



PERSPECTIVES

MANAGING YOUR INVESTMENTS, PROTECTING YOUR FUTURE

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Market Recap

The bumpy ride that began in late July continued in Q4 due to financial uncertainty in Europe, and political bickering and indecisiveness in the U.S. The stock market began the quarter with a rally and broke out of the trading range it had been in since the financial crisis started in August, as politicians in Europe worked hard to craft a bailout plan. But in November, the plan started unraveling and the crisis spread from Greece to Italy and Spain. It did not help that the U.S. Super Committee failed to reach an agreement on deficit reduction just before Thanksgiving and, as a result, the markets fell once again into the middle of the August trading range.

In our opinion, it wasn't until December 2nd, when central banks lowered overnight borrowing rates to improve European bank liquidity that financial crisis risks began to diminish. Then, on December 8th, the European Central Bank stepped in and gave 523 European banks three-year, 1% loans totaling a record €489 billion. These two moves largely allowed the steam to escape from the boiling pot, and Powers Capital began to get more constructive regarding putting money back to work (Powers Capital had weightings of roughly 10-20% in cash since early August in order to protect portfolios).

Volatility continued to be the keyword in Q4. In fact, the aver-

age daily difference between the intraday high and low on the Dow Jones Industrial Average ("DJIA") since August 1st has been 269 points!¹ Volatility makes it very difficult for managers to time moves for investing, as it is challenging to get the timing right.

Q4 U.S. profits are expected to be almost 20% above the peak of the last recovery cycle (Q3 of 2006) and rose at a healthy 8.5% annualized pace in Q3.² This V-shaped recovery in profits, healthy corporate balance sheets, and reasonable valuations should have boosted stock prices, but macro fears have dominated fundamentals, and risk assets struggled throughout 2011. The S&P 500³ was flat for the year; U.S. stocks as a group fell about 1%⁴; the Dow Jones Industrial Average⁵ was up a respectable 5.5%; while a flight to quality pushed 10-year Treasury yields down to 1.88%. But, European stocks⁶, many commodities, and key emerging markets had a very difficult year, down anywhere from 10-20%.

We were predicting an up 15-20% kind of year for the S&P 500 in 2011, and our forecast was right on target until late July and the onset of the European financial crisis. We had company, as the mean estimate of Wall Street strategists was a year-end forecast of a 10% rise, according to data compiled by Bloomberg. The European financial crisis was a big speed bump, but once resolved (and we are getting there) better times should be ahead.

Forecast

Why did God create economists? To make weatherman feel good about themselves! Our sunny forecast for 2011 got derailed by a thunderstorm in August. Nevertheless, here is our 2012 forecast.

Fears of a U.S. recession during the second half of 2011 subsided on a string of better-than-expected economic reports, and that trend is continuing. Q3 GDP grew at 1.8%, but Q4 GDP growth is expected to be in the 3.2 - 3.5% range and consensus expects the U.S. to grow by 2.1%* in 2012. Inflation should be benign, and interest rates are expected to stay very low. The average year-end forecast for the S&P 500 is 1,348; a 7% gain before dividends.⁷ Powers Capital is forecasting the gain for the S&P 500 (total return) will be in double digits, supported by mid-to-high single digit earnings growth and P/E multiple expansion.

We believe 2012 will be the year the U.S. actually makes some headway in generating stronger economic growth. Private job creation through the first 11 months of 2011 has accelerated to about 155K/mo.² Job gains should lead to a slow but steady decline in the U.S. unemployment rate. In addition, we don't think unemployment benefits (for 99 weeks) will be extended in February. As benefits expire, many job

seekers may simply leave the labor force and no longer be reported as unemployed, putting downward pressure on the unemployment rate. As consumer confidence rises (and it is), cash-rich U.S. companies should increase capital expenditures and hiring. In addition, there are signs that we may be close to the bottom in the U.S. housing market, lifting a source of drag on the economy for the past four years.

We expect the vast majority of European

countries to fall into recession due to forced deleveraging by banks and reduced lending to restore their balance sheets. In addition, the austerity programs put in place create a drag on GDP as spending is cut. But, there will be pockets of strength in Europe (Germany) and the overall recession in Europe is expected to be minor (consensus expects less than -1%).⁷

In summary, the forecast is mostly sunny with a chance of intermittent showers!

The Score Board

	12/31/11	YTD (Change)
Dow Jones Industrial Average*	12217.56	5.5%
S&P 500*	1257.60	0%
NASDAQ Composite*	2605.15	-1.8%
MSCI EAFE (USD)*	1412.55	-14.82%
DJ-UBS Commodity Index	140.68	-13.37%
Barclays Aggregate Bond Index	1669.79	7.8%
10 Yr U.S. Treasury Bond Yield	1.88%	-142 bps
30 Yr Fixed Mortgage Rate	4.10%	-97 bps
Prime Rate	3.25%	UNCH
Crude Oil (\$/barrel)	\$98.83	8.15%
Gold (\$/oz.)	\$1565.80	10.18%
U.S./Euro	\$1.30	3.3%
Core Inflation (ex food/energy)		2.2% **
Inflation (with food/energy)		3.4% **

* Without dividends ** Unadjusted 12-mos. ended November '11 bps (1 Basis Point = 1/100%) UNCH (Unchanged)
Sources for Score Board and quoted statistics: WSJ, US Dept. of Labor, Federal Reserve

Portfolio Management

2011 was a tough year for active managers because of tremendous uncertainty in the world and record volatility. This hurt portfolio performance for the second half of the year, but, we strongly believe active management will provide better returns over time, and the majority of our clients' portfolios are in actively-managed funds.

