in the world.

Capital Markets

Despite event-driven volatility, the two broad measures for US investors literally did nothing in Q4…the S&P 500 declined -0.38% and the Barclays Aggregate Bond index rose 0.22%. Among other indicators, foreign stocks rose the most in Q4; MSCI EAFE and MSCI Emerging markets were up over 5%; while gold dropped 7.3%.

For equities at the country level, Turkey, Austria, and China all rose between 13-15% for the quarter; and Ireland, Germany, and Spain rose between 8-10%. The Americas trailed the global pack, generating low single digit returns, or slightly negative returns in the case of Canada and the US.

In fixed income markets, international high yield was up about 8% for Q4. High grade US corporate bonds gained in the low single-digits, while mortgage backed securities and long-dated treasuries declined about 1%.

Capital Market Returns	Q4- 2012	1 Year
Barclays 1-3 Yr Tsy.	0.06%	0.43%
Barclays Agg Bond	0.22%	4.22%
London Gold Fix	-7.25%	8.26%
S&P 500	-0.38%	16.00%
MSCI EAFE	5.59%	17.32%

For the full year, among the 15 broad market benchmarks we follow, the DJ US Real Estate Index was the best performer, gaining 18.9%, just beating the S&P US Preferred Stocks, up 18.6%. The MSCI Emerging Markets and EAFE (developed markets) Indexes sandwiched the Russell 1000 Value Index, in the 17-18% range, ahead of the S&P 500's 16%.

Bond indexes had another positive year but returns were in the low single digits.

Strategy

We were rewarded for two of three tactics we mentioned in our last report as foreign bonds and foreign real estate were strong. But US stocks, which remains our preferred market for risk/reward, was flat.

Stock market volatility is at a 5-year low, while the indexes are near highs with a fragile recovery entering its fourth year. Stocks seem to be much favored over bonds, even if growth is tepid.

We favor equities and inflationary assets like gold and real estate, at least thru Q1-2013, but remain on watch for more volatility. Bonds yields have likely hit bottom, putting principal at risk if rates rise.