The ACM Journal

"Securities"

A lot of people have installed security systems in their homes. It makes sense. Despite the monthly cost, an investment in your personal safety, and that of your family, is one of the smartest you can make. However, because of my own peculiar circumstances, I don't feel the need to have a security system in my home.

My wife, Nipa, recently tested for and earned a black belt in karate. The test took over three hours and was physically grueling. She had to stand in front of a panel of twelve other black belts and prove her proficiency in every technique she had learned over the past several years. She then had to perform a number of self-defense moves that involved flipping, throwing, and physically disarming her would-be marauders. Lastly, she had to spar with eight black belts to show she could perform her moves when demanded.

Both of my boys have also earned their black belts in karate over the past couple years. They are young, but they are quickly getting to the point where their old dad can't keep up with them anymore. In fact, even my daughter, at only two years old, has gotten in on the act. If you grab her hand and say "You're coming with me" in a menacing way, she starts yelling "hi-ya" and trying to kick you in the shins.

So, with my family of ninjas, I am feeling very secure these days. That is, as long as I keep repeating the phrase "yes, dear".

In This Issue

Capital Markets Review

It was a year of crises. We started the year with Greece in turmoil, which then spread to many of the other European nations. There was concern the European Monetary Union would dissolve and the Euro would be replaced with sovereign currencies, such as the Deutsch Mark, Italian Lira, French Franc, and the like.

Worry over the strength of the economic recovery in the U.S. also made headlines. Employment was weak, housing stagnated early in the year, and business and consumer confidence were anemic, at best. The Fed continued to provide stimulus through its bond buying and money printing mechanisms to help ensure we did not fall back into recession.

The misery was broken only by interludes of circus-like episodes of political folly. There was wrangling over whether Obamacare would be declared unconstitutional. There was an election where each candidate spent close to $1 billion to win the hearts and minds of the American public. And, of course, there was the "Fiscal Cliff," which we detail elsewhere in this newsletter.

Against such a backdrop, no one would have expected the capital markets to provide gangbuster returns. Yet, that is exactly what happened. The nearby chart illustrates the strong returns provided by virtually every asset class.

Despite the negative headlines and predictions of continued misery throughout 2012, there were actually a lot of positive supports for the capital markets:

- Low interest rates, while frustrating for those relying on portfolio income, are tremendously positive for corporations trying to finance future growth.
- Corporate earnings were strong throughout the year, partly as a result of low interest rates, but also because of the lean operational structure corporations have created since 2008.
- Inflation has also been low. This may not continue for too many years, but during 2012

inflation was below the historical norm, which helps encourage consumers to spend.

- Housing, a drag on the economy early in the year, started to rebound around the country later in the year. This was a tremendous benefit to the household segment of the economy, but also a huge boon to financial institutions, which own a lot of real estate as a result of all the foreclosures of the past couple years.
- A boom in domestically-produced energy has benefitted specific regions of the country and made energy cheaper for the nation as a whole. North Dakota and Pennsylvania, in particular, have seen their economies lifted as oil drilling and hydrofracking for natural gas have produced greater energy supplies.

These factors, often ignored by the popular financial media, have created the foundation for significant economic and corporate earnings growth. Stocks responded in 2012, and it is possible the beneficial impact will last a while longer. Despite the surge in stock prices in 2012, valuations still remain at historically attractive levels, so it is not a foregone conclusion that 2013 will be a year where the markets reverse what they earned in 2012.

Big Things Come in Small Packages

Interestingly, smaller stocks outperformed large-cap stocks for the year. Mid-cap and small-cap stocks tend to pay less in the way of dividends. Since dividends are currently in vogue, it is odd that these asset classes would outperform the higher-yielding large-cap segment. Also, smaller stocks currently trade at much higher valuations than large-cap stocks. Large-cap stocks have generally outperformed smaller stocks the past couple years, but the prior ten years saw smaller stocks dominate. It seems likely that at some point the cycle should shift, so again, we were surprised by the relative gains of mid-cap and small-cap stocks in 2012.

That said, smaller stocks do provide a great way to diversify a more traditional all large-cap portfolio, so even with higher valuations, we believe they are good long-term investments. Historically, over longer periods, smaller companies tend to outperform because of their higher growth rates and the higher risk they pose.

