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Valicenti Advisory Services, Inc.

Asset management as individual as you

"Positive Returns, Confidence Floundering"

By Joseph M. Valicenti
President/CEO

The third quarter returns for the equity and fixed income markets steadily improved into the end of the quarter (see Market Table). The Federal Reserve became a bit weary of the recovery and implemented QE3 to keep the economy on course and to help provide a backdrop for future growth and improved consumer confidence.

For consumers, investors, small business owners and large private corporations, the "wall of worry" or uncertainty going into 2013 has yet to improve. (See Market Symmetry on pages 3 and 4.) The private sector has been in a deleveraging process since mid-2008 and has remained cautious since. The public sector, however, has just begun the process. These two phenomena are currently working against the Federal Reserve in this low growth environment. The private sector is unwilling to invest, spend or borrow until it knows what rules to play by and the public sector (government) wants to tax, spend and borrow – together, creating a slow growth economy in a historic low interest rate environment.

Some good news coming from the economic data points shows housing is finally turning the corner after six years of decline. Employment is improving slightly, albeit not enough to "move the needle", and consumers' confidence is stabilizing following some European agreements and the implementation of Far East monetary stimulus.

Although we have improving data points and the market returns have been impressive this year (see Market Table), the keys to growth – fiscal policy, international growth, housing stability and balancing the deficit long term – will be determined in the next 12 to 18 months. Innovation and corporate profitability will continue to grow, but may be hampered by higher taxes, more regulation and increased government mandates.

In the current markets, we are continually reviewing our clients' individual goals and needs and we will rebalance and diversify with our disciplined approach.

Market Table

VALICENTI ADVISORY SERVICES, INC.
COMPARATIVE INDEX PERIOD RETURNS
FROM 06-30-12 THROUGH 09-30-12

	DJIA	S&P 500	NASDAQ	Lehman Muni Bond Index	Citi Corp Corporate Bond Index	US Treas. Bill Index (90 day)
06-30-12 to 07-31-12	1.26	1.52	0.15	1.77	2.93	0.03
07-31-12 to 08-31-12	0.87	2.17	4.34	0.13	0.33	0.00
08-31-12 to 09-30-12	2.84	2.58	1.61	0.67	0.68	0.03
Cumulative Returns-Q3 06-30-12 to 09-30-12	5.05	6.40	6.17	2.58	3.96	0.06
YTD Returns 12-31-11 to 09-30-12	12.23	16.47	19.62	6.78	8.75	0.22

"Coming together is a beginning; keeping together is progress; working together is success."
Henry Ford

September 2012

Will QE3 Save the Economy?

By Andrew R. Clark, CFP®
Vice President of Investment Research
Portfolio Manager

The Federal Reserve announced that it intends to purchase $40 billion worth of mortgage backed securities every month until the economy achieves a sufficient growth rate or unemployment improves. Including the market run up in anticipation of further Fed action, the market's response to the new round of monetary policy has been overwhelmingly positive. In general, the market participants believe that Ben Bernanke & Company will continue to support the economy and are unlikely to remove the highly addictive stimulant anytime soon. The initial response to the Fed's action appears to be positive, but should investors be optimistic about the Federal Reserve's ability to drive the economy higher?

There are clear benefits to the three rounds of Quantitative Easing (QE) implemented by the Federal Reserve since 2009, but the marginal benefits from the Fed's actions continue to diminish. The Fed's action has clearly fostered an unprecedented interest rate environment, which we may never see again in our lifetimes, and it has helped restore badly needed liquidity within the banking sector. What the Federal Reserve has been unsuccessful in achieving is economic growth and greater overall employment.

In order to succeed in its efforts to stimulate economic growth and job creation, the Federal Reserve needs the economy to grow nearly 3% a year. By purchasing securities from the banking sector, the Fed has basically transferred printed dollars to banks hoping that they would lend the newly received money (liquidity) to Main Street. Any increase in lending by the banks ultimately produces a multiplier of growth for the economy and helps to restore the labor market. Unfortunately, the banks have opted to simply redeposit the liquidity back with the Federal Reserve to earn interest of 0.25%, rather than lend the money to individuals and businesses. As we have discussed in past articles, banks have increased their excess reserves held with the Federal Reserve from a mere $2.3 billion in 2008 to over $1.4 trillion (Chart 1). By redepositing the funds with the Fed, banks are collecting risk free interest of $3.5 billion per year.