Two of the funds we use whose managers, Bill Gross and Bruce Berkowitz, were recently named Morningstar's "Fund Managers of the Decade" for fixed income and equities, respectively, performed in the bottom quartile of their respective categories in 2011. Do we think these managers have lost their edge? The answer is simply no. The macro environment dominated fundamentals this year, and we do not believe that will continue. These funds still boast some of the best 5, 10, and 15-year returns for funds of their kind. These managers simply made investment decisions that did

not turn out well. But, their decisions turn out much better than expected more often than not based on past performance—and that is why they were named "Managers of the Decade" by Morningstar.

Another drag on performance was tactical trading. The great investor, Peter Lynch, said, "In this business if you're good, you're right six times out of ten. You're never going to be right nine times out of ten." Our call on taking money off the table in early August hurt performance as the world did not ultimately unravel, but we felt we needed to act to protect clients' portfolios from a possible significant market decline, and will again if necessary.

We did not have any significant exposure to U.S. Treasury bonds in 2011 because at the beginning of the year they were at almost record low yields. We did not think yields would fall any lower and, in fact, were more

likely to rise, which results in a fall in bond prices. It was the same mistake PIMCO's Bill Gross made.⁸ But, there was a flight to the safety of U.S. Treasuries as the European financial crisis unrolled, and yields did go lower. Not having exposure to this asset class cost us performance.

We took significant steps to reduce volatility in portfolios during the quarter. First of all, seeing how closely correlated to stocks our high yield bond funds were, we moved them up into the equity section of our portfolios. We still believe these are opportunistic investments and we wanted to keep them, so moving them reduced our stock exposure and made room for less volatile bonds such as agency mortgage-backed bonds, which we purchased. We are also attempting to reduce volatility without sacrificing returns through a new investment for qualified clients in a W.P. Carey global non-traded real estate investment trust.

Talk With Us

There is often confusion as to the difference between a registered investment advisor and a stockbroker. We want to help lift the cloud of confusion and explain why working with a registered investment advisor is important to you.

A registered investment advisor must adhere to the "fiduciary standard" – which requires the advisor to put clients' best interests first. Stockbrokers are held only to a "suitability standard", which means making recommendations consistent with the client's goals and risk tolerance.

Stockbrokers are paid commissions by clients or by companies whose products they recommend. That fee structure can sometimes result in conflicts of interest between the client and the broker. Most registered investment advisors provide advice and services for a fee based on a percentage of assets under management. You always know what you are paying. This structure is simple and easy to understand, and seldom results in conflicts of interest. It gives your advisor an incentive to grow your assets – when you succeed, your advisor succeeds.

Price-Metrix, a wealth management consulting firm, reported that a quarter of the advisers who manage accounts for households of \$250,000 to \$500,000 charge their clients fees of 1.75% or more on the assets they oversee.⁹ Powers Capital's top management fee is only 1.25% (assets under management under \$500,000).

Finally, registered investment advisors use institutional custodians – like Charles Schwab & Co. – to hold and safeguard clients' assets. We also provide free consultations and reviews to family and friends who clients think may benefit from working with a registered investment advisor.

If you want to discuss further how Powers Capital Investments, Inc., a registered investment advisor, works for you or have a friend or family member who can benefit working with a registered investment advisor – **Talk to Us!**

1. Wall Street Journal, "In the Markets" (December 28, 2011).
2. Wells Capital Management, "Economic and Market Perspective Update" (December 21, 2011).
3. The S&P 500 is designed to be a leading indicator of US equities and is commonly used as a proxy for the overall market. The S&P 500 is a market-value weighted index; each stock's weight in the index is proportionate to its market value. The 500 stocks are chosen for market size, liquidity, and industry grouping among other factors.
4. The Wilshire 5000 Total Stock Market is a market-value weighted index. The index is intended to measure the performance of most publicly traded companies headquartered in the US.
5. The Dow Jones Industrial Average (DJIA) is the most-quoted market indicator in newspapers, on television and on the Internet. The DJIA is a price-weighted stock market index that shows how 30 large, publicly owned companies in the US have traded during a standard trading session.
6. The MSCI EAFE Index is an unmanaged index that is generally considered representative of the international stock market and includes stocks in Europe, Australia, and the Far East.
7. Goldman Sachs Asset Management, "Outlook for 2012 and 2013 GDP Growth" (December 2011). *As of November 2011
8. PIMCO, "Investment Outlook – Mea Culpa" (October 2011).
9. Price-Metrix, "The Anatomy of Outperformers" Vol. 5 (December 2011). *The fees may reflect different levels of services offered by each firm.

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