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New Year Letter

2011 Predictions:
Did they come true?

2012 Predictions:
What could come to pass?

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To my investors:

Thank you for your continued vote of confidence.

2011 could be termed a lot of things; a tie in a tug of war between the bulls and the bears, a "something in it for everyone" market, and the most descriptive, in my opinion, the roller coaster market. I like this one because roller coasters have lots of ups, downs, and turns, but they end in the same place where they started.

Investors are starting off 2012 with a positive tail wind. The U.S. macroeconomic statistics have been improving since late in the 3rd quarter of '11 and have culminated with a much better than expected employment report of 200,000 newly created jobs (Bureau of Labor Statistics) on January 6, 2012 (I always wait for the December payroll figures to be released before I write this). More specifically, private sector hiring increased much more than Government layoffs increased. Let's be happy about this; we all wanted to see the private sector take the baton from the Government sector.

But it was the 3rd quarter that really put the kibosh on what started out as a good year in January 2011. Europe hit the skids due to the inability to rollover short term debt by Eurozone peripheral countries, notably Greece. (Note: Eurozone is a block of 17 countries that use the Euro as its' common currency and European Union includes the Eurozone nations plus 10 others in a political and economic alliance) We investors watched in horror as the Eurozone heads of state agreed on measures, some sweeping and most woefully inadequate, that completely unraveled by the beginning of the following work week. Then the horror show became scarier with the budget impasse in Congress, which lead to Standard & Poor's dropping the U.S.'s coveted AAA status (T-Bills maintained AAA rating, which is why money markets were OK). The loss of investor confidence during our summer of discontent quickly spread to the real world and the oft mentioned mantra from many economists was "double dip recession". I am data driven and the data went from good in the first quarter to very bad in the 3rd quarter in stunning velocity. Remember those 500 point swings last August? Who can forget?! September followed up with double digit losses for the major averages.

The trading lows that were reached in August were successfully tested (meaning, the market made a technical bounce and recovery) on October 4th and low and behold, the U.S. macroeconomic stats turned positive. Keep this in mind: poor economic stats caused by abrupt changes in investor and business psychology are usually knee jerk reactions and are brief. In addition to employment statistics, manufacturing, exports, consumer confidence, and retail spending statistics also showed improvement…solid improvement, in fact. This ushered in a yearend relief rally, which squared away the major averages for the full year. So, 2011 could be split into 3 equal parts; the 2 four-month bookends and the 4 month middle.

It was my strong and public contention (written and video form and distributed to my database of over 2,000 people) that the economic slowdown/interruption this past summer would be temporary and that we would pick up steam as opposed to go into recession. Again, I am data driven. I do not have patience for analysis based on “I think” because it sounds to me like “I hope”…not reliable enough for us, right? Back to the data; U.S. automobile manufacturing, domestic energy sector growth, and exports kicked things off and were the data I cited. I continue to stand by this theme. The stocks of cyclical nature recovered mightily from their ’11 trading lows, but didn’t have quite enough runway left on the calendar to take off. I expect the runway to extend into ’12 and for this space to gain altitude.

It is important that you know exactly what was on my mind this summer. If the Eurozone banks truly collapse, if Greece leaves the Eurozone, if Italy needs to be but cannot get bailed out (2 Trillion in debt…mama mia!), if Europe goes into recession…what could happen to my clients’ portfolios? I follow interest rate spreads and LIBOR; things were getting ugly. Cash was the viable option. If it meant that stocks rocket back up and I miss out on some returns, so be it. Better that than a retracement to the 2009 March lows. Mind you, no disasters. We moved through the ’11 roller coaster relatively unscathed. Some were up a little and some were off a little, but nothing major. I was quoted this past December 23rd, 2011, by CNBC:

“As an active investment professional, it was my duty to try to keep clients out of harm’s way in case we had a Lehman-like event in the euro zone,” said Mitchell Goldberg of ClientFirst Strategy. “No doubt, many of my colleagues acted with the same protective qualities. As a result, we had more cash on hand than we’d normally want.”

Clients allocated more toward fixed income held up best, for sure. But for 2011, diversification was actually a hindrance in a few ways. Specifically, international equities and small cap equities suffered disproportionately, as did financials, energy, and industrials. But based on the economy, the stats I follow and cited above, industrials, energy, and financials represent values and last year gave us a chance to build a portfolio for this year. We purchased and/or added to positions from these sectors last autumn when the major averages were a good deal lower. We had exposure to healthcare and consumer type stocks as well and I continue to hold them. It’s just that after the move some of these had last year, I would prefer to wait for pullbacks and let our buy-limit orders do their job.

Dividend paying stocks were a popular theme lately in the media, but something long in use here. I track daily activity every single day and I am more than pleased to see all of the dividend income being deposited into client portfolios. I’m on the hunt for more.