With a new round of quantitative easing about to be implemented, it is dubious to expect a different outcome than the two previous rounds of QE. Ultimately, until the Federal Reserve can force the banks to lend the added liquidity or begins to deposit funds directly into individuals' bank accounts, the printing of $40 billion a month will likely have muted economic benefits and only contribute to a greater bond bubble.

If the Federal Reserve has lost control of the growth of the economy, what could help to improve the state of the Union and to promote job creation? Clear direction from our politicians would go a long way to solve the trepidations of businesses and consumers that are acting as major limiting forces for the economy and the labor market.

Reviewing the August National Federation of Independent Business (NFIB) survey results, it is clear that small businesses remain concerned about their future prospects, with limited plans to expand their operations or to hire new employees (Chart 2). When asked what is the single most important problem facing their businesses, respondents listed taxes and government regulations as the biggest increases from a year ago. Poor sales actually declined from the biggest issue a year ago to the third largest issue facing small businesses (Chart 3).

If we add the weaker than normal consumer confidence and excessive corporate savings to the political and regulatory uncertainties, there is a clear case for a presidential election cycle that produces a clear-cut and comprehensive plan of action to restore individual and business confidence in this country. If we instead receive an election result that maintains the status-quo, we are likely to remain dependent on the Federal Reserve to maintain the last line of defense to keep the economy sheltered from the mildest of shocks that would otherwise cause the economy to lose its forward momentum.

We have attempted to further outline the variables that are either aiding or limiting the economy and markets in our 'Market Symmetry' section, and we encourage you to review those variables and to contact us if you have any questions or concerns as we enter a critical stage for the markets.

