



2011 Year End Newsletter

2011 proved to be a difficult year for the global financial markets. Domestic growth continued to be subpar due to high unemployment, uncertainty surrounding government policy towards business, lingering consumer apprehension from the 2008-2009 market debacle, and renewed concerns regarding the European Union. For the year, the S&P 500 was essentially flat, while international stocks (MSCI EAFE index) were down about -12%. **The bright spot in the financial markets were bonds, and with falling interest rates, bond prices hit new highs.** In the domestic stock market, dividend focused funds did better than growth funds, confirming investor’s appetites for ***current income in the new zero percent interest environment we now live in.*** The government continued to print more money to support our lagging global economy and prop up businesses. Internationally, the European Union has been trying to figure out how to save the Euro while Greece, Italy, Spain, Portugal, and Ireland work through severe debt overload issues.

There are some bright spots for stock investors in the midst of this global uncertainty. Corporations that trade on the S&P 500 have never earned more money than they did last year (amazing to consider that in the wake of the global economic meltdown just 3 years ago). Corporations are also holding **record amounts of cash, have the healthiest balance sheets in history, have been providing very strong dividend increases, and are finding new revenues from the ever expanding emerging markets.** The emerging markets are clearly the driver for global export driven companies, and we do not expect this trend to stop. The move toward middle class consumption in the Pacific Rim and South America are irreversible, with expectations that over 400 million new middle class consumers will be created in the next 8 years. In the past 2 years, 100 million people left the poverty line. This is the big driver for U. S. business, and after we get some kind of settlement in Europe, we expect the market to move higher reflecting these new growth opportunities. As the market sits now, the S&P 500 trades at a discount to the historic price earnings (P/E) multiple (about 13 times earnings, versus a historic multiple of 16 times), making stocks relatively attractive. In addition, dividend yields on many high quality companies are significantly higher than the yield on the 10 year Treasury (now about 2%). The disappointing returns in the stock markets last year will likely be corrected as **stock prices follow earnings**, and earnings have been very strong. According to Thomson Reuters, earnings growth for the S&P 500 is estimated to be an attractive 10.1% in 2012.

Index	2011 Return
S&P 500	2.11%
NASDAQ	-1.80%
Russell 2000	-4.18%
MSCI EAFE	-12.14%
Barclays US Bond	7.84%

Source: WSJ, January 1, 2012.
Past performance does not guarantee future results.
Indices cannot be purchased directly.

We continue to position portfolios for high levels of current income, **keeping our allocation balanced between stock and bonds.** In a flat year like 2011, a high level of current income (dividends and interest) becomes very important; weakness in the global stock markets in 2011 was offset by strong returns in the bond market. We continue to favor income securities over growth securities, and expect that balanced portfolios will help investors sleep much better than growth portfolios. In the bond market, we favor corporate bonds, tax-free bonds, and convertibles over government issues. In the stock market, we continue to focus on high dividend paying strategies, with a heavier weighting in the U.S. versus the foreign markets.