



January 9, 2012

Dear Clients and Friends,

***"Who's on first?" – "I Don't Know" – "Third base!"***  
~ Abbott & Costello

We've previously mentioned some forthcoming changes in the way our custodian-brokers (primarily Charles Schwab and TD Ameritrade) present cost basis information on tax reports. In a nutshell, they previously *didn't*, and now they *will*. And oh! how we wish it were that simple.

Here's what will happen in early 2012: For year 2011 transactions in taxable accounts, you will receive a newly redesigned form 1099, dubbed **1099-B**, which for the first time will provide cost basis information to you and to the IRS. But the 1099-B you receive in 2012 will provide basis only for equity securities (stocks, mainly) that were acquired on or after January 1st of 2011 ... but not if the stock was acquired in a dividend reinvestment plan! (Costello: "What's the guy's name on first base?" Abbott: "Oh, no, no. What is on second base!")

For equity securities acquired in years prior to 2011, and for other non-covered equities, you may still utilize the realized gain/loss reports that we provide to you or your accountants for tax preparation purposes.

Please note, in all cases, the information in the 1099-B will take precedence over anything we provide in our realized gain/loss reports. Our operations manager Bridget Simpson spent a great deal of time over the past year reconciling our records with those of the custodians, and we believe most issues have been resolved. However, if you notice any discrepancies between what the custodians report and what we show on our reports, please notify your portfolio manager immediately.

What about reporting for bonds, mutual funds, and whatnot? Those other securities will become "covered" in the next two years. We've enclosed a chart showing the reporting requirements by year and security type for your reference. What the chart doesn't tell you is that securities with missing basis will be treated as having a zero basis and will automatically be sold first from an account when multiple tax lots are involved; this may result in a higher tax liability for you. As a reminder, if you have missing basis information in your accounts, please try to find it and send it to us, so that we can update our and the custodians' records.

So now, with administrative matters behind us,

***"The past is not dead. In fact, it's not even past."***  
~ William Faulkner

At the start of 2011, we highlighted a few of the headwinds facing the stock and bond markets, including the European credit crisis, US municipal credit worries, the military situation in the Koreas, China's slowing economic growth, and political gridlock in the US that would prevent necessary fiscal changes. During the year we added to our "list of woes" the supply disruptions caused by the Japanese tsunami and nuclear

meltdown, flood-related disruptions in Thailand, Middle-East tensions especially with Iran, the US debt rating downgrade and the threat of an actual US debt default as political weapon, albeit a foolish one.

And yet, US stocks were flat to modestly higher for the full year, and US Treasury bonds actually rallied following the rating downgrade.

In early days of 2012, none of the above economic headwinds has dissipated, but some things have indeed changed. Recall that we argued Wall Street's 2011 forecasts were too rosy, and that we anticipated a "slow and low" recovery with similar market performance. Now, Wall Street is bordering on pessimistic, which the contrarians among us find somewhat encouraging. Consider that the dividend yield on the S&P 500 is now greater than that of the 10-year US Treasury, or that the earnings yield on stocks is at a multi-decade high. Corporate balance sheets remain strong, and we have seen an increase in dividend hikes and share repurchases. At the consumer level, retail sales remain 'okay' – not great, but certainly not terrible either. And the leading economic indicators, which took a notable dip in the summer following, have been trending higher since.

Wall Street's newfound caution may be understandable considering the past year's volatility, but is at odds with indicators that suggest a continuation of the sub-par economic recovery, which is still a recovery! And if things should "go right" for a change, especially in Europe, then our own expectations may prove too cautious, and we will adjust our positions accordingly.

In the meantime, we anticipate that larger, dividend-oriented stocks will remain as the core of our portfolios, but we do not want to ignore opportunities that exist elsewhere in the equities arena, such as midcaps (more potential growth) and international stocks (potentially undervalued.) As we rebalance portfolios this year, we may add to those sectors as opportunities arise.

In the credit markets, we do not expect major changes in interest rates, and would actually welcome somewhat higher rates as a benefit to our fixed income investors. Rising rates may signal the economy is advancing more rapidly, and could engender a rotation out of bond mutual funds and into equities, a reversal of what we've experienced over the past few years.

As always, we thank you for your continued trust in our investment team.

Sincerely yours,

Mitch Schlesinger  
FBB Capital Partners

enclosures:

## Overview of Reporting Requirements

| Implementation Phase                           | Covered Securities                | Uncovered Securities           |
|--|-----------------------------------|--------------------------------|
| Equities*                                      | Acquired on or after Jan. 1, 2011 | Acquired prior to Jan. 1, 2011 |
| Mutual Funds<br>ETFs<br>DRIPs**                | Acquired on or after Jan. 1, 2012 | Acquired prior to Jan. 1, 2012 |
| Fixed Income<br>Options<br>Other Securities*** | Acquired on or after Jan. 1, 2013 | Acquired prior to Jan. 1, 2013 |

### Broker vs. Taxpayer Responsibility

**Covered Securities:** Brokers will report cost basis to IRS and taxpayer on Form 1099-B. Taxpayer will use Form 1099-B data in preparing their tax return filing for 2011 and following years.

**Uncovered Securities:** Broker may supply cost basis information to the taxpayer. Taxpayer will report cost basis to IRS.

\* Equities include corporate stock (other than stock in a regulated investment company [RIC] or stock acquired in connection with a dividend reinvestment plan [DRIP]). Internal Revenue Code section 6045(g)(3)(C)(I) provides that the applicable date is January 1, 2011.

\*\* For stock in RIC (RIC stock) or stock acquired in connection with a DRIP (DRIP stock), section 6045(g)(3)(C)(II) provides that the applicable date is January 1, 2012.

\*\*\* For any other specified securities, section 6045(g)(3)(C)(III) provides that the applicable date is January 1, 2013, or a later date to be determined in the future. The reporting rules for options transactions apply only to options granted or acquired on or after January 1, 2013, as provided in section 6045(h)(3).

This information is for illustrative purposes only, may be historical in nature and should not be used as a basis for any investment decision. Any investments reflected are for illustrative purposes only and are not intended to be nor should they be construed as a recommendation to buy sell or continue to hold any investment.

(Source: Charles Schwab & Co.)