Holt Capital Partners, L.P.

Third Quarter Financial Market Commentary

"Ninety Days in Ninety Seconds"

September 30, 2012

The Summer Doldrums - Not This Year

- Summer is often a slow period for market-moving news, but that was not the case during the third quarter. Southern European countries continued to struggle with high unemployment and restricted access to credit, but the European Central Bank cut interest rates and ECB President Mario Draghi committed to do "whatever it takes" to preserve the euro. Second quarter earnings reports showed disappointing revenue trends, but earnings were ahead of expectations and stock prices responded favorably. Recent data from the Case-Shiller Home Price Index affirmed our view that home prices have bottomed. The announcement of Paul Ryan as the Republican candidate for Vice President increased the likelihood that a substantive debate about the federal budget will be a key issue during the last two months of the campaign. Finally, Ben Bernanke and the Federal Reserve announced further quantitative easing in order to resuscitate the economy.

Tomorrow's Newspaper - A Long Term Forecast

- Dateline: *Sometime in 2014*...In spite of continued weak economic growth in peripheral Europe, global growth has accelerated. The export side of the domestic economy is experiencing robust growth as a result of demand from emerging economies throughout the world. Manufacturing jobs have begun to return to the United States and housing has recovered. Both of these factors have boosted consumer confidence and lowered the unemployment rate.
- A reform movement in Washington has resulted in bipartisan compromises on taxes and entitlement spending. These policy changes have boosted the confidence of business leaders and capital expenditure budgets are experiencing robust growth. Merger and acquisition activity is on pace to reach record levels this year.
- In response to economic growth, ten year government bond yields have risen to 3% without noticeable harm to economic activity. Investors have begun to abandon the bond market and stocks have become the new investment of choice, as illustrated by record positive flows into equity mutual funds. In this environment, stocks have risen sharply, with the S&P and Dow Jones approaching 2,000 and 20,000 respectively. This rally has been driven by earnings growth and dividend growth, as well as valuations, which are only now beginning to approach their average levels of the past 25 years. Governments throughout the world have been deleveraging through the sale of infrastructure assets to the private sector, thereby rebuilding their sovereign balance sheets.

QE ∞

- In mid-September the Federal Reserve rode to the rescue with an expanded and open-ended program of bond buying that has been dubbed, "QE Infinity". The objective of this new round of quantitative easing is to cut borrowing costs further, especially in the mortgage market.
- The biggest criticism of this new policy initiative is that it is transforming the Federal Reserve into the role of a central economic planner. Monetary policy, the Fed's traditional role, is typically focused on short term interest rates and short term economic stimulus. The open-ended focus on manipulating long term interest rates and providing long term stimulus has generally been the role of fiscal policy which should originate in Congress. The combination of an aggressive Federal Reserve and a dysfunctional Congress is taking the economy into uncharted territory.

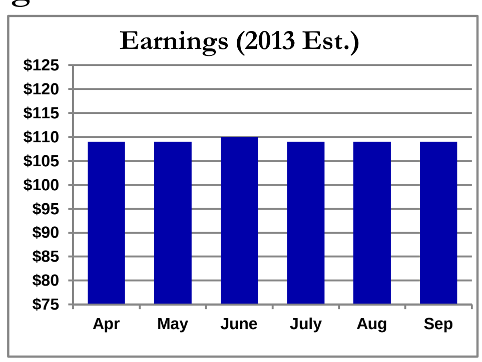
RISKS TO CONSIDER

- Dysfunctional politics in Washington have resulted in a dysfunctional fiscal policy. The art of compromise has been lost by members of both political parties amid the perceived need to adhere to strict ideological tenets.
- Inaction on the so called "fiscal cliff" of higher taxes and spending cuts has the potential to cut economic growth sharply and throw the financial markets into a tailspin. Congress and investors have lived through several stalemates over the past several years and the short term impacts have not been pretty. One would hope that we do not have to relive this game of political chicken again.
- Can profit margins continue to rise? Corporations have achieved record margins with tight cost controls and productivity gains. Will investors continue to applaud earnings growth in excess of revenue growth or will the focus shift to organic revenue increases? The interaction of revenues, margins and profits will be a key determinant of stock price trends in 2013.

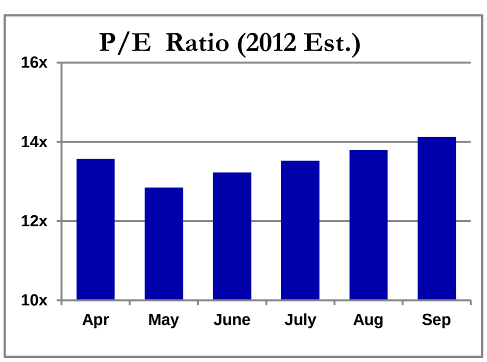
EARNINGS AND VALUATIONS

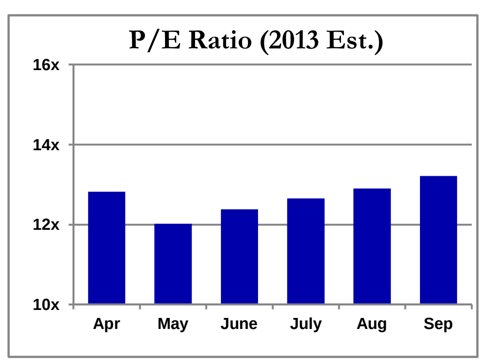
- Earnings estimates have seen very little movement this year.
- Price-to-earnings ratios have risen slightly this year, but are still well below the average levels of the past twenty-five years.

