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Annual Market Review 2011

Dear Clients and Friends,

Attached is your 4th quarter and annual 2011 investment performance report for the period ending on December 31, 2011.

The global village became very real as 2011 was consumed by debt, debate, downgrades, and potential default both here and overseas. U.S. economic data had to struggle for months against headwinds from abroad that preoccupied Wall Street even as Wall Street itself got occupied.

Driving markets worldwide were concerns about the impact of the Arab Spring revolts on oil markets, the triple disaster in Japan that left the world gasping for autos and parts, and most especially the shaky state of Europe's finances and banks with heavy sovereign debt exposure. After Greece, Portugal, and Ireland turned to their peers for financial support, the contagion threatened to spread to larger and potentially more threatening economies. As Italian and Spanish bond yields hit the 7% level considered unsustainable, investors worried they might be both too big to fail and too big to bail out despite an enhanced rescue fund and a new agreement increasing the eurozone's ability to impose fiscal discipline on members.

However, some of the turmoil was home-grown, such as the congressional combat that held the United States' credit rating hostage and threatened a first-ever default. Though the buck-inheriting supercommittee failed to prevent \$1.2 trillion in budget cuts scheduled to start in 2013, the conflict ultimately didn't faze bond investors, who sought refuge from Europe's travails in U.S. Treasuries.

Despite the upheaval caused by the global financial system's need to deleverage, the U.S. economy ended the year looking a bit stronger, with increased potential for continued recovery in 2012--assuming that Europe can manage not to implode in the meantime.

Market/Index	2010 Close	As of 9/30	As of 12/30	Q4 Change	2011 Change*
DJIA	11577.51	10913.38	12217.56	11.95%	5.53%
NASDAQ	2652.87	2415.40	2605.15	7.86%	-1.80%
S&P 500	1257.64	1131.42	1257.60	11.15%	0%
Russell 2000	783.65	644.16	740.92	15.02%	-5.45%
Global Dow	2087.44	1725.68	1801.60	4.40%	-13.69%
Fed. Funds	.25%	.25%	.25%	0 bps	0 bps
10-year Treasuries	3.30%	1.92%	1.89%	-3 bps	-141 bps

*Equities data reflect price changes, not total return.

Snapshot 2011

The Markets

- Equities: A strong first quarter helped push the Dow to its highest level in almost three years, and by the end of April, the Russell 2000 was at its highest level on record. However, May launched a downhill slide punctuated by the occasional hair-raising bout of volatility. Three of the Dow's 12 largest daily point gains in history occurred in 2011 (two in August alone); unfortunately, August also featured three of the Dow's 12 largest point declines ever. Nevertheless, the Dow was the only index of the four to show a gain for the year. The volatility cost the small-cap Russell 2000 dearly; despite a good start and strong finish, it ended the year down 14% from its April high. The Nasdaq also suffered, ending 2011 with a 9% fall from its April high and its first losing year since 2008. And despite all the ups and downs, the S&P 500 ended 2011 almost exactly where it began. Not surprisingly, global equities were harder-hit than their U.S. counterparts as credit markets showed signs of strain, threatening both emerging and developed markets.

January 04, 2012

See disclaimer on final page



- **Bonds:** Despite the Federal Reserve's easing its way out of quantitative easing, U.S. Treasury yields hit historic lows thanks to the European debt crisis and the Fed's intent to preserve rock-bottom interest rates through mid-2013. After sinking to roughly 1.7% in September, by year's end the benchmark 10-year yield had recovered slightly but remained below 2%, while spreads between the 2-year and 10-year bonds narrowed over the year.
- **Oil:** Despite the uncertain global economy, oil prices continued to rise at a slow but relentless pace. After spending much of 2010 under \$80 a barrel, oil not only surpassed \$90 in 2011, but ended the year near \$100.
- **Currencies:** After reaching US\$1.48 in the spring, the euro plummeted in 2011's last four months, ending the year just below US\$1.30. By May, the dollar had lost nearly 10% against a basket of six currencies, languishing for much of the summer before the European debt crisis helped return it to roughly even for the year.
- **Gold/silver:** Global anxiety steadily pushed gold to record after record in 2011. The ascent became jet-propelled in August, when the price hit an all-time high near \$1,900 an ounce only weeks after reaching \$1,700 for the first time. However, by year's end the luster had begun to fade; despite a late-fall rally, the precious metal closed out 2011 at roughly \$1,550 an ounce. Silver also went parabolic for a time, hitting a high near \$49 an ounce in the spring before ending the year not far from its \$29 starting point.

The Economy

- **Unemployment:** Starting at 9.4% in December 2010, the unemployment rate remained stuck within a point or two of 9% until November, when the biggest monthly decline in more than 13 years cut it to 8.6% (a level last seen in March 2009). Cuts in state, local, and federal government employment partly offset gains in private-sector jobs.
- **GDP:** After a slow start--0.4% during Q1--the economy gradually began to improve. Though Q3's 1.8% annualized gross domestic product was much lower than 2010's 2.5%, it kept hope alive for continued recovery in 2012. The manufacturing and services sectors both avoided contraction, and by Q3, corporate after-tax profits were up more than 11% from a year earlier.
- **Inflation:** Ominously high inflation at the wholesale level in Q1 failed to flow through to consumers as retail spending remained tentative for much of the year, at least until the weekend after Thanksgiving. By November, consumer inflation was running at an annualized 3.4%--not far above its historical average--but wholesale prices were up 5.7% year over year.
- **Housing:** Housing starts and home sales showed signs of life by year's end. Housing starts were up 24% from last November, and new home sales were almost 10% higher. Though home prices seemed to stabilize a bit, by October they were back to mid-2003 levels and 3.4% lower than a year earlier.

As always, please contact me if you have any questions, concerns or would like to schedule an appointment.

Sincerely,

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Data sources: Includes data provided by Brounes & Associates. Economic: Based on data from U.S. Bureau of Labor Statistics (unemployment, inflation); U.S. Dept. of Commerce (GDP, corporate profits, retail sales, housing); S&P/Case-Shiller 20-City Composite Index (home prices); Institute for Supply Management (manufacturing/services). Performance: Based on data reported in WSJ Market Data Center (indexes); U.S. Treasury (Treasury yields); U.S. Energy Information Administration/Bloomberg.com Market Data (oil spot price, WTI Cushing, OK); www.goldprices.org (spot gold/silver); Oanda/FX Street (currency exchange rates). All information is based on sources deemed reliable, but no warranty or guarantee is made as to its accuracy or completeness. Neither the information nor any opinion expressed herein constitutes a solicitation for the purchase or sale of any securities, and should not be relied on as financial advice. Past performance is no guarantee of future results. The Dow Jones Industrial Average (DJIA) is a price-weighted index composed of 30 widely traded blue-chip U.S. common stocks. The S&P 500 is a market-cap weighted index composed of the common stocks of 500 leading companies in leading industries of the U.S. economy. The NASDAQ Composite Index is a market-value weighted index of all common stocks listed on the NASDAQ stock exchange. The Russell 2000 is a market-cap weighted index composed of 2000 U.S. small-cap common stocks. The Global Dow is an equally weighted index of 150 widely traded blue-chip common stocks worldwide. The U.S. Dollar Index is a geometrically weighted index of the value of the U.S. dollar relative to six foreign currencies. Market indexes listed are unmanaged and are not available for direct investment.

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