Chart 1

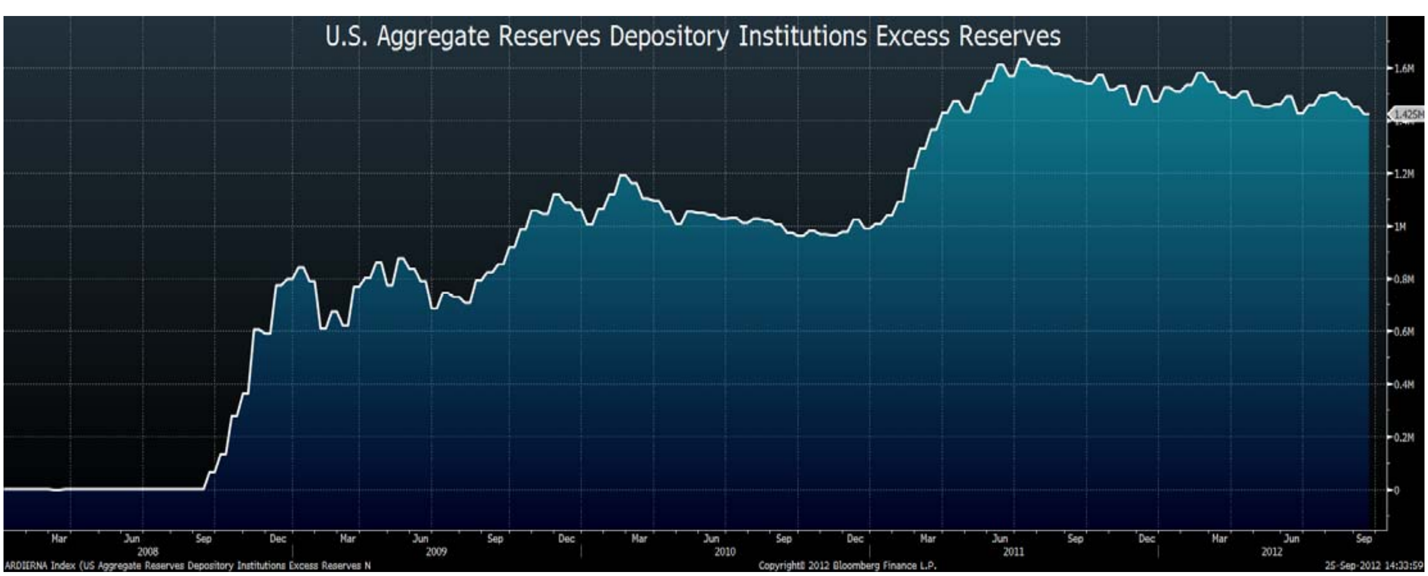

Chart 2

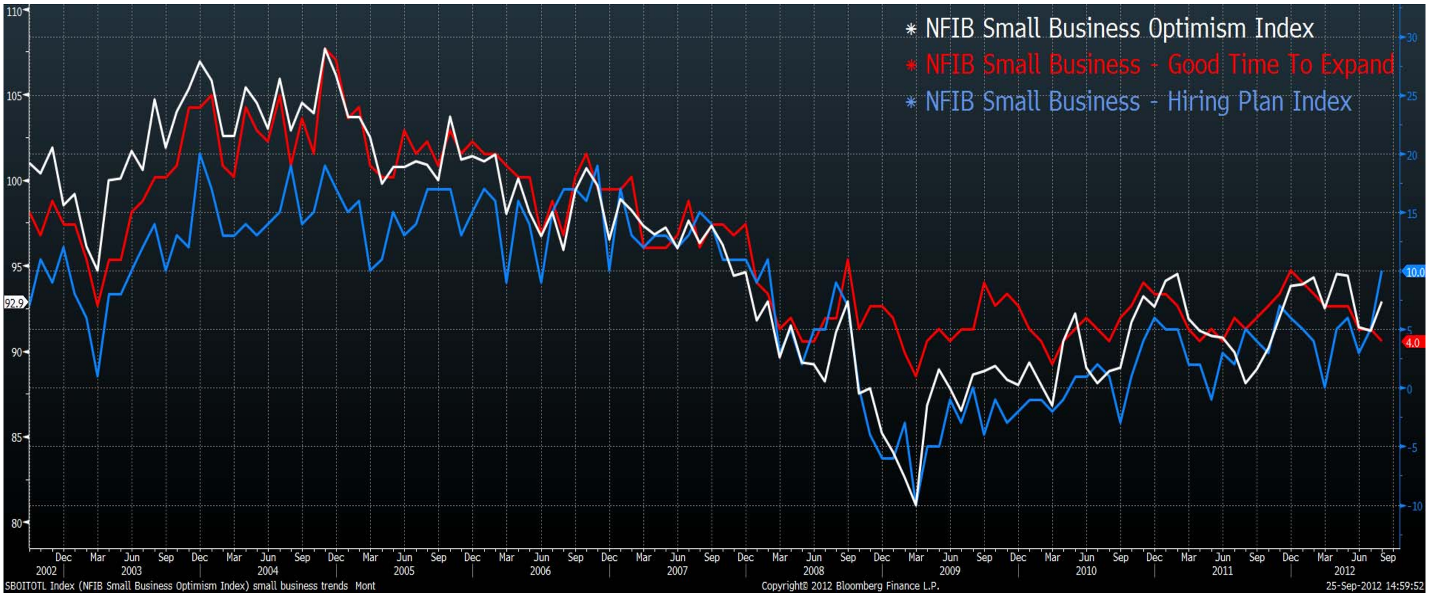

Chart 3

Single Most Important Small Business Problem - Aug. 2012

Problem	Current	One Year Ago	Survey High	Survey Low
Taxes	23	18	32	8
Govt. Reqs. & Red Tape	21	19	27	4
Poor Sales	20	25	34	2
Comp. From Large Bus.	7	8	14	4
Cost/Avail. of Insurance	7	8	29	4
Inflation	6	6	41	0
Quality of Labor	6	4	24	3
Other	4	8	31	1
Fin. & Interest Rates	3	4	37	1
Cost of Labor	3	3	9	2

NFIB The Voice of Small Business® nfib.com/sbet

Investment Strategy

By Jeffrey S. Naylor
Executive Vice President/CFO

The third quarter continued to have challenges, such as ongoing high unemployment, the Eurozone debt crisis, U.S. political gridlock and uncertainty on the outcome of the U.S. presidential election. Despite a sluggish economic environment, our decision to remain steady with our asset allocation was rewarded when the Federal Reserve stepped in to provide additional quantitative easing measures in the hopes of improving the economy.

