INVESTMENT COMMENTARY

4th Quarter 2011

Bragg Building
1031 South Caldwell Street, Charlotte

INSIDE THIS ISSUE

QUARTERLY LETTER
After Santa

MARKET UPDATE
Remarkable Resilience

PORTFOLIO REPORT
Eating Lunch in a Raincoat

We feel that this emphasis on protecting capital will have better overall results than "swinging for the fences" and potentially "striking out." Or as my father is fond of saying, we hope to "win by not losing."

AFTER SANTA

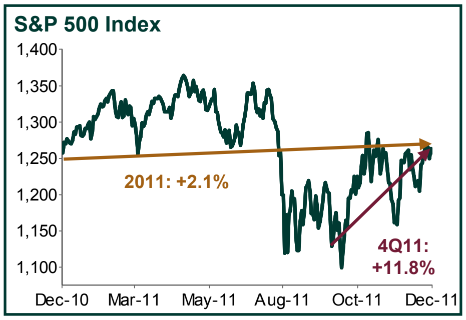
My wife and I were married in Salisbury, North Carolina a few days after Christmas in 1995. Alice's home church was still decorated with Christmas greenery and we sang "Joy to the World" after exchanging our vows. As a result of the seasonal wedding, we received a large number of very fine (so I'm told) glass Christmas ornaments as wedding gifts. Alice has cherished these ornaments through the years, cautioning the children to be careful during the annual decorating of the tree.

A few weeks ago at 2 a.m. on the night after Christmas I was jolted awake by the sound of our beautiful Christmas tree tipping over and crashing to the floor. How Alice slept through it, I can't imagine. The sound of all of her cherished ornaments shattering in unison was deafening. I eased quietly downstairs to find that the damage was extensive. I learned that when fine glass ornaments fall on a hardwood floor, they break into a zillion tiny pieces. Hoping to possibly dampen the coming drama, I made haste to dispose of the remnants of the treasured ornaments before Alice arrived on the scene. For the next 45 minutes I swept glass, untangled strands of lights and pondered the fact that the tree had stood straight and tall for the entire month of December, only to collapse the day after Santa came to visit. How appropriate and perhaps symbolic of our current economic condition. The excess of the Christmas season is analogous to the excess of the world economy of the last ten years. At

(Continued on page 4)

REMARKABLE RESILIENCE

Stocks dug out of a hole in the fourth quarter. After losing 14% in the third quarter, large company US stocks, as measured by the S&P 500, jumped almost 12% during the final three months of 2011. For the full year, the S&P return was just barely positive at 2%. As shown in the chart below, the S&P 500 is now up 97% since the low of March of 2009 but it remains almost 12% below the high reached over four years ago in 2007.



As shown in the table on the next page, mid-sized and small company stocks had negative returns for the year, trailing their large cap brethren on an annual basis for the first time in a decade. Foreign stocks, dragged down by the European debt crisis and the

(Continued on p. 2)

BRAGG
Financial Advisors
1031 South Caldwell Street, Suite 200 • Charlotte, North Carolina 28203 • (704) 377-0261 • Fax (704) 334-9754

Remarkable Resilience *(Continued from page 1)*

impact of the Japanese tsunami, had a poor showing for the year, losing 12%.

We find it noteworthy and encouraging that the broad market had a positive return in 2011, considering the significant challenges the year brought, including the nuclear disaster in Japan, violent uprisings throughout the oil-producing Arab world, a downgrade of the US credit rating and the ongoing debt crisis in Europe.

