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REVIEW & OUTLOOK: FIRST QUARTER 2012

REVIEW

Stocks continued to gain in the first quarter with the S&P 500 achieving a total return (price change plus dividends) of 12.6%. The DJIA and S&P 500 indices came close to their 2007 highs, but did not close above those important psychological prices. The NASDAQ is still well below its January 2000 high.

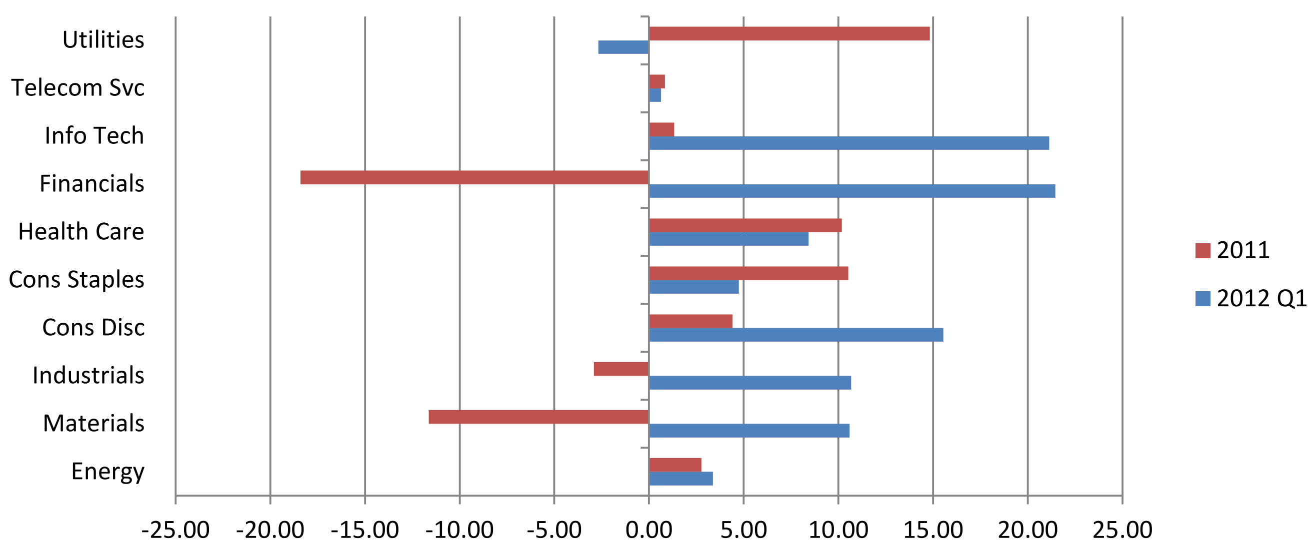
Steadily improving economic indicators, the apparent avoidance of a Eurozone collapse, and an unattractive bond market all helped investors gain confidence in the stock market, at least relative to other investment alternatives.

Returns generated in the bond market were disappointing. Treasuries of all maturities had negative returns. As investors gained confidence in the Eurozone, they sold the safe haven investment and drove prices down. Long-term Treasuries had a return of -6.7%, while the less “safe” Intermediate-Term Government/Credit index (combination of Treasury and high quality corporate bonds) eked out a return of +0.6%.

S&P 500 PERFORMANCE BY ECONOMIC SECTOR

All sectors except utilities gained. Financial stocks had the largest gains, followed closely by Information Technology.

Figure 1. S&P 500 Index Performance by Sector



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The Utilities sector was the top performing sector for the full year in 2011, only to languish in the first quarter 2012. On the other hand, the Financial sector performed dismally in 2011, yet has been the top sector this year. Significant variability across sectors at any given point in time and over time is the norm.

The same can be said of the performance of different capitalization groups. These differences are one of the reasons we believe it is important to be diversified across sectors, as well as across businesses of different sizes.

OUTLOOK

Stock prices rose and corporate earnings fell slightly in the first quarter. The average price/average earnings ratio of US stocks rose from 15.3 at year end to 17.4 at the end of the first quarter; higher but not excessive. It will be important to monitor 1st quarter corporate earnings as they are reported.

Many economists are calling for modest GDP growth in 2012 (below the long-term average). The challenge is in predicting the impact of domestic changes and global risks on financial markets. Domestic changes include lingering corrections in the housing market and restructuring in state and local governments. Global risks include tensions with Iran and the related impacts on oil prices, as well as slower growth in the "emerging" economies.

While attending the National Association for Business Economics conference earlier this month, Hart heard:

- Ben Bernanke explain why he thinks high unemployment is due to cyclical (not structural) factors – which helps explain his stance on interest rates and easing;
- Doug Elmendorf (Director, Congressional Budget Office) explain why projected budget deficits and the debt cannot be adequately addressed with just spending cuts or new taxes, saying that a mix of both is needed;
- Philip Verleger assert that current oil prices are due more to Japan's expanded use of sweet crude (they've closed almost all nuclear facilities) rather than tensions in Iran; and
- Senator Mark Warner ask business leaders to lend their support for a meaningful, bi-partisan budget.