S&P 500 Earnings Estimates



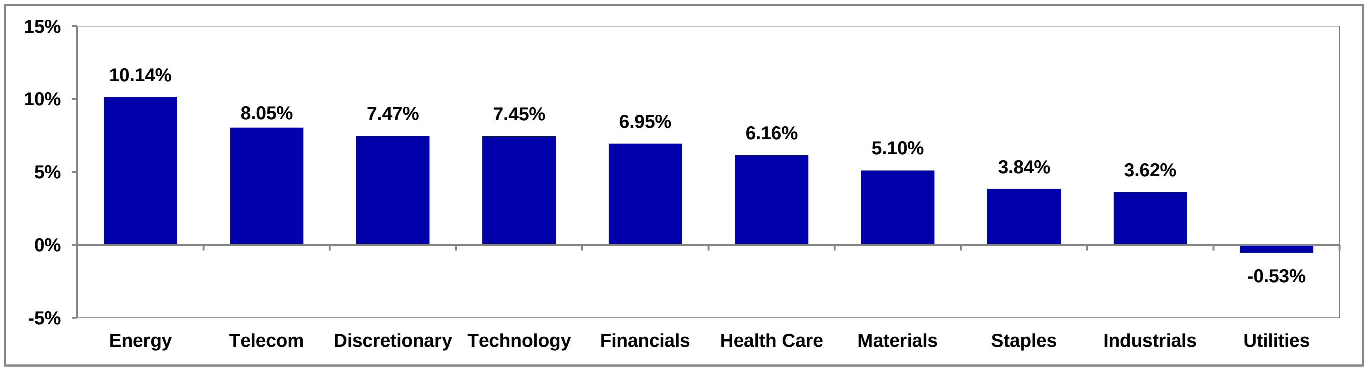
S&P 500 P/E Ratios



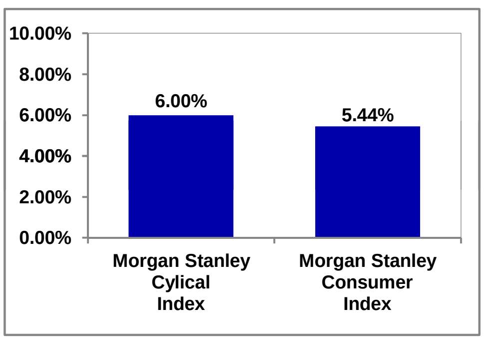


Third Quarter Investment Performance (including income)

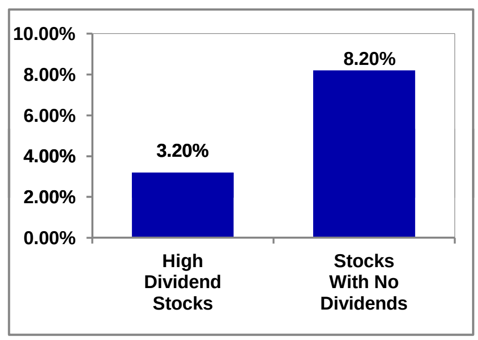
By Economic Sector



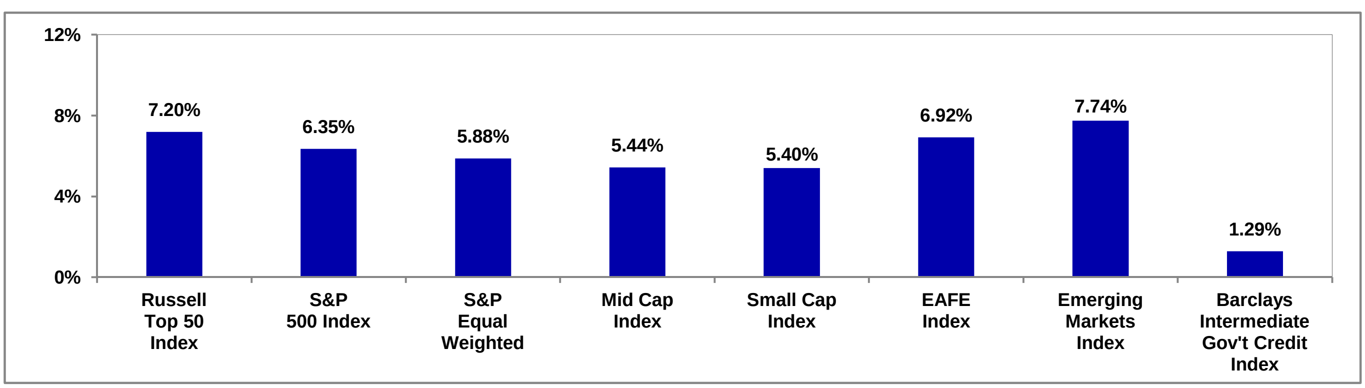
By Economic Sensitivity



By Dividend Yield



By Market Capitalization, Geography and Asset Class



- The third quarter was a good time to be an investor in the financial markets. Virtually every broad category of securities generated positive returns.
- The more economically-sensitive sectors were generally the best performers, but the traditionally more volatile small and mid cap indexes lagged the lower risk mega-caps during the quarter.

Conclusion

- The year-to-date period has generated strong double-digit returns across most benchmarks. However, four consecutive months of positive returns, along with low volatility, should not lull investors into a false sense of security regarding our national and global problems. Uncertainty around the election and the fiscal cliff, as well as concerns regarding economic growth in the emerging markets and Europe, could easily produce short term headline risk and stock market volatility.

- Any decline in stock prices should be viewed as an opportunity to increase equity exposure. In the long run, stocks continue to be supported by modest valuations, rising free cash flows, and strong balance sheets.