Market Index Total Returns for Periods Ending December 31, 2011

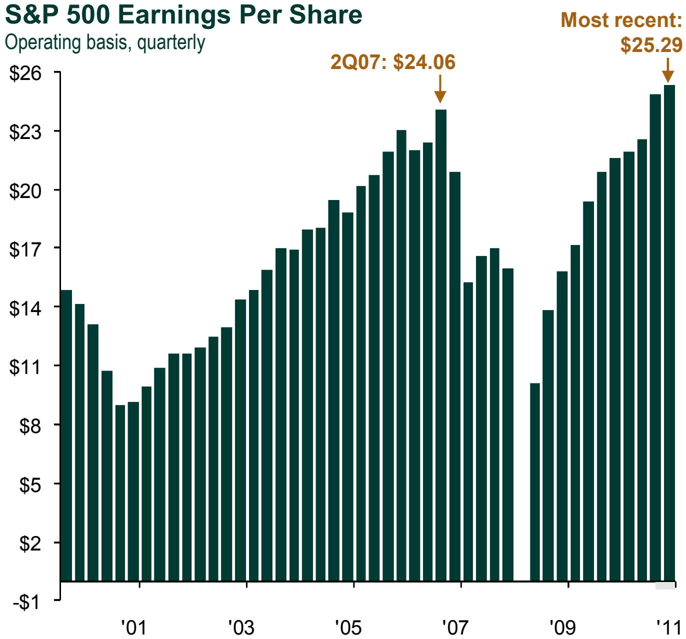
Index	4th Qtr 2011	One Year	Three Years	Five Years	Ten Years
S&P 500 (US Large Cap)	11.8	2.1	14.1	-0.3	2.9
S&P 400 US (US Mid Cap)	13.0	-1.7	19.6	3.3	7.0
Russell 2000 (US Small Cap)	15.5	-4.2	15.6	0.2	5.6
MSCI EAFE (Foreign Equity)	3.3	-12.1	7.7	-4.8	4.7
Barclays Aggregate Bond	1.1	7.8	6.8	6.5	5.8
Barclays Muni Bond	2.1	10.7	8.6	5.2	5.4

Three, Five and Ten-Year Returns are annualized

While stock prices remained basically flat in 2011, corporate earnings jumped significantly (see chart on S&P 500 earnings per share). This has resulted in an improvement in valuation metrics such as trailing price-to-earnings ratios. Relative to historical averages, these metrics now look quite favorable. Dig a little deeper, however, and you'll find that corporate profit margins and profits as a percentage of GDP (see chart on adjusted after-tax profits) are today much higher than average. Historically, profit margins have been mean-reverting; they have always fallen back to the average over time. When you view valuations after normalizing profit margins, stocks do not look as cheap, relative to history.

Importantly, while we study these valuation metrics, we rarely make significant portfolio moves based on our view of valuations. The market can remain overvalued or undervalued for years and we think that any attempts by us to make significant portfolio moves in anticipation of short-term changes in the market are not in your best interest.

S&P 500 Earnings Per Share
Operating basis, quarterly

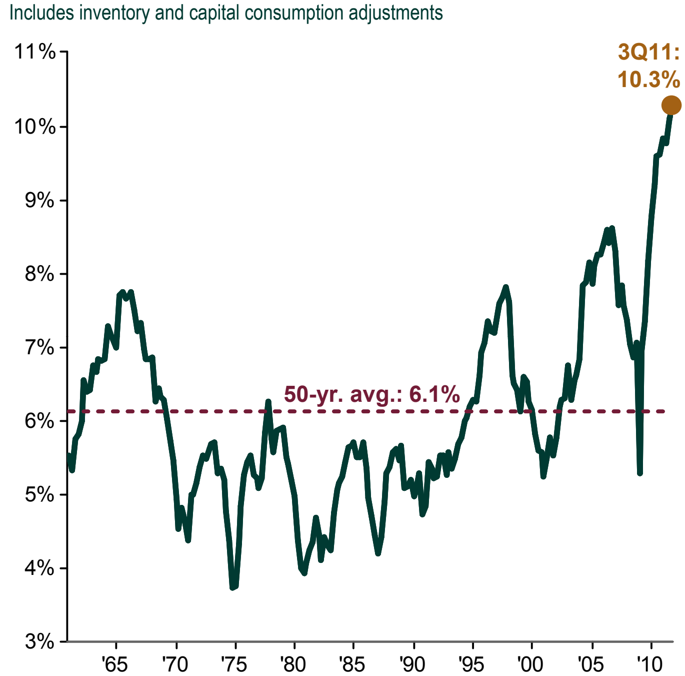


EATING LUNCH IN A RAINCOAT

A friend of mine with a very short commute is able to scoot home from his office each day for lunch. Before he sits down to eat, he puts on his raincoat and zips it all the way up. He says this is a precaution to keep food from splattering on his tie. I laughed when he told me that and I bet you're chuckling right now as you read this. You would probably agree that while effective, this level of caution is a bit extreme. Who wants to dine in a vinyl raincoat every day? Maybe using a napkin or even flipping the tie over his shoulder would do the trick?

