



2011 in Review

U.S. stocks took a wild ride to nowhere in 2011, which will be remembered as one of the most volatile years on record. From the U.S. debt downgrade to European sovereign debt worries, the market had quite a bit to worry over and digest this past year. While it is tempting to convey a great amount of significance on this volatility, we must remember that many of the issues faced by the global economy coming into 2011 have continued into 2012. The events, both positive and negative, that unfolded during the year were significant in themselves, yet the resulting impact on Large Cap U.S. stocks, from beginning to end of 2011, was negligible.

One of the most significant issues facing the U.S., and consequently the global economy, is the paralyzing effects of politics. Anyone who runs a business or manages a family budget knows that if your fiscal condition is poor, some combination of increased revenues and/or decreased expenses is the only sustainable solution. In the case of our government, this is going to mean some type of reform to both taxation and spending.

Equities

For all of its volatility, the market (as measured by the S&P 500) ended the year roughly flat on a price basis and slightly positive including dividends. Other equity asset classes fared much worse as investors fled Developed International, U.S. Small and Mid Cap, and Emerging Markets for the safer haven of U.S. Large Cap equities. The underperformance of these various equity asset classes is shown on the following table.

	2011
S&P 500	2.11%
Russell Midcap	-1.55%
Russell 2000	-4.18%
MSCI EAFE Index	-11.73%
MSCI EM (EMERGING MARKETS)	-18.17%

The Euro Zone faces a challenge greater than the United States, China, and even most of the emerging markets. The coordination of 17 independent countries has proven to be nothing short of impossible, although modest progress was made during 2011. Many believe that the Euro Zone still faces a significant chance of recession going into 2012. The biggest threat is a Lehman-style financial breakdown of an EU Member country which would immediately push the Euro Zone further toward a recession and most likely dragging the global economy down as well. There seems to be a great focus on austerity in the European countries right now which has the potential to slow economic growth.

The equity markets in 2011 traded on fear rather than fundamentals. As headlines came across the wire (i.e., supply disruptions due to the earthquake in Japan, stalemate in Congress, increasing sovereign debt yields, etc.), the markets would trade off. Investors would subsequently pour into “safety” assets -- namely U.S. treasuries and gold. All the while U.S. companies were earning higher profits, stockpiling cash on their balance sheets, and increasing dividends.

The current valuations of stocks, both domestic and international, are cheap by historical standards. The S&P 500 ended the year at roughly 11x next year’s earnings, versus the average of 15x, and Emerging Markets ended at 9x versus its average of 12x. We believe these depressed valuations create attractive opportunities for 2012 and beyond.

Fixed Income

The U.S. debt downgrade by S&P did little to dissuade investors from U.S. Treasuries even as yields fell below 2% to historic lows. Once again, fundamentals were ignored as global investors continued to perceive the U.S. government as the safest place to invest driving down yields. Many professional investors missed the rally as they were underweighted in this asset class for much of the year.

Despite dire predictions for the municipal bond market in 2011, municipal credits generally improved with the exceptions being a couple of widely expected bankruptcies and those geographic areas with exceptionally weak real estate prices. Otherwise, both corporate and individual tax receipts grew modestly while cost cutting measures reduced expenditures resulting in improved financial positions.

For the first time in history, the Federal Reserve telegraphed a long-term rate guidance stating they would keep rates near zero until mid 2013 at a minimum. This has been further updated to late 2014 at the most recent Fed meeting. That being said, the U.S. economy remains soft and consumers are reluctant to take on more debt as they continue to deleverage. The public sector is almost solely responsible for current borrowing domestically. As a result, we don’t expect much movement up or down in fixed income assets for 2012.

Commodities and Real Estate

Gold increased 10.8% in 2011 as investors sought the perceived safety of this asset class. Oil increased 8.2% while natural gas declined 32%. The Dow Jones UBS Commodity Index, a basket of energy, metal and agriculture commodities, decreased 13.3% for the year. Real Estate prices remain depressed across most of the country although the pace of decline has slowed. While 30 year mortgage rates dipped below 4%, it has had little effect on housing as credit remains tight, prices depressed, and supply of housing exceeds demand. Housing starts also remain depressed although off the lows of 2008. It appears that the long expected arrival of inflationary pressures has been further postponed.

2012 Outlook

As we look to the year ahead, we expect much of the volatility to continue even though the economy seems poised for modest improvement. The tug-of-war between governments attempting to spur growth through spending in the short term and the deleveraging and austerity required in the long term cloud the near term outlook. With control of the White House and Congress uncertain, investors will

again have to endure the divisive rhetoric across party lines and the continued inability to make progress on needed fiscal reforms.

U.S. equities are being perceived as a safe haven for capital and are likely to outperform over the short term. Longer term, however, we continue to favor a significant allocation to emerging markets' equities given their higher growth rates and stronger balance sheets and are underweight to developed international equities.

Fixed income markets face headwinds as we feel rates will increase from these historically low levels, although likely not until late 2012 or early next year. We anticipate commodities moving higher as global demand picks up in the third and fourth quarters. Residential real estate is expected to bottom sometime in 2012.

At Atlas Brown, we remain committed to our diversified approach to portfolio management, utilizing multiple traditional and alternative asset classes to create portfolios that seek to minimize volatility while enhancing returns over the long term. We appreciate your continued confidence in our team to assist you with your investment and wealth planning needs. If you would like to discuss our outlook, your portfolio, or other wealth planning needs, please call us to schedule an appointment. We always enjoy hearing from you.