HUDSON ADVISOR SERVICES, INC

OUR VIEW OF THE MARKETS

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In April we predicted the market would remain more positive than negative in 2012. We said it would not go off the cliff as it did in 2011. Well okay, at the mid-year point, that outlook is challenged – but it is not yet discarded. The negative results of the second quarter were indeed like some bad innings of baseball. But the game is not over and we keep the belief that 2012 will squeak by as a modest win.

Our perspective is relative and we judge conditions in the context of what we call the "sleep test." Four years ago we awoke frequently in the night and checked Bloomberg cable television for the market news from Asia and Europe. We were alarmed at the prospect of a collapse in the financial system. By comparison, many current trends are worrisome. But we sleep through the night. The worrisome conditions are countered by some considerable forces of stabilization. In fact, we almost take comfort in the fact that the second quarter did not turn more negative than it did.

Investors are clearly troubled by the financial and economic challenges in Europe, by the sluggishness of the economy and the uncertainties of the political situation in the United States, and by the resultant slowdown of growth in China and other developing economies. Bad news on many fronts does seem capable of sending the market into a tailspin.

Large companies are managing prudently, protecting their balance sheets, and holding cash reserves. We will be watching earnings reports carefully. We expect the trend to stay essentially positive and stocks will remain attractively valued. That basic equation gives us the comfort to manage the sleep test. Compared to the alternatives, we remain convinced that our preference for equities is the correct long-term strategy for our clients.

MARKET TRENDS

The accompanying table summarizes stock and bond market results for the first half of 2012. Since early April, stock prices have moved steadily downward. The gains of the spectacular first quarter have eroded – even though all the major equity indexes remain in positive territory for the year. Meanwhile, the bond market is benefitting from the nervousness about equities. Once again, investors are turning to the relative safety of U.S. Treasuries.

Equity Markets: The equity rally that pleased us considerably in the first quarter reversed itself in April and stayed in a negative funk for most of the next 10 weeks. The concerns were rooted in the financial problems of the Eurozone and the clear signs of a slowing global economy.

The Dow Jones industrial average was down 1.85% for the quarter – but remained 6.83% positive for the year. The story was similar for the other major indexes. The S&P 500 was 2.75% negative for the quarter and 9.49% positive for the year. The MSCI EAFE was -9.20% for the quarter and 0.77 positive for the year. The Russell 2000 index was down 3.47% for the quarter, but still ahead 8.53% for the year. The strongest equity sector was technology stocks -- with the Nasdaq composite index being ahead 12.66% for the year – even though losing 5.06% for the quarter.

Fixed Income Markets: In the first quarter, investors seemed finally to be turning away from their long fixation with the bond market. But the desire to just get somewhere safe returned in the second quarter. The investment of choice was again U.S. government debt which, despite all the long-term fiscal problems, is still perceived to be the haven for the cautious. The yield on the 10-year Treasury note, which moves inversely to prices, was 2.22% at the end of March. Three months later it had dropped to 1.66%. The mood is reflected in the shifting of investments within mutual fund asset classes. In the second quarter, U.S investors pulled about $44 billion from stock funds at the same time that bond funds picked up $71 billion of new money.

THE OUTLOOK

The Economy: There is not much to cheer on the economic front. The annual growth rate of the U.S. economy is well under 2%. Job creation showed momentum earlier in the year – with three months of new job creation over 200,000 per month. In the last three months, however, that number has averaged a disappointing 80,000. The official unemployment is 8.2% -- but probably much higher if discouraged workers were counted.

We do not see much prospect that Washington will be able to formulate a constructive fiscal policy. Nothing will happen until after the November election. Even then, regardless of who wins the Presidency, the Democrats are

MAJOR MARKET INDEXES

	YTD Total Return
Dow Jones Industrials Average	6.83
S&P 500	9.49
***Russell 2000**	8.53
***NASDAQ Composite**	12.66
***Barclays Aggregate Bond**	2.37
***MSCI EAFE Index**	0.77

*Total return *excludes* reinvested dividends.

likely to retain control of the Senate. The gridlock over taxes and spending will continue. We then face the issue of the so-called "fiscal cliff" – meaning the scheduled year-end expiration of the tax cuts and economic stimulus package. Failure to act may push the economy dangerously close to recession. Should this situation materialize, the Federal Reserve does have some additional capacity to act. But we share the concern that further monetary actions may have limited impact to prop up the economy.

The international outlook is even more troublesome. In Europe, we were relieved to see the late June action to shore up the weakened European banks. We believe the European leaders will continue to make tactical decisions to prevent fiscal meltdown. But the economic impact is dire and most of Europe is looking at a period of deep and prolonged recession. The ripple effect is global. With less import demand from Europe and the U.S., the emerging economies, which have been the bright spot of recent years, are slowing. That effect is especially significant with respect to China.

The Market: Given this economic view, how do we stay relatively optimistic on the market? As explained, the key is U.S. corporate earnings. Big companies are managing quite astutely in this economy. They have trimmed expenses – with restrained hiring and capital investments – and built up cash reserves. The result was record corporate profits in the first quarter. While earnings may slip somewhat in the pending round of second quarter reports, we expect profits will remain quite strong.

The effect of these good earnings on stock prices is powerful. The price-to-earnings ratio for the S&P 500 is now under 13 – extremely cheap by any historic metric. We believe this situation with stock values creates immense support for the market. Intelligent investors will see the benefit of staying in the market or making new purchases. Interestingly, U.S. stocks have seen an uptick in interest from foreign investors. Thus, we believe the market will stay in positive territory for 2012 despite the economic headwinds.

OUR STRATEGIES

Asset Allocation: For clients investing new money, we continue to recommend 60% allocation to equities, and the remaining portion to cash, bonds with maturities under two years, and alternative investments.

Equities: We remain focused on large cap companies with strong balance sheets, sustainable cash flows, and credible business models. Companies that pay attractive dividends are critical to our strategy. Why take the interest risk that accompanies 10-year Treasury notes when you can earn a better return with generous and growing dividends. Our sector preferences include:

TECHNOLOGY: Most technology companies have next generation products in development. Both consumers and corporations seem to recognize the need to keep their computer equipment and communications systems up to date.

HEALTHCARE: The aging of the U.S. population creates inherent demand for companies that manufacture health care products or operate retirement homes.

CONSUMER STAPLES: Companies that provide the necessities of life are good dividend payers in the current market – and gain value quickly when the market rises.

ENERGY: We are intrigued with the trend in which the U.S. is becoming an exporter of natural gas – and have interest in the companies that manage production and transport of natural gas.

Fixed Income: We retain our aversion to long-term bonds. Interest rates have only one direction to go: and that is up (eventually). While U.S. Treasuries offer safety with regard to default risk, they will suffer principal losses in a rising interest rate environment. We prefer to keep the non-equity portion of client portfolios in short maturity bonds and cash. We also take part in a program in which we invest some client monies in pooled packages of municipal tax liens. (See accompanying article on this program).

Dow Jones U.S. Sectors (Percent Change for YTD, Ending June 30, 2012)			
Oil & Gas	**-2.50**	**Consumer Services**	**14.81**
Basic Materials	**1.73**	**Telecommunications**	**16.21**
Industrials	**8.02**	**Utilities**	**4.12**
Consumer Goods	**6.27**	**Financials**	**13.81**
Health Care	**12.22**	**Technology**	**12.36**

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