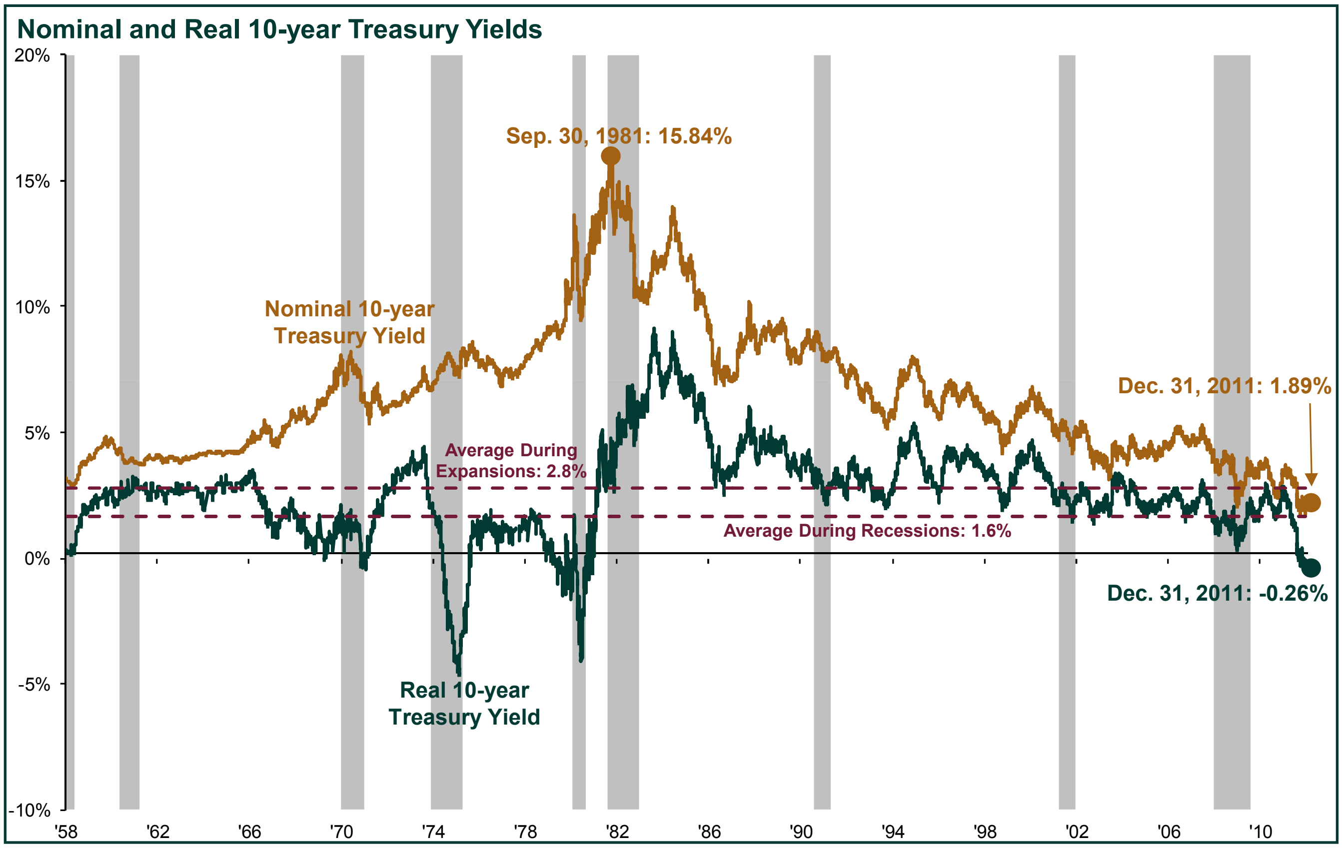
I am reminded of this as I think about our portfolio. The unpleasant investment experience of 2008 and 2009 understandably makes us want a thick vinyl raincoat for our portfolio. "Protect it from harm!" At the same time, we know we need to grow our capital in order to keep up with inflation. Our effort at Bragg is to own a blend of securities that reflects both the desire to protect and the need to grow the capital.

