MURRAY
INVESTMENT MANAGEMENT

4th Quarter 2011 Update

Economic Review

The U.S. economy posted marginally better economic data throughout the 4th quarter, and concerns of a U.S. double-dip recession seemed to fade. 3Q11 U.S. GDP growth came in at 1.8%, which was slightly better than the 2nd quarter. Growth in business and consumer spending contributed to the overall improvement.

The primary focus throughout the quarter was on Europe's debt crisis and the potential for a European recession. European leadership attempted to restore investor confidence but generally left investors wanting a more concrete plan toward sounder footing.

The U.S. Federal Reserve left interest rates unchanged (0%-.25% target) during the quarter. The Fed noted that it expects "a moderate pace of economic growth over coming quarters" with global financial markets posing "significant downside risks to the economic outlook."

The employment situation continued to show modest improvement with the unemployment rate falling to 8.5%. While the economy is growing, it does not appear to be growing at a rate that is fast enough to put a meaningful dent in unemployment. The U.S. Federal Reserve is expecting unemployment to decline "gradually."

Equity Market Performance

	3 Mo	YTD
S&P 500	11.82%	2.11%
MSCI EAFE (International index net return)	3.33%	-12.14%

Domestic equity markets produced very strong 4th quarter performance but see-sawed between a risk-on / risk-off trade during the quarter and for most of the year. Throughout the year, Treasury prices generally rallied during the "risk off" trade while riskier equity assets performed well with the "risk-on" trade. This created a tremendous amount of market volatility during 2011 but ultimately resulted in slightly positive domestic performance for the year.

Large cap blue chip domestic stocks generally performed well and outperformed small cap stocks during the year. The Dow Jones Industrial Average (which is a good proxy for blue chip stocks) was up 8.38% during the year and outperformed the broader S&P 500 index. Broad International markets were extremely weak during the year as the European debt crisis weighed on International markets.

Bond Market Performance

	3 Mo	YTD
BarCap US Aggregate Bond (Broad Bond Market)	1.12%	7.84%
BarCap Municipal	2.12%	10.70%
BarCap US Treasury Long	1.86%	29.93%
BarCap US Corporate	1.93%	8.15%
BarCap US Corporate High Yield	6.46%	4.98%

The overall bond market was strong during 2011 as interest rates moved lower. The 10 year Treasury fell during the year leading to very strong Treasury performance. Treasury performance was more a function of investors seeking safety than compelling fundamentals for the Treasury market.

Economic Outlook

The U.S. economy currently appears to be picking up steam and is expected to produce moderately positive growth (around 1.5% to 2%) during 2012. This cautious forecast is largely due to the economic risks noted below and has led some to refer to 2012 as a period of "muddling through."

Given the impact that consumer spending has on our economy, slow ***employment*** growth is probably the biggest impediment to a more robust economy in 2012. Employment should continue to improve, but high unemployment is significantly cutting into consumer spending. In addition, both consumers and the U.S. Government are attempting to ***deleverage*** (reduce debt), and while this is a good thing for the long term, it slows growth currently.

The debt crisis in ***Europe*** also continues to cloud the economic outlook as Europe is in or will likely have a recession. A quick and convincing resolution to the European crisis would be a very positive development for economies worldwide.

A weak ***housing*** market is also a drag on the U.S. economy and is expected to only show limited improvement in 2012. Pent up demand in housing, however, could be a surprise to the upside.

The U.S. corporate sector remains in very good shape, but many U.S. businesses are facing a ***crisis of confidence***. They are seeking clarity on taxes, health care and other regulatory issues before making significant investments in people or capital. ***Corporate earnings,*** however, have been strong, and corporate balance sheets are solid. Increased corporate spending and hiring could be a positive development in 2012. In addition, the Fed remains ***accommodative,*** and low interests rates should lead to increased economic growth.

Source: standardandpoors.com, bls.gov, Morningstar, BEA.gov, CNBC.com, WSJ.com and federalreserve.gov.
The performance data shown represents past performance, which is not a guarantee of future results.
Return data is as of 12/31/2011. Except as noted, index returns are Total Returns.

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While there are issues to be resolved, the U.S. has proven its resilience time and time again in the face of uncertainty. The hurdles that the economy faces in the current year are not insurmountable, and the economy could be set up for some positive surprises as the year unfolds.

Market Outlook

Investors should expect more macro-driven volatility as we work through 2012, but from a valuation standpoint, U.S. equity markets are currently trading at attractive levels. As corporate earnings improved over 2011 and equity market performance was modest, the market's P/E (price to earnings) ratio has become more attractive.

While there remains a great deal of uncertainty, equity markets seem to have priced most of the uncertainty / negative news into the market. While significant P/E multiple expansion is not expected during the year, continued earnings strength could drive stronger market performance in 2012.

Europe remains a big equity market risk in 2012, and in the first part of the year, global equity market performance will likely hinge upon what happens there. Any sort of unsettling news out of Europe (sovereign defaults, a larger than expected recession, etc.) will likely lead to a sharp equity sell off. On the other hand, with an improving U.S. economy, a resolution or a path to a resolution of the European crisis could be the springboard from which equity markets rally.

Within the context of a diversified portfolio, it seems reasonable to pair conservative, higher-yielding equity investments with more aggressive equity holdings. The high yielding securities will produce income and should provide some stability if we experience a significant increase in volatility.

Relative to equities, the bond market is not particularly attractive. With interest rates at extremely low levels and massive debt throughout the world, interest rates are likely headed higher. Cash and shorter term, high quality fixed income investments seem to be a reasonable approach for the fixed income piece of an investor's portfolio.

Murray Investment Management

If you would like help with establishing an investment plan or would like to schedule a portfolio review, please give us a call. Also, please pass along our name to anyone that may be in need of investment advice.

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