With the help of the Federal Reserve and continued progress with U.S. corporate earnings, the equity markets surged forward with the U.S. equity markets moving past earlier 2012 highs. We remain cautiously optimistic about the equity markets and remain flexible with our asset mix.

Our asset mix is currently 10% to 20% cash, 30% to 35% fixed income and 40% to 60% equities and will vary based upon specific client needs, risks and directives.

Market Symmetry

By Andrew R. Clark, CFP®
Vice President of Investment Research
Portfolio Manager

In updating the market symmetry to account for changes over the past three months, we have included the recently announced monetary action by the Federal

Reserve in the positive influences on the market, removed the strengthening of the U.S. Dollar versus major world currencies and replaced it with tax lot harvesting in the negative influences on the markets.

Positive Market Influences:

- Strong Corporate Profitability – U.S. corporate profits are above levels last achieved in 2006.
- Extremely Low Interest Rates – Global central bankers have produced record low interest rates to help stimulate the global economy.
- Improving Household Balance Sheets – Households have significantly repaired their balance sheets and increased their savings since the 2008-09 recessions.
- Savings Exhaustion & Replacement Cycle – Consumers and businesses will ultimately grow tired of their self-imposed austerity budgets and will be forced to spend on replacement parts and possessions.
- Cheap Equity Valuations – The equity markets have factored in a decent amount of negativity and trade at a historical discount based on record profits.
- Adequate Financial Sector Liquidity – The Federal Reserve has pumped the U.S. banking sector full of money, with banks now holding over $1.4 trillion in excess reserves.
- Indefinite Monetary Stimulus – The Federal Reserve announced it will purchase $40 billion of mortgage debt a month, until the pace of economic growth and/or the labor market improves to a desirable level.

Negative Market Influences:

- European Debt Crisis – The growing debt crisis has put the investment world on notice of another possible credit crisis should the European Union collapse.
- Deceleration in Asia-Pacific Economies – China in particular has engineered a slow down in its economy to minimize inflationary pressure, but concerns exist over its ability to reinvigorate growth and to help offset European weakness.
- Loss of Consumers' Purchasing Power – Consumer wage growth continues to trail the rate of inflation, reducing the purchasing power of each dollar earned by individuals.
- U.S. "Fiscal Cliff" – With over $1 trillion in government spending cuts and a return to higher tax rates planned for 2013, there is concern that the economy could enter a recession due to the anti-stimulus measures.
- Restricted Bank Lending – While banks have plenty of cash available to lend, cautious lending practices have been prohibitive to economic growth.
- Investor Caution Over Owning Stocks – Money flow into equity markets has been below average since 2008-09, reducing the level of buying activity within the equity markets.
- U.S. Presidential Election – While both candidates are likely to face and to react similarly to the same economic variables starting in 2013, the uncertainty surrounding the election and the ability to restore America's growth prospects are likely to create some volatility leading up to the election.
- Agricultural Commodity Prices – Warm and dry weather throughout the Midwest may produce smaller commodity yields, in particular corn crops, which could lead to higher food prices.
- Tax Lot Harvesting – If Congress fails to extend the existing capital gains rate, it is possible that investors will sell large gains to take advantage of the lower capital gains rates before year end, which would produce additional selling pressure in the markets.

Positive Influence	***Negative Influence***
Strong Corporate Profitability	European Debt Crisis
Extremely Low Interest Rates	Deceleration in Asia-Pacific Economies
Improving Household Balance Sheets	Loss of Consumers' Purchasing Power
Savings Exhaustion & Replacement Cycle	U.S. "Fiscal Cliff"
Cheap Equity Valuations	Restricted Bank Lending
Adequate Financial Sector Liquidity	Investor Caution Over Owning Stocks
Indefinite Monetary Stimulus	U.S. Presidential Election
	Agricultural Commodity Prices
	Tax Lot Harvesting

Help Us Help Someone You Know…

We work hard to assure the satisfaction of our clients. We would appreciate your referring friends and family to us, so that we can deliver the same level of service that we provide you.