International Rebounds

International stocks are starting to rebound after lousy returns for the past couple years. Indeed, they outperformed domestic large-cap stocks by a decent margin both in the fourth quarter and over the past year. While problems with European economies still plague the continent, they seem to be past the point of crisis. The same was true of the United States in 2009 when our market bottomed out and began a significant rally that so far has lasted over three years. While it is far from certain, European stock markets could experience a similar rally as valuations return to "normal" levels, rather than their current depressed levels.

The emerging markets also performed well in 2012 after struggling in 2011. Interestingly, China was not a key contributor to this growth. The Shanghai Composite Index was only up 3.2% in 2012. Rather, it was countries that don't often make headlines (at least not in good ways) that accounted for much of the upside. Turkey's stock market rose 53%, the Philippines' rose 33%, and Thailand saw a rise of 36%. Many of these same nations experienced poor stock market performance in 2011, which illustrates the point that diversification is important, especially in the volatile emerging markets. It is very difficult to pick next year's winners and losers, but if you buy a fund with exposure to all of the emerging market nations, you can still earn solid returns with a lot less volatility than picking just one or two countries.

Real Estate Continues to Soar

Commercial real estate had another stellar year. In fact, REITs were the best performing asset class we track, earning almost 19.0% in 2012. REITs are now almost four years into a very significant rally that appears undeserved. After all, corporations are not exactly clamoring for more office space. In fact, the national vacancy rate for office properties is 17.1%, not much below the peak of 17.6% in the wake of the 2008 recession. There are some bright spots, such as apartments. While lending standards have made it tough to purchase residential property in recent years, apartments have become the abode of choice. Apartment vacancies are at very low levels and rents have steadily increased. However, the economic fundamentals for the overall commercial real estate sector have not been great.

REITs do offer a solid way to diversify your portfolio and they historically have paid significant dividends. We believe the latter is the reason for REITs meteoric rise the past few years. You can't open a financial periodical these days without reading about how important income is. While we're not sure we share that view, low interest rates for bonds and bank accounts have led many to high yielding vehicles such as real estate investments. Ultimately, higher valuations for REITs may slow investors' appetite for them. Nevertheless, we like REITs for their diversification benefits, and we will continue to hold them for most of our accounts.

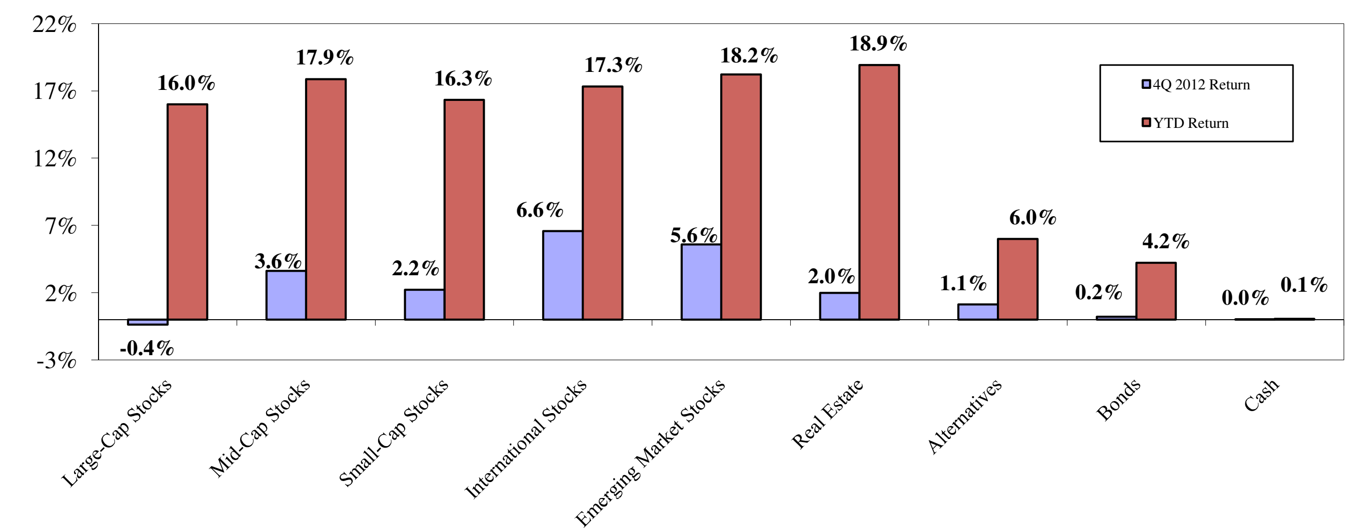
Bonds Uninspiring

The overall bond market rose 4.2% in 2012, below its historical average. This is not surprising given the low level of interest rates. Intermediate-term Treasury bonds were the most anemic, returning only 1.7%. Mortgage-backed bonds were better with a return of 2.6%. However, high quality corporate bonds provided the strongest gains, rising 6.6%. While bonds are not providing much in the way of return, and less in the way of income, they are a necessary evil in most portfolios. Despite low yields, bonds provide an important buffer against dramatic drops in the stock market. In 2008, for example, when stocks dropped 37.0%, bonds rose over 5.0%. While we are not forecasting another large stock market decline, those events are largely unpredictable, and bonds will help protect your portfolio when another adverse market event occurs.

Alternatives Steady

Alternative investments rose 6.0% during 2012. The range of returns for the various components of this

Fourth Quarter 2012 Asset Class Returns



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indcies. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite Index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 30-day T-Bill.

group was diverse. For example, commodities were down slightly for the year, while high yield bonds rose over 14.0%. The currency strategy we use was up over 10.0%, whereas some of the hedge fund-type investments we use rose only around 3.0%. A broadly diversified mix of alternative investments is designed to reduce overall portfolio risk, and that was the case in 2012. Over longer time periods, we expect returns less than stocks, but greater than bonds. The real reason for alternatives, though, is for the risk reduction properties they offer.

Conclusion

Overall, it was a great year for investors. Given the dire headlines, particularly early in the year, not many would have guessed that returns would have shaped up as well as they did. That is the reason why it is difficult, and dangerous, to try to time the market. The best course of action is to stay invested, through good times and bad. While such an approach may be difficult to stick with in some market environments, it has proven fruitful over longer time periods.

The discipline to stay invested, diversification across a range of different asset classes, low fees, and smart tax management make up the foundation of a solid investment plan. We try our hardest to incorporate all of these concepts into the portfolios we manage.

CLIFF NOTES

After much hand wringing and dire prognostications by economists and financial journalists, the "Fiscal Cliff" turned out to be as insignificant as Y2K or the Mayan apocalypse. Without a deal to the contrary, January 1st would have seen automatic across-the-board tax increases and significant spending cuts, particularly in the defense budget. While our elected officials took it right down to the wire, a compromise on tax increases and spending reductions was eventually reached.

The net effect is tax increases on individuals earning in excess of $400,000 or couples earning over $450,000. The new marginal income tax rate for this group will be 39.6%, up from 35% last year. There will also be new limits on deductions that higher earners will be allowed to take. Additionally, long-term capital gains and qualified dividends will be taxed at 20%, up from 15%, for those in the highest income tax bracket. Tax rates will remain the same for anyone earning below the new top thresholds.

Estate taxes were also part of the bargain. The new estate tax exemption, or amount under which estates won't have to pay taxes, is $5 million per person. The new tax rate for estates is 40% versus the previous 35% rate. This is generally good news, as there was talk that the estate exemption would be reduced to $3.5 million or possibly even $1 million. Even better, "portability" and "stepped up basis" are still part of the estate tax law. Portability allows your estate exemption to be moved to your spouse. For example, if one spouse dies and leaves his entire $5 million estate to his wife, she can then exempt $10 million upon her death. Stepped up basis allows the original cost of any securities held within an estate to be repriced at the date of death so that heirs may be able to avoid capital gains taxes. Both of these represent important provisions that we're glad have been retained with the new law.

Also important, the alternative minimum tax was adjusted. The "AMT" was put into effect years ago to ensure "fat cats" wouldn't end up paying nothing in taxes because they concocted a lot of deductions. However, many of the wealthiest Americans have come up with far better ways to pay nothing in taxes and the AMT has largely hurt those in the upper middle class. As part of the Fiscal

Cliff, the AMT would have reverted back to prior year levels and ended up costing even average income earners quite a bit of money. Fortunately, that has been averted and the AMT is back to merely hurting those in the upper middle class.

There were also a number of other components to the budget deal, none of which resulted in any significant reduction in the federal deficit. For example, milk prices will be held steady rather than spiking, and a congressional salary increase was halted. There is a 2% increase in the employee portion of the Social Security tax, back to where it was a few years ago. I'm sure these are all important to someone, but not of real consequence to most of us.

So, despite months of concern, the Fiscal Cliff came and went without catastrophe. Both Democrats and Republicans are upset that they didn't get what they wanted and the proverbial can of a runaway federal deficit was kicked farther down the road. Ultimately, there was only a modest revenue improvement from the Fiscal Cliff deal, and hardly anything in the way of expense reduction. Of course, in two months the country will once again reach its debt ceiling and we'll have to go through this all over again.

FIRM NEWS

It was the best of times; it was the worst of times. Thus, was our year at Armbruster Capital in 2012. We had a number of distractions to our day-to-day business, including merging Armbruster Capital and Fulreader & Komma Management, and an audit of both firms by the SEC. However, we also had a number of victories, including our best year ever for new business.

Mergers, Audits, and Headaches…Oh My!

I acquired a majority interest in Fulreader & Komma Management two years ago. For a while we ran the firms separately and our intent was to continue that into the future. However, as time passed it seemed crazy to keep separate books and operations for companies that shared the same management team. We also realized that many of our clients would pay lower fees if we were to consolidate the firms. So, 2012 was the year to roll up our sleeves and get it done. I know the process was an inconvenience for many of you, but we appreciate your cooperation. Now that the consolidation is done, we have one firm with much smoother operations, unified policies, and a more streamlined way of working with clients.

The big surprise for 2012 was that the SEC audited both Armbruster Capital and Fulreader & Komma. The SEC conducts periodic audits of all registered investment advisors, and apparently it was our time. While the process was not fun, it did help us improve the way we do business and maintain required records. These audits are also a significant safeguard for our clients. The SEC reviewed all aspects of our firm (portfolio management, operations, marketing, performance reporting, etc.) and they looked for irregularities that could result in clients being treated unfairly. These audits, and having an independent custodian (like Charles Schwab or Merrill Lynch), help assure that we are always working in your best interest and not thinking of ways to emulate Bernie Madoff. The result of the audits was that we had a few operational issues to correct, but there were no findings of malfeasance or mistreatment of clients.

A Year of Growth

The good news for 2012 was that we grew the firm significantly. We were able to bring in more new clients than ever before, and the stock market was very cooperative in helping us grow the assets we manage. While we do aim to grow the firm over time, there are new challenges that come from getting too big too fast. There are also benefits. The scale we have now has allowed us to compete for business which we otherwise would not have been considered for. We also now have the resources to further build out our technology, infrastructure, and most importantly, our service team.

Service Team

Speaking of our service team, I would like to point out that without our staff, none of the above would have been possible. Barb Bensink, John Lyon, and Sue Herrmann worked tirelessly throughout the year to make the merger possible, survive the audit, service existing clients, and bring new clients on board. I wouldn't trade our team for anything, and I'm sure as you work with them, you will agree.

We will likely add additional team members in the coming year. We've had serious discussions with someone about joining us for business development and client service. We have also started talking with a couple potential new employees to help us with investment analysis/trading and operations. We want to make sure we build the team so that we can keep up with the growth in our firm. Providing a high level of service to our clients is our main objective, and we need to keep investing to ensure we consistently meet that goal.

Office Space

In order to accommodate all these new bodies, we're going to have to move our office. We have identified some space just a couple miles from our current location and have been negotiating terms. Whether this particular space works out or not, 2013 will definitely be "the year of the move" for us. We not only need more space, but we need better facilities as well. Many of our clients are older and have trouble navigating the stairs up to our current office. Wherever our new space ends up, we will definitely have an elevator and easy parking.

Retirement Plan Business

Finally, we entered the 401k retirement plan business in a more significant way in 2012. We have a number of businesses to whom we provide these plans. We have partnered with other firms that provide the administrative component and we handle the investments and employee education. If you have a business with a retirement plan, we'd love to talk with you about what we offer. Generally the total cost for the plans we manage is highly competitive, the investments are sound, and the administration is easy. Let us know if we can help you or someone you know.

WHAT IS ARMBRUSTER CAPITAL MANAGEMENT?

Armbruster Capital Management is an investment advisor to individuals, families, and smaller institutions. Because we don't sell any investment products, we remain unbiased in our selection of funds. We use index funds to drive down costs, manage the tax bite, and gain broad exposure to the various segments of the global capital markets. Ongoing communication is the cornerstone of our service offering. Please let us know how we can help.

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