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DECEMBER MARKET COMMENTARY

By Tom Crow

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Index	Month End	Gain (Loss) by Period Month	Most Recent Quarter	Year-to-Date	Trailing Twelve Months
Dow Industrials	12,218	1.4%	12.0%	5.5%	5.5%
S&P 500	1,258	0.9%	11.2%	(0.0%)	(0.0%)
Nasdaq	2,605	(0.6%)	7.9%	(1.8%)	(1.8%)

Happy New Year!!! After what can only be described as a tumultuous year, the S&P 500 finished 0.04 lower than it started. Going back to January 1, 2000, the 12-year returns for the indices are: +6.3% for the Dow, -14.4% for the S&P 500, and -36% for the Nasdaq.

Were markets this past year really more-volatile than usual? Yes. Since the April high, US indices have moved an average of 1.3% per day, compared to a 50-year average of 0.6% before the 2008 financial crisis put all global market in turmoil.

If you need more evidence that the deck was stacked against investors, comparing this recession which officially started in June of 2009 to the past six in the US (1961, 1970, 1975, 1982, 1991, and 2001), shows that so far, this one has exhibited the steepest decline and the weakest recovery to date.

What about the results? Terms like trying, frustrating, and depressing are fairly accurate descriptions of how investors, both individual and professional have felt for the past couple of years. And yes, institutional managers are feeling the pain as well. Investment firms are closing their doors or consolidating and fund managers are trying every trick they know, and inventing some new ones to try and find profits for their clients, with little or no success.

Bruce Berkowitz was Morningstar's "Equity Fund Manager of the Decade." His Fairholme Fund lost over 30% last year. So, the hedge funds must have made a killing, right? Well...not exactly. Billionaire hedge fund manager John Paulson, who was practically vilified for making obscene amounts of money by first shorting sub-prime mortgages and then buying distressed bank stocks ahead of the government bailouts is reported to be down more than 40%.

Here's the bottom line…over 80% of active fund managers did worse than the indices last year…us included. The strategies we've been using successfully for over 30 years let us down. Yes, we've moved in a more-technical direction and added research and screening criteria since Bill Bayne left the company, but his basic, fundamental analysis and growth projection screen is still one of the final hurdles a stock has to clear before it makes it on our "buy" list.

The New Year prompts analysts to dust off their crystal balls and make all sorts of predictions about what the year ahead will bring. For the most part, their outlook for the year ahead is rather grim. The specific numbers for GDP growth, unemployment and inflation are all over the map, but a few common themes emerge that are worth keeping in mind.

1) The US economy is improving, but…
    a. unemployment will remain high;
    b. corporations and consumers will remain cautious, which will limit growth potential, and
    c. political uncertainty will not help a. or b.
2) The European Union will remain weak and could slip into recession.
3) China and emerging markets will slow.
4) Interest rates will remain artificially low, which won't help keep inflation in check.
5) It will be many years before developed economies can move beyond high debt and low growth.

All of the above and many other factors have us believing that 2012 will be another tough year for investors. The markets are likely to remain range-bound and over-reactive to every piece of news, foreign and domestic. Stocks will remain highly correlated, meaning individual winners will remain elusive. Volatility will remain high, meaning capturing profits will be challenging as, like last year, they can be wiped out in a matter of minutes by a wave of selling, often brought about by

completely unrelated circumstances. In the near-term, higher oil prices and persistently weak gains in employment and housing will keep the broader indices from breaking out to new highs.

If there is a bright side, interest rates are likely to remain low for at least another year, meaning those who are still able to borrow money will be able to do it cheaply, but a continued aversion to risk will dampen the effects cheap money typically has on the economy.

Friday's unemployment report was better than expected. The private sector created 212,000 jobs and government shed 12,000 for a net gain of 200,000, above expectations of 150,000. The unemployment rate dropped to 8.5% from 8.7%. October's jobs created were revised higher by 12,000 and November's were revised lower by 20,000.

The increase in jobs was largely concentrated in sectors that do a lot of seasonal hiring, like couriers, retail, and leisure and hospitality (hotels, restaurants and bars.) Elsewhere, increases in mining, manufacturing and health care are a bit more-encouraging. Looking back from a couple of months down the road, barring any major winter storms that shut down highly populated areas will give us a much better picture of the real jobs situation when the seasonal fluctuations are revised out. The markets shared my wait-and-see opinion and responded by generally ignoring the report.

Once again, a rough year in the markets has clients, friends and family members under increased pressure from the annuity salesmen. Preying on fear and promising guaranteed returns no matter what the market does, they goad investors into making emotional decisions, which cause them to change investment strategies at a time when the only real guarantee is that they'll be selling low, and they could be giving up penalty-free access to their money for many years.

I wish I could say we'd never lose money in an investment, but that's not investing…or reality. Investing in companies and their futures always involves risk. Some do pretty well for a long time, some win big and others fail completely. If you don't have an appetite for risk, we can accommodate that and invest accordingly, but you have to let us know, and your expectation of returns must also be adjusted. Take a look at what short-term US Treasuries and FDIC-insured deposit accounts are paying right now to get some idea of what virtually-zero-risk investing yields. Hint: They can't even keep up with current, historically-low inflation rates.

In the face of continued political and economic uncertainty, we will continue to search for sources of growth and income that don't expose our clients to excess risk. Our strategies are adaptable and we continue to believe they will reward us for not making rash and hasty decisions based on fear and hysteria.

Despite considerable optimism in the first few trading days of 2012, the Dow is still struggling to pass and stay above the 12,500 level. This may be another sideways year thanks mostly to the upcoming elections, but unless something has changed fundamentally with the way markets and economies work, the cycle will play out and the downturn will once again give way to growth and expansion…and we'll be in a position to help our clients profit from it. The folks who say things like, "this is the new normal" and, "things are different this time" have been proven wrong every time.

We'll update and revisit things in about a month. Please call or e-mail if you have any questions, comments or concerns. We are here to serve you and we really like doing it.