Adjusted After-Tax Corporate Profits (% of GDP)
Includes inventory and capital consumption adjustments



All charts compiled by JP Morgan and used with permission. S&P 500 Index source (p. 1): Russell Investment Group, Standard & Poor's, FactSet. S&P 500 Earnings Per Share source (p. 2): Standard & Poor's. Adjusted After-Tax Corporate Profits source (p. 2): BEA, FactSet. Nominal and Real 10-year Treasury Yields source (p. 3): Federal Reserve, BLS. Price Impact of a 1% Rise/Fall in Interest Rates source (p. 3): US Treasury, Barclays Capital, FactSet.

Eating Lunch in a Raincoat *(Continued from page 2)*

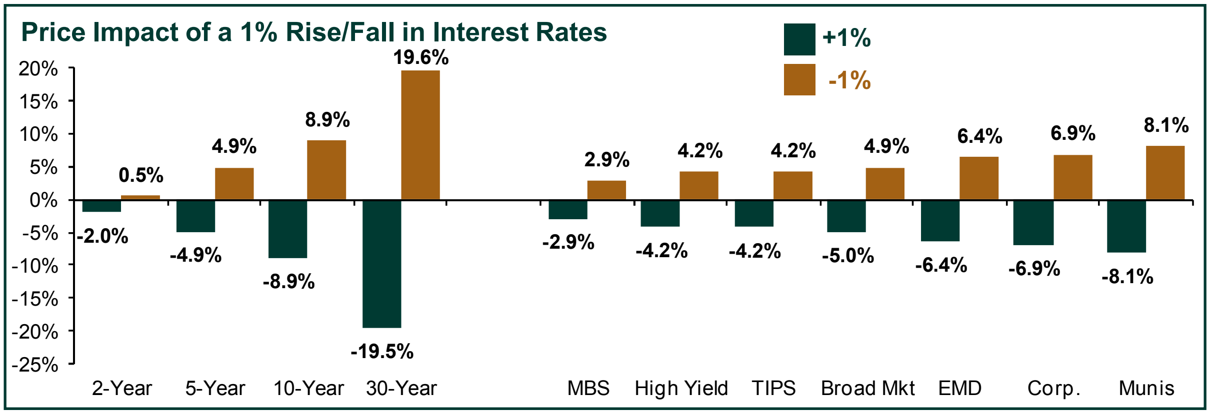


Our "raincoat" is the bond portion of the portfolio. Bonds have performed extremely well over the last ten years as rates have fallen, but in today's yield environment it will be almost impossible to grow capital by owning bonds. After inflation, yields on treasuries and many other highly-rated bonds are negative to barely positive (see above chart on Treasury yields). And yet we own the bonds to provide liquidity and a buffer against equity-market declines.

For longer-term money, we own a diversified collection of stocks to give us the potential to grow our capital. This portion of the portfolio will be subject to the dramatic swings of the market but it is our belief that over the next decade, the volatile stock portfolio will be a better investment than the stable, low-yielding bond portfolio.

As to equity portfolio specifics, we continue to have a high weighting (about 65% of the equity portion) in US large companies that have significant global operations. Small and medium-sized companies make up 18% of the equity portion and foreign companies comprise the balance of the equity portion at approximately 17%.

While we can't guarantee that this will happen, the equity portfolio is designed to demonstrate less volatility than the broad market. Specifically, we expect to slightly trail the market when the market has sustained rallies and we hope to outperform the market when the market is in decline. We feel that this emphasis on protecting capital will have better overall results than "swinging for the fences" and potentially "striking out." Or as my father is fond of saying, we hope to "win by not losing." Simple math backs up the idea of "winning by not losing." A manager who loses 20% needs a subsequent return of 25% to get back to even. A manager who loses 30% needs a return of 43%



