STALEY CAPITAL ADVISERS, INC.
THIRD QUARTER 2011 COMMENTARY

Market Data: The S&P 500 declined 13.9% in the third quarter, for a year-to-date loss of 8.7%, and most other equity benchmarks performed even more poorly. Our small cap underweight paid dividends in the quarter as the 21.5% decline for the Russell 2000 Small Cap Index represented the worst performance versus large caps since Q1 1999. The MSCI EAFE International Index declined 19.6% and the Emerging Markets Index fell 22.5%. As China continued to attempt to engineer an economic soft landing, its equity market declined 25% and the country's reduced demand for commodities influenced the 11.3% decline in the Dow Jones UBS Commodity Index. Despite fears surrounding a U.S. debt default, long-term treasuries gained 23.8%, which was their biggest quarterly gain on record and the largest margin of outperformance (20%) versus the Barclays Aggregate Bond Index in at least thirty five years. Gold gained 7.9% despite falling 11.4% in September.

Blue Chips Offer Value: As we discussed in previous commentaries, the market has been heavily influenced by macro factors and the latest pronouncements from policymakers. This has added to daily volatility, particularly as long-term retail investors have fled from mutual funds and have left a larger amount of daily volume to algorithmic computer trading programs. As we have stated many times, we recognize this de-leveraging environment will naturally lead to instability and we have been managing portfolios with a margin of safety. This volatility does not divert our long-term focus from the intrinsic value of assets, and in fact it at times provides greater opportunities to establish positions. One theme that we continue to pursue is that blue-chip companies represent a compelling asset class in the current environment. Even factoring in an earnings slowdown, the market as a whole is not overvalued, and the largest companies in particular are historically cheap, both in absolute terms and certainly relative to bonds. With interest rates at such low levels, it will be exceedingly difficult for bonds to out-perform stocks over the long term. Additionally, the S&P 500 carries a dividend yield of 2.3%, versus a yield of 2.1% for the ten-year Treasury note. There are numerous high quality companies, one example being Du Pont, with global growth opportunities that are trading at low valuations with dividend yields over 3%. The "dividend strategy" is perhaps becoming too touted in the market, but with diminished expectations for global growth, and as the baby boom generation moves into retirement, we believe there will continue to be strong demand for quality assets that provide current cash flow. It is also important to note that despite the growth focused market of the 1990's, dividends have provided over half of the return of the S&P 500 since 1930. We are prepared to add "beta" through greater small cap and emerging market exposure, but would look for either a more stable backdrop or lower valuations than currently prevail. In fixed income, municipal bonds are cheap relative to taxable bonds and high yield has again become more compelling as an asset class.

The Macro Picture: Europe was the major drag in the quarter, where over a year into a Eurozone sovereign debt crisis leaders have consistently disappointed investors with small steps and half measures that have failed to approach a comprehensive response. This crisis, in a nutshell, is that Greece is facing a government debt default or restructuring and other Mediterranean Euro members are facing debt downgrades and greater scrutiny from debt holders. As a result, we believe that the numerous European banks carrying sovereign debt at unrealistic prices will require massive capital injections. These banks are finding it difficult to obtain short-term funding from other banks and U.S. money market funds. Also, though the U.S. banking system's direct exposure to Europe appears to be limited, memories of the Lehman contagion in 2008 have made investors wary of them as well. This situation has depressed confidence and the natural capital flows of the system as global GDP struggles to maintain its momentum. The stronger markets we have experienced in early October reflect the market's belief that the leaders of Germany and France finally "get it" and intend to have a plan in place by early November. A plan is only the beginning, however, because execution will be quite challenging. Because the required bailout should be quite large in relation to European GDP, coordinated support will be required by the European Central Bank, the recently created European Financial Stability Fund, seventeen Eurozone governments, with likely backup provided by the deep pockets of the International Monetary Fund. Despite being in the news for over a year, developments in this storyline likely still have the potential to be positive market catalysts, or ongoing drags.

Policy has dominated headlines in the U.S. as well. Fears of a weakening economy first led the Federal Reserve to promise to hold short-term rates at zero until at least mid-2013 followed by the initiation of a watered down version of quantitative easing, dubbed Operation Twist. Instead of printing new money to buy bonds, the Fed is selling short-term bonds to buy long-term bonds in an effort to reduce long-term rates, to make mortgages more affordable and to induce the banks to sell their treasuries and write loans. The Federal Reserve is getting no fiscal help from a divided government, with the Senate rejecting a jobs bill from the President that did not seem to be backed by sound economics. Despite the theatrics in Washington, the data continues to reveal economic resiliency. Expectations for third quarter real GDP are running above 2.5% with the fourth quarter expected to be at a similar level. If the U.S. sidesteps a double dip, current equity market levels will likely prove to represent a bargain.

We are clearly experiencing a period of unprecedented volatility. We appreciate your support and long-term approach, and we assure you that our investment team is engaged every day in managing your assets in a proactive and prudent manner.

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