2011 RECAP, 2012 OUTLOOK JANUARY 2012

2011: RECORD VOLATILITY AND HEIGHTENED RISK

Financially speaking, the recently finished year will be remembered as a year of whip-lash movements in the investment markets and a resurgence of economic troubles that refreshed memories of the dark days of the Credit Crisis in 2008. Most categories of the U.S. and international stock markets were down for the year, typically ending somewhere between being flat to down over 20%.

The year began strong, as the rally from the Fall of 2010 continued into mid-February. However, at that point the stock market began unraveling . . . once again proving itself as a leading indicator of things to come. The March Japanese earthquake exacerbated the decline, but potentially masked the market's earlier economic concerns in the inevitable post-earthquake relief rally that followed. By May, the declines had resumed, and exponentially worsened due to the US economy slowing, increased acknowledgement of America's debt problem, political uncertainty, and a developing banking and sovereign debt crisis in Europe. The end of the year witnessed a partial stock market recovery. The question of course now is: Is this rally real and sustainable, or another one of the many head-fakes that we have seen throughout the past decade?

POSSIBLE ECONOMIC SCENARIOS FOR 2012

As it stands now, a persuasive case could be made for both optimistic and pessimistic economic results for the coming year. From a dour perspective, U.S. economic growth is too slow for a normal recovery and is certainly not enough to bring the unemployment rate markedly down for years. Throw in a consumer that still needs to continue on a multi-year budget belt-tightening routine to reduce personal debt, a government that is running out of ammunition for its attempts to stimulate the economy, and a world-wide slowdown from what almost certainly is a recession in Europe, and one pretty much has an open and shut case for a continuation of the malaise we have been in for a decade.

That being said, we do have a few things going for us. For starters, after a lull in the middle of last year, which was partially due to factory supply shocks from the Japanese earthquake, economic growth has resumed its forward march. While consumers are still creating economic drag by being in a prudent debt-reduction mode, a magical thing happens during this process . . . extra cash is left over at the end of the month that previously would have been spent on interest. This excess cash flow usually finds its way to a shopping mall. Sometimes it makes its way into a 401(k) plan too. Either way, the debt reduction process increasingly becomes a form of economic stimulus instead of a headwind. In addition, a substantial amount of pent-up demand for durable goods was created during the no-shopping years of 2008-09. We are seeing this postponed activity come back in new-car sales figures. At some point, houses will follow. Also, even though there has been a behavioral change over the generations, Generation Y won't want to live with mom and dad forever. And finally, while the U.S. and Europe deal with their consumer and governmental debt reduction, emerging markets continue their evolution to mature economies, providing a lot of new customers for U.S. and European businesses. At some point, enough of these positive trends add up to the realization that there *is* light at the end of the tunnel.

POSSIBLE INVESTMENT MARKET SCENARIOS FOR 2012

Like the cases for divergent economic outlooks, the same opposing movements could easily unfold in the markets. With the stock market being a leading indicator, the 2011 decline and volatility could be foretelling the much talked about double dip recession, with the recent rally being the market's evil trap to catch a few more suckers. Conversely, if economic growth can continue the trudge forward, the market is undervalued by any reasonable measure, and would likely enjoy a solid run. The markets have an unmatched efficiency in leading people to have disappointed outcomes from what they believed would occur. Therefore, the current overwhelming adherence to a belief that the equity markets are "dead" is an excellent contrarian indication that a long-term rally could happen soon. Based on what the market has done the past 18 months, and where it stands today from both a fundamental and technical perspective, it would be likely that a decisive move for the better or worse could happen sooner rather than later.

Looking out a bit longer, and studying data from the most similar economic events throughout the world, a case can be made that we are in a very long-term cycle of difficult growth and fiscal realignment. Periods like this have been punctuated with the same type of one to three year booms and busts we have witnessed during the past twelve years. From an investment standpoint, this presents opportunities . . . and opportunities for losses that are beyond repair.

If this is in fact the path that is before us, then I have a calm sense of confidence about how we can work to navigate through it. Ryan Poage & Co.'s investment discipline is a combination of allocating capital based on both the underlying fundamentals of the economy and companies, and the technical market movements that provide guidance to where the global money is actually going. By adhering to both, we focus on academically sound principals while being cognizant of and adaptable to what is occurring in the marketplace.