Last year, exogenous events were aplenty; the saddest was of nature’s making. The giant tsunami that swept through Northeast Japan, the ghastly images burned into our brains, is tragic. I feel insensitive to even think about the economic impact on the global economy when so much life was either lost or ruined. But one cannot look back at ’11 without including this one. There have been far deadlier natural disasters, but this one is regarded as an economic event due to its impact on Japan’s electrical grid, which idled manufacturing there for months. The impact on financial markets turned out to be short-lived. What appears to be long-lasting is the impact it had on U.S. manufacturing via Ford and General Motors. In addition, the Thai floods had a major impact on technology companies, but this already appears to be abating. My expectation is that lost sales by tech companies will be made up this year.

Bottom line for 2011 is that there was an awful lot to contend with. We investors have endured and have lived to fight another day…a little brawny in my reference, but it makes the point, right? That is what investing is all about; survive in the bad times to make hay in the good times…my father taught me this many years ago…successful business man he was. I would add to this, when I pass this knowledge down to my own children, to also rebalance in both survival times and hay times.

We have worthy portfolios…worthy of your hard-earned Dollars and that is the main reason to keep up the fight…just a little more use out of that above brawny reference.

Going boldly into 2012:

Potential trouble spots for 2012 come from familiar places; Europe for economics and Iran for geopolitical problems. Programs/facilities are in place to provide liquidity to Euro area banks and countries, so for now, financial Armageddon is off the table…my opinion, of course. There are many others who are much more qualified than I to opine about Iran, but a battle over the Straits of Hormuz would not be good for anyone, unless of course Iran is degraded militarily in a permanent way…again, my opinion, of course.

Politics and economics create a sort of natural intersection and in a Presidential election year, this goes more than ever. So, here is my simple prediction about the November election (I am often asked about this topic and what it means for investors). If the economy improves, Obama wins reelection. If the economy rolls over and gets worse, Obama loses his reelection bid. Healthcare, social issues, budget deficits, financial regulations…all are trumped by jobs, spending power, and financial security. This is not me being political; this is simply how I see it. Other than that, I predict that so much money will be spent on this election, it'll become its own financial stimulus program…oh…and it'll be very interesting.

Too be sure, in the U.S. economy, things are far from perfect. But it is the environment for large publicly traded companies that guide my bullishness on individual stocks. Operating leverage, cash rich balance sheets, access to inexpensive financing (via debt or equity offerings), low P/E multiples, dividends, and overseas businesses and consumers that are desirous of American products, creates an environment that has historically favored investors. Contributing further are 3 key takeaways that are positive from the EU debt crisis, which are very real and are considered an important part of the valuation equation for equities in general; global inflation has come down, Germany has benefited greatly in terms of exports due to the weakened Euro (as Germany is the linchpin of the Eurozone and the greater European Union), and China has already begun easing monetary policy.

There is a growing list of companies that have raised their dividends recently, from companies in different sectors of the U.S. economy: industrial, aerospace, automobile, and entertainment/theme parks. Aside from the fact that dividends are on the rise, which is a strong indication of management confidence, I see M&A activity picking up meaningfully...very meaningfully. M&A activity, my interpretation, grounded to a near halt because no manager would want to make a bold move when the financial/banking system could crumble very near term. But now companies can focus on tuck in deals, cost cutting deals, as well as the occasional transformational deals; the 3 kinds now defined for you. If investors are worried that companies can't keep growing their bottom lines, it is for this very

reason that M&A activity should become more prominent as a theme. If organic growth is difficult to come by, companies have ample means to buy it.

Problems still abound and new ones will appear, but if you want the right set of conditions that are supportive of equity returns, you have them right now.

Last year, I put forth 11 predictions for 2011. Some of these are meant to be "off the radar" things. Some are not actually investable ideas. None are guaranteed. But I learn from each and every one of them and to me, this is the fun part…my favorite writing of the year. Before I begin rehashing my '11 predictions (and kicking myself a little), I want to reiterate that I believe anyone who manages money in the financial services industry must be willing to put his/her own thoughts in public view. I simply do not have patience for fence straddlers, the cowards who claim to be right but have no proof of claim and who merely follow the marching orders from ivory towers spouting biased recommendations. One is allowed to be wrong; it is a necessary part of investing. The key thing is to own one's mistakes and to adjust quickly and accordingly. While many in my profession adjust their predictions late in the year so they appear like they are right, I like to look them up a year later and see how I did…it's just more fun that way.

