



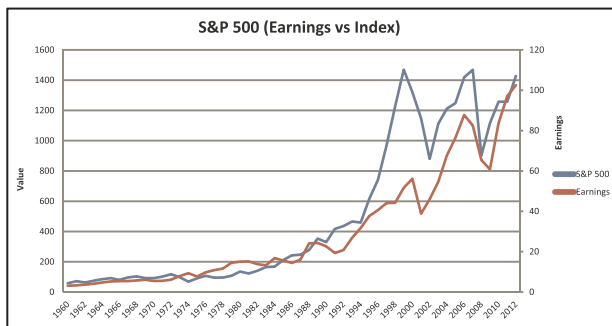
Fourth Quarter 2012 Report

Dear Valued Client:

We are happy to say 2012 was a good year for equity investors. Although some gains were given back in the fourth quarter, returns for the year were strong and we are off to a good start in 2013, thanks to the fiscal cliff compromise at year-end. For the year, the S&P 500 returned 16.0%, having declined 0.4% in the fourth quarter. The Dow Jones Industrial Average was up 10.2%, declining 1.7% in the quarter. Other broad equity categories, including small cap and non-US developed, posted similar one-year returns and emerging markets topped the group, returning 18.2% for the year. What is most surprising is that Europe, amidst crisis concerns throughout the year, returned 19.1% in 2012.

As of the date of this letter, the S&P 500 stood at 1469. Operating earnings for the S&P 500 for 2012 were expected to be between \$99 and \$104. At these levels, the price/earnings multiple of the S&P 500 was between 14.8 and 14.1. 2013 earnings are expected to increase to between \$108 and \$113. That would result in a price/earnings multiple of between 13.6 and 13.0, above the five year average, but below the average over longer periods. At this level, stocks are fairly valued and, if earnings come through as expected, there should be room for price appreciation.

<u>Index</u>	<u>Qtr</u>	<u>1 Year</u>
S&P 500	-0.38	16.00
Russell 2000	1.85	16.35
MSCI EAFE	6.57	17.32
MSCI Emerging Mkt	5.58	18.22
Barclays 1-5 Yr Treas	0.04	0.89
Barclays Agg Bond	0.22	4.22
DJ Commodity	-6.33	-1.06
HFRI Hedge Fund of Fund	1.06	3.62
10 Yr Treasury Yield	1.76	1.88



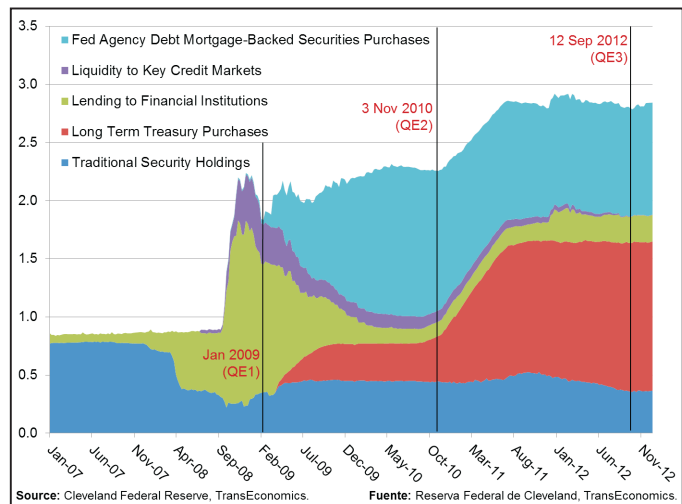
Demand for bonds remains strong. The yield on a 10-year Treasury ended 2012 at 1.78%, down slightly from 1.88% at year-end 2011 and the Barclays Aggregate Index returned 4.2% for the year. Within corporate bonds, the new issue market reached record levels in 2012, but yet was still unable to keep up with investor demand. This has pushed dealer inventory in the secondary market to all-time lows. At current yields, we see bonds generating negative returns after taking inflation into consideration but feel they are a necessary part of the portfolio for liquidity and risk mitigation purposes. Other asset classes had a more difficult year - the Dow Jones-UBS Commodity Index was down 1.1% for the year and the HFRI Hedge Fund Composite Index was only up 3.6% through the end of November, substantially lagging equity returns.

Fourth Quarter 2012 Report (continued)

Economic statistics reflect an economy which is growing slowly, but steadily. U.S. Gross Domestic Product grew 3.1% in the third quarter, an increase from 1.3% in the second quarter. Unemployment has slowly ticked down to 7.8%. The Institute of Supply Management Manufacturing Index increased to 50.7% in December, up 1.2% from November. This represented the 43rd consecutive month in which the economy grew. We also saw improvement in the housing situation - the Case-Shiller Home Price Index showed an increase in housing prices of 4.3% on a year to year basis through October 2012. Improved housing has the potential for substantially improving GDP growth. According to Standard & Poor's, housing improvements provided 0.3% of the 3.0% GDP growth in the third quarter of 2012.

The Federal Reserve Board has continued to use its balance sheet to promote economic growth. In its September meeting, the Federal Open Market Committee ("FOMC") agreed to inject an additional \$85.0 billion per month into the economy through purchases of treasury and mortgaged-backed securities. In addition, the FOMC made a significant change in its policy statement. It announced that it intended to keep the target rate of federal funds between 0 and 0.25%. Rather than tying that to a date in the future, the Committee indicated that it would keep the rate at that level at least as long as the unemployment rate remained above 6.5% and inflation was projected to be no more than half a percentage point above the Committee's 2.0% long term goal. By linking a change of rates to these factors, the Committee opened the possibility of increasing rates sooner than the end of 2014, which had been the target.

While there will likely be anxiety in the next two months over the debt ceiling issues, we expect a rational outcome at the 11th hour. Having gone through multiple economic and fiscal crises over the past two years, investors seem to have "crisis fatigue" and market reactions leading up to these deadlines may be more muted. As we look past these events, we still see a market with slowly improving fundamentals and reasonable valuations where patient investors will be rewarded.



Yours truly,
Hemenway Trust Company LLC

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