Eating Lunch in a Raincoat *(Continued on page 4)*

After Santa *(Continued from page 1)*

Christmas, the kids enjoy a superabundance...no school, piles of gifts, cookies, candy, a magic man in a red suit landing his sleigh on our roof, flying deer, elves, a tree in the house, bulging stockings and lots of memory-making time with cousins and grandparents. We adults have indulged in this superabundance as well. Massive borrowing by individuals and governments have left the world economy in a fragile state. We thought we could use our equity lines and credit cards to live well above our means indefinitely. Similarly, governments around the world have been on a spending spree, making huge commitments that simply can't be kept. Greece, Italy and Spain are showing the world that when the number of people riding in the wagon exceeds the number of people pulling the wagon, the system breaks down.

So Santa's gone, the tree has fallen down and the world has begun the multi-year process of sweeping up the pieces. While corporations and individual consumers have made significant moves to reduce debt, governments have yet to address their problems. Banks have been propped up, more money has been borrowed (or printed) and bad loans have not been written down. For us to truly see growth again, there will need to be losses; assets written down, banks allowed to fail and government spending cuts. Taking medicine like this will be acutely painful for lenders and investors in failed ventures. It will also be painful for direct beneficiaries of government spending. And investors of every stripe will be affected as losses and the effects of austerity and higher taxes ripple through the economy.

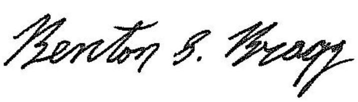
Politicians are loath to make these tough decisions, preferring to muddle along and hope for the best. This election year in the US will certainly be no exception. We can't imagine the enactment of any legislation prior to the November elections that would be unpopular with large numbers of Americans such as broad-based tax increases or cuts to entitlement programs. This means we can expect more uncertainty and likely more rocky times ahead for the market. The volatility we experienced during the summers of 2010 and 2011 (in both cases the market was off at least 20%) is an excellent example of the rockiness we can expect during this time of transition.

Economic reports of late, including unemployment, manufacturing activity, consumer spending, inflation and even housing have generally been positive. It seems that as long as these positive reports dominate the headlines, the market holds up well. Then the Europe crisis gets back in the headlines and we're seeing red all over the screen. How long can this go on? At least through the elections, we think. Depending on the outcome of the elections, we may have continued gridlock and more of the same or we might find ourselves on a new path. Like you, we are watching closely.

So the boxes of decorations (somewhat lighter) are back in the attic, the Christmas tree is resting peacefully in the woods and the kids are back in school. Christmas will come again and it will, of course, be wonderful. For now though, it's time to get back to work. Good hard work...it will get us through.

I hope 2012 is great for you and your family. Thank you for choosing Bragg to help you with your planning and investing.

Sincerely,



Benton S. Bragg, CFP, CFA
President, Bragg Financial Advisors, Inc.

Important Tax Reminder:
It is tax season and new IRS cost basis reporting regulations are in effect for 2011. Please be on the lookout for detailed information mailed from Bragg and Pershing in February. All 1099 tax information statements will be mailed by February 15th. Also, please note that the IRS has extended the 2011 tax filing deadline to April 17, 2012.

Eating Lunch in a Raincoat *(Continued from page 3)*

to get back to even...a much higher hurdle.

Our bond portfolio is approximately 45% government bonds and 55% corporate bonds. The government portion is a blend of treasuries, agencies, municipals (for non-IRAs), foreign government bonds and inflation-protected treasuries. The corporate portion is primarily investment grade (highly-rated) bonds with a small allocation to both higher-yielding (lower-rated) bonds and foreign corporate bonds.

The average maturity of our bond portfolio is shorter than the broad bond market, as measured by the Barclays Aggregate Bond Index. This has, and likely will, result in our portfolio trailing this benchmark when rates are falling or are flat. In a rising rate environment, however, we expect our shorter-maturity portfolio to hold up better than the benchmark, although there is no guarantee that this will happen. The Price Impact chart at the bottom of page 3 illustrates the impact of changing interest rates on bond values. As the chart shows, the longer the maturity of the bond, the greater the impact of a change in rates. We certainly keep this in mind as we construct the bond portfolio.

I hope this description of our current portfolio has been helpful. Please let us know if you have questions or would like to discuss your accounts.