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Financial Market Commentary: 1st Quarter 2012

Favorable Economic Data Propels Markets

The upward pace of the equity markets from the lows of March 2009 has been at times volatile and nerve-wrecking. Despite the bull market experienced in many parts of the world there is still plenty of uncertainty about the short term path of the global economic recovery. In fact, plenty of potential potholes lie in the road ahead however you wouldn't know it by looking at returns in the first quarter. Favorable economic data and stabilization in Europe propelled most equity indexes to double digit returns.

State of Global Economies

Improving US Economic Data

Data from the U.S. was solid in the first three months of 2012. The U.S. appears to be on a path of slow but steady growth. Positive news came from the employment market. Strong job growth was seen across the economy. Although the unemployment rate hovers at 8.3% more and more employees are feeling confident about their jobs. Retail sales were also promising in the quarter. One of the few sectors which did not display overwhelming success in the quarter was the housing market as news remained mixed. However existing home sales are 8.8 percent higher than during this same time in 2011. The Northeast has seen a steady increase in home sales and many listings are receiving bids from multiple buyers. However, real estate in parts of Florida, Arizona, Nevada and California while improving, still have a way to go. One thing is certain, if employees continue to feel confident about jobs, the sustained growth in the retail and housing markets will likely progress.

U.S. corporate earnings reported in the quarter remained robust as firms continued to expand profitability and produce respectable cash flows. Expect continued fundamental corporate growth as a result of pent-up demand for consumer goods and sturdy corporate balance sheets.

Improving International Economic Data

The European sovereign debt crisis has appeared to stabilize for now. After tense negotiations, Greece was able to secure another round of bailout financing and avoid a disorderly default by convincing private bondholders to take a big haircut and by passing further austerity measures. The European Central Bank's plan to pump liquidity into the banking system via three-year loans, launched in 2011, also proved to ease the crisis.