Here they are with comments:

1. The major averages will be higher for 2011. The majors lost a decade and are just back to even with the year 2000…oh yeah…except for the NASDAQ! I will use several large capitalization old line tech names as my proxy when I compare the tech laden index to 10 years ago. (Well…let's call this '11 flat…Dow up, S&P off by .04 points, and Nasdaq off about 1.8%...I am reiterating this one for '12!)
2. The best place to be will continue from last year…large U.S based global companies. (Right…and I will add this to '12 list)
3. Tech is, in my opinion, a real "buster outer". Look for the old line techs to go higher. (Yearend '11 they are moving…decent year in'11, but not "buster outer" by any stretch…right on direction but wrong on magnitude)
4. A metaphorical food fight will break out within the halls of the Federal Reserve as Fed Head Bernanke focuses on wage push inflation and other voting members focus on food and energy inflation. Bernanke will move toward conciliator with the new voting members who are inflation hawks. This is the year that the Fed starts to hike the Fed Funds rate. (Wrong…plain and simple. There were simply a lot of extraordinary issues last year. Between money printing and food inflation early in '11, I thought I was going to be spot on, but agriculture commodities prices retreated, China slowed and Europe hit the skids, and employment is not strong enough yet to push wages higher. Natural gas prices also collapsed in '11 due to enormous supplies. Now, the FED adjusted its policy and will keep rates low well into 2013…source-FED Reserve. Regardless, we like low inflation, so all in all, this is a good one to be wrong about)
5. Long term Treasury Securities go down and rates go up in '11. (Wrong…we don't fight the FED and its policy of tamping down yields for a multi-year period took this worry off the table…Fear of Euro-financial contagion and FED actions pushed rates lower and Treasury prices higher. I believe this trade is incredibly overcrowded and will push this one into '12.)

6. Sonic boom…from companies colliding in the form of hyper mergers and acquisitions activity. With over a Trillion Dollars on corporate balance sheets, deals should close quickly too as deals will likely involve cash instead of issuing stock which is dilutive to per share earnings. (Right…especially on the smaller "non-headline" deals. I am huge on this theme for '12. The cancelled deal between AT&T and T-Mobile along with political and EU uncertainty didn't help causes either…I'll keep this for '12)
7. Stock mutual funds will be the favorite of retail investors as opposed to bond funds. (Wrong…Bond funds took in huge amounts of investors' cash and stock funds saw outflows…I look for reversal in '12…too much went wrong in '11 for retail investors to throw cash at stock funds and after 11 years of flat performance and several bursting asset bubbles, investor cash levels are high and sentiment is low…bullish for stocks)
8. The new investors that will replace retail investors will be the companies mentioned in #6. So, when pundits say there isn't enough retail money going into stock mutual funds, don't worry because it won't matter. (Mostly right, but I was helped big time by corporate buy-backs and a lack of IPO's…the equity market continues to shrink…good for supply/demand ratio…written in "The Incredible Shrinking Market", July, 2010)
9. The Dollar strength that began in late '10 should continue…not in a straight line! But I do think the Dollar will reassert itself as the global currency of choice because of desire and not by defacto. (Right…King Dollar is alive and well…still the reserve currency of the world and the Euro never became the reserve currency investors thought it would become a few years ago)
10. Both big and small banks alike will raise their dividends...yeah I know, that one is an easy call…but anyone who purchased JPM for that reason knows I said it last year. (We need more of this but I am going to say RIGHT…especially thanks to JP Morgan's re-initiation of its dividend)
11. One more as a follow up…increased tax receipts from increased economic activity and employment will help bring down the deficit, which will still remain tremendous…I said it last year and I will renew this prediction for this year. (Right)

Here they are for 2012:

1. Major averages to be higher for 2012. Dow hits 14 K…only about 14% move so very realistic. Plus, about 10 stocks in the index haven't moved in many years but are in some form or fashion of a turnaround.
2. Best place to be is American large cap global companies.
3. Long term Treasury rates move higher in '12!
4. Unemployment rate moves to 7.5% in '12.
5. MER…ticker symbol for Merrill Lynch before it was rescued by Bank of America…comes back…after Bank of America spins it off to shareholders in its bid to create shareholder value. Dodd-Frank makes the financial supermarket a less viable business model.
6. The FED doesn't raise rates in 2012…easy call since they already said so…now I have to add an extra prediction.
7. Mergers & Acquisitions activity booms in 2012.

8. The Euro strengthens as the short position in it is potentially overdone. If Germany has a funding problem, then consider this one recanted!
9. Stock funds regain the affection of investors.
10. Windows 8 is a big success.
11. Instead of BRIC (Brazil, Russia, India, and China) as the best emerging economy play, look at another set of letters, USA, as the new emerging economy as the risk premium of emerging markets is no longer so much higher than domestic equities as to warrant the risks associated with allocating more toward emerging market investing. (Not to say that emerging markets will do poorly or well in ’12, but to suggest that they do not have the super high accelerating growth that they used to have)

Longer term, natural gas and the widening of the Panama Canal (to be completed in 2014…100 years after its opening) add to the appeal of manufacturing in the U.S.

However these predictions workout, you can be sure that I’ll hold my feet to the fire a year from now. Investing takes discipline, especially in the face of uncertainty, so I shall continue being diligent in following “everything”, keeping up to date, remaining skeptical, thinking deeply before acting, and in keeping you informed.

Following are articles and quotes from ’11.

Wishing you health and happiness in 2012,

Mitchell O. Goldberg

Mitch

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