

Fourth-quarter 2011 Securities Market Commentary

As the fourth quarter of 2011 drew to a close, the major market indexes had regained much, if not all, of the losses they suffered in the third quarter of 2011. The Dow Jones 30 Industrials gained 5.53%, the Standard & Poor's 500 returned 0%, the NASDAQ Composite returned a -1.8%, and the Barclays Aggregate Bond Index (formerly Lehman's Aggregate Bond Index) returned a positive 6.82% for the year. The Investor's Business Daily (IBD) Mutual Fund Index, comprised of 20 top-performing equity growth funds returned a disappointing -4.45% for the year. It is quite clear that investors had a very small appetite for risk in 2011, making it one of those rare years when investors willing to accept greater risk were not rewarded, rather, the less risk you took, the more money you made. With earnings for the S&P 500 companies rising roughly 15%, investors still showed little interest in equities, leaving the year-end performance for the index at an anemic 0.3%. The NASDAQ Exchange, with its predominantly small-company bias, found even fewer buyers that were willing to expose themselves to small and medium growth companies, particularly in the last half of 2011. However, investors did find the larger industrial companies within their risk tolerance; as well as, government bonds, in spite of the turmoil in the European markets and the U.S. losing its AAA bond rating in 2011.

Technical Market Overview

Out of the 64 trade days in the fourth quarter, the Dow Jones 30 Industrials had a rising 200 day moving average only about half of the time, or 35 days. The Standard & Poor's 500 had only two days out of the 64 trade days last quarter that showed a rising 200 day moving average. Likewise, the NASDAQ Composite experienced only four days of the 200 day moving average that was rising for the entire quarter. The 200 day moving average is a broadly accepted indicator of the market(s) trend. This indicator is often used with indexes such as the S&P 500 or the NASDAQ Composite. As the name indicates, it is the average price of an index or a security over the last 200 days. If today's average price of the last 200 days is greater than yesterday's average price of the past 200 days, the trend is considered to be rising; a positive indicator for the market moving forward. Conversely, if the most recent 200 day moving average price is less than the previous day's average price, the trend is declining and is considered a bearish indicator moving forward. As you can see, the environment was not very conducive for the growth investor. Nonetheless, those with a moderate or lower risk tolerance found a more cooperative environment, with long-term government bonds leading the pack.

Issues Influencing the Market

European Union Debt Crisis

The financial headlines for the third quarter were dominated by Greece and the fear of its impending collapse. In the fourth quarter, it becomes apparent that the entire European Union is in danger of economic collapse. Germany appears to be the most financially solvent and stable economy of the European Union. On the other hand, countries such as Italy, Spain, Belgium, Ireland, Portugal and even

France are struggling under their enormous levels of government debt. This realization elevated the European debt crisis from a point of focus in the third quarter to an obsession in the fourth quarter. Obviously, an economic collapse in the European Union would cause significant stress on our banking system due to the entwined nature of our global economy. Nonetheless, the markets hour by hour scrutiny of every press release that comes out of Europe has become exaggerated, well beyond reasonable levels in my opinion. As the fourth quarter drew to a close, there were signs that this fixation was slowly subsiding. Still, a heightened sensitivity to the health of the European Union and its currency may remain well into 2012.

The Federal Debit Limit

As mentioned in last quarter's correspondence, the sub-committee charged with the task of reducing federal spending was doomed to fail from the start. Not disappointing, the group of 12 (six Republicans & six Democrats) were asked to find substantive ways to reduce federal spending in an effort to slow the rate of growth in our federal debt. It was obvious that both political parties would appoint their most partisan ideologues to represent their respective views. With this polarizing dynamic in place, the "special" committee achieved nothing other than proving their lack of understanding and naïveté regarding the consequences of our enormous unsustainable federal debt.

Consumer Confidence Index

The Sentiment Index rose to 69.9 in the December 2011 survey from the 64.1 in November. Importantly, this was the fourth consecutive month that the Sentiment Index increased from its August low of 55.7. This index is compiled by the University of Michigan's economist Richard Curtin. CSI is considered to be an indicator of the consumer's current attitude toward spending, along with, their future expectations regarding their personal spending. When one considers the fact that political uncertainty often causes consumers to be reluctant to spend, an increase for the fourth consecutive month in this index, might be considered a very positive and leading indicator toward future economic expansion.

Unemployment

Unemployment declined from 9.1% in September to 8.6% in the most recent data from November 2011. This is a welcome reduction in the unemployment rate that had stubbornly hovered above 9% for quite some time. Out of the 372 metropolitan areas surveyed when calculating the unemployment rate, 351 experienced a decline in the unemployment rate, while 16 of the 372 had increased unemployment and five areas remained flat. With these geographically broad movements lower in unemployment, it appears to indicate a healing economy may be on the horizon. It is important to remember that this increase in jobs may take several months to really identify, if in fact, a positive trend in job creation is emerging. Equally important to note, these are the first, meaningfully positive changes in the unemployment rate in several years and should be viewed as very positive news.

Housing

Builders broke ground in November on more houses than at any time in the past 19 months. This was led by a surge in multifamily units, signaling the market may be stabilizing heading into 2012. Housing starts increased by 9.3% to an annualized rate of 685,000, exceeding the highest estimate of economists surveyed by Bloomberg News, and the most since April 2010. Commerce Department figures showed building permits, a proxy for future construction, also climbed to a more than one-year high. This data is particularly encouraging because economists estimate that approximately 33% of all employment in the U.S. is either directly or indirectly related to housing. With this unexpected improvement in the construction market, this may further stabilize the improving unemployment rate and go hand-in-hand with a more optimistic consumer, as indicated in the consumer sentiment index or CSI.

Risk Management

Due to continuing global concerns, the portfolio management process for 2012 will likely point toward a 50-50 balanced allocation, with 50% bond/conservative investments and 50% equity/company stock oriented positions. The equity portion of the portfolios that may offer growth opportunities are the larger, well capitalized companies with solid balance sheets. While the smaller and mid-cap companies continue to experience above average volatility due to the markets uncertainty. The models will continue to look for market trends that appear to be sustainable and will likely rotate to those sectors that are showing strength, in spite of difficult economic conditions and a politically uncertain environment.

Summary

As mentioned above, it appears the economy is slowly beginning to expand. While growth may remain slow and tepid, it appears to be heading in a positive direction. Corporate America found a way to increase earnings approximately 15% for the companies in the S&P 500 over the past year. We have reason to believe this positive earnings trend may continue.

Energy costs will be something to watch in 2012 with the recent political tension in the Middle East. Threats from Iran to close the Strait of Hormuz, through which almost 20% of the world's oil travels annually, could cause a major disruption in the world's oil supply. This could inadvertently spike oil prices creating a global economic shock. The U.S. and its allies have stated repeatedly that they would not allow Iran or anyone else to close the Strait of Hormuz due to the global economic implications of such an act.

There are stark differences in the visions that both political parties have for our country and its future. Perhaps more importantly, the ways in which they believe we can achieve their goals is probably as different as at any point in our history. Additionally, this extreme divide in political philosophy will cause great uncertainty in the markets for 2012. Ironically, markets often perform better once they understand what that news is, even if it's bad news. Unfortunately, this election may be the most bitterly contested and brutally partisan presidential election in recent history. In my opinion, the markets will trade based on the prognosis for the candidate they believe will be most accommodating to

capitalism and the many benefits it offers investors of all income levels. If the market views the leading candidate as one that supports new regulatory oversight and intrusive government intervention in corporate America, markets will selloff in anticipation of lower earnings. Conversely, if the candidate leading in the polls is more pro-business, less intrusive, and will provide an environment in which business can grow and profit while creating employment, it is my belief the markets will respond positively.

Hopefully, Europe can rectify its financial situation in a satisfactory fashion, so as to let the world's markets focus on other global economic factors and move in a positive direction.

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Sources

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