

Looking Towards 2012 For Opportunities

As this year begins to wind down, let's recap what we experienced in 2011 and turn our attention to 2012. Growth in the United States was disappointing in 2011. The consensus among economists surveyed by the Philadelphia Federal Reserve in early 2011 was that real Gross Domestic Product (GDP), which measures the output of the economy, would grow by 3.2%. Instead, the economy expanded at a disappointing annualized rate of just 1.2% in the first three quarters of 2011. The unemployment rate remains stuck at the eight to nine percent range. Debt issues on both sides of the Atlantic continue to plague the financial markets. Despite record corporate profits and very low interest rates, the combination of mixed economic news, political uncertainty, and ongoing European debt concerns has left the S&P 500 essentially flat for the year. More importantly, the year has been extraordinarily volatile as evidenced by the nearly 200-point daily swings in the Dow Jones Industrial Average.

Looking to 2012, we expect these aforementioned questions and concerns to continue to affect the markets as they have for the past couple years. For the 2012, we anticipate the following:

- **Economy:** Our outlook for growth in 2012 is mixed. Most economic indicators in recent weeks have been positive. They do not add up to a robust economic recovery, but they also do not point to the recession that some feared this past summer. The most likely outcome, in our view, is moderate growth—trend-like at best—for the coming year.
- **U.S. Equities:** We expect the S&P 500 to generate a mid-single digit return for 2012. We believe moderate economic growth and macroeconomic factors will keep a lid on gains. On the other hand, low market valuations and continued strength in corporate profits will offer a support level. According to Thomson Reuters, earnings growth for the S&P 500 is estimated to be an attractive 10.1% in 2012.
- **U.S. Fixed Income:** We expect the combination of the Federal Reserve's efforts to stimulate the economy and growing concerns about the U.S. debt load to push the benchmark 10-year U.S. Treasury yield higher. A recent survey of Federal Reserve's primary dealers suggests a 2.4% year-end level, which we also feel makes sense.

For more insight regarding the five developments likely to be critical in driving investment returns in 2012, please see the 2012 Outlook publication. This publication discusses what transpired in 2011, five themes likely to impact investor returns in 2012, and how to navigate the volatile markets that we expect to continue for another year.

Over the long-term, we believe a strategically diversified approach works well regardless of market environment. However, with 2012 and beyond looking like a volatile market environment characterized by weak economic data and increased uncertainty, the question for investors is what to do. We remain focused on investments and investment strategies that may mitigate some of the anticipated volatility and take advantage of opportunities. To mitigate volatility, we find alternative strategies, dividend paying equities, defensive sectors, and larger capitalization companies attractive. From an opportunistic standpoint, we continue to favor fixed income spread product (i.e. non-Treasuries). Case in point, yields on corporate bonds rated Baa by Moody's are trading at a spread of about 329 basis points over yields on 10-year Treasury bonds. This is much less than the 600 basis point spread at the height of the financial crisis in late 2008, but well above the 196 basis point average spread since 1962.

We believe a combination of all of these investment opportunities offer the ability to both protect and profit in the 2012 financial markets.

MARKET Commentary

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