



SPRUCE HILL

CAPITAL, LLC

Dear Client:

Happy New Year and I hope you all enjoyed your Holidays. We say goodbye to the ambiguity of 2011 (the market that couldn't decide what to do) and look forward to a new year with excitement and a positive outlook. You heard me right – I'm tired of the negativity that's surrounded us. Oh sure there's plenty to worry about still. Europe will get worse. Our debt picture hasn't been addressed. Markets remain volatile and uncertain. But I believe there's a way through this, which I will describe below. First a brief review.

➤ **2011:**

Markets were up and down all year. Many ended down for the year, especially International markets. It was exhausting wasn't it!? This year we have the Presidential election, with those awful "gotcha" ads running every candidate down. I hope you are able to ignore them and do some in depth reading on each candidate.

Anyway we've spent plenty of time exploring the problems we face in these newsletters. And we will continue to keep on top of them for you, believe me, it's a lot of what we do. **But you know what? Let's look at the positive side: we survived intact.** The good old US of A turned out to be the place of refuge worldwide and I think that will continue. US markets actually did better than most. The dollar has rallied recently. Interest rates remain low. Oil is up but manageable so far. Commodities like grains and metals have gotten cheaper after hitting highs. Inflation remains modest. Housing is showing small flickers of rebounding. Unemployment numbers are turning a bit positive. Yes, we have a long way to go. And there are many challenges ahead. **But we're strong enough to surmount them, and I believe we will.**

➤ **What We're Doing:**

We've plotted a course that we can feel confident about no matter what happens, so let's talk about that. What's our plan for 2012?

➤ **Systems**

I believe we've developed, and continue to develop, premier systems to manage money in this environment. **I am confident we have in place what we need to preserve your capital on a relative basis and experience gains as opportunities arise.** I predicted a 15%+ correction last year, it happened, and our systems caught it well. Toward the end of the year we cautiously built equity exposure to try to take advantage of a year-end rally. It came very late, and barely, but we were ready for it.

➤ **Allocation Models**

We have continually updated our models to take what markets will give us. I will show you the details when we review your accounts with you, but basically we are investing your portfolios as follows:

- **The core of your portfolio is large company stocks that pay good dividends;**
- **Because big companies tend to survive just about anything; and**
- **Dividends give us real cash every quarter.**

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No matter what markets do stocks like Johnson and Johnson, MacDonald's, Exxon-Mobil, and Proctor & Gamble have always bounced back. **So even if markets decline, we can be confident of what we own.** In addition, the dividends they pay are important for another reason: **we reinvest them into the funds, buying you more shares.** The name of the game with mutual funds is **amassing a large number of shares.** Then when markets eventually rebound, assuming the funds rebound too, **all those additional shares go up with them.** That's the leverage that reinvesting gives you.

➤ **Sectors We Are Invested In**

Our core holdings will include conservative/defensive sectors like consumer staples, utilities, communication services, basic materials, and real estate. **These sectors have tended to do better in a slow growing economy.** We will also look for opportunities in healthcare and energy which represent special situations. We are de-emphasizing areas like consumer cyclicals that tend to better in a booming economy, which we do not yet have. In our bond allocation we will continue to stay with shorter duration funds that pay good dividends but have the flexibility to adapt in a low interest rate environment.

Tactically we are building a list of individual stocks that we can choose from at any given time to add to your portfolio. Two examples we own now are Vodaphone, which pays a 5.3% dividend and we believe has upside potential; and Microsoft with a 3.2% dividend and also upside in our view. **At any market dip we can choose from this list to add stocks we feel have the potential to bounce back strongly.**

In addition, we are developing an options strategy for your portfolios. Options can add income to a portfolio and increase returns. Again, I will describe this to you in greater detail when we meet.

And of course we continue to use quantitative systems to increase/decrease market exposure to protect you.

➤ **Reduced Fees and Ticket Charges**

For 30 years I did not cover ticket charges, you did, as is standard practice in our industry. For the last 2 ½ years I have covered them. At Commonwealth they were about \$20/fund, at TD Ameritrade they are \$10 (\$9 for stocks, \$0 for bonds). I am going to need to change this policy. I can no longer pay the ticket charges for the reasons stated below. In return **I will reduce your management fee by 5 basis points effective January 1 this year.** For many of you this will more than cover them. I will continue to cover ticket charges through January. You will be responsible for them starting February 1st.

There are several reasons I have had to do this. First, there are potential regulatory problems with doing it and I have been advised to end the practice. Second, the costs are completely unpredictable making it very difficult to run this business properly. Advisors generally do not cover ticket charges, for the reasons stated above. We are far and away the exception, and I can now see why. It was something I wanted to do and tried to do for you, but I hope you will understand that it is not possible for me to continue. We will do everything we can to keep this to a minimum for you. There are funds we can use that don't have a ticket charge, and when in your best interest we will use them. Also, overall, we fully intend to control trading activity. The approach I described above takes that into account.

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We have further plans to increase staff this year which will only improve our service to you. I need to have clarity on expenses going forward to be able to accomplish this very important objective.

➤ **New Partner News**

Finally, I'd like to share with you my feelings on our new structure here. I'm excited about the way Vince Esposito, Jim Newman and I are meshing as an investment team. Vince is my junior partner now, and Jim is our investment and portfolio analyst. We look at all aspects of the economy, markets, and investment world continually and compare notes on what we're seeing out there. It's a constant process, and we're always comparing notes, but we have a formal meeting schedule as well.

The first is on Monday morning with Ted Wong, our technical analyst to review market activity from all angles. Then we meet again early Tuesday morning to review investments, portfolio performance, our models, and to decide on any possible changes to make. We are constantly looking for new ideas, changes in the economy, examining investments we're using and tracking, and looking for potential investments we want to put on our radar.

I can't tell you what a pleasure it is for me personally to have created and now operate in a collaborative environment where we can discuss ideas and decide on action plans. I'm not quite sure why I did this alone for 30 years but I'm glad I allowed myself some space to evolve.

And we all LOVE the new office! Everyone who's been here does, so please come up and visit us when you can, we'd love to see you. In addition to Patty and Joy, we now have Vince's assistant Alisha. She's just lovely to work with. Also we are working on updating and improving our website. Note our new logo above - a very small but important first step in the process. We will announce the new website to you when it is completed. Stay tuned!

We thank you for your continued trust and business and wish you and your loved ones a happy, healthy, and successful 2012!

Sincerely,
Peter

Disclosure: The preceding was provided by Peter J Nagle of Spruce Hill Capital, LLC a Registered Investment Adviser located at 2614 Boston Post Road, Guilford, CT 06437, (203)689-5742. This report has been derived from information considered reliable but it cannot be guaranteed as to its accuracy or completeness. Certain sections of this Commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is no guarantee of future results. Investment return and principal value of an investment will fluctuate, and when redeemed, may be worth more or less than their original cost. Investors should consider the investment objectives, risks, charges and expenses of any investment carefully before investing. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The NASDAQ Composite is a stock market index of the common stocks and similar securities listed on the NASDAQ stock market, made up of over 3,000 components. This newsletter is not an offer to sell or the solicitation of an offer to buy any security in any jurisdiction where such an offer or solicitation would be illegal. This newsletter is distributed for informational purposes only and should not be construed as investment advice or a recommendation to sell or buy any security or other investment, or undertake any investment strategy. It does not constitute a general or personal recommendation or take into account the particular investment objectives, financial situations, or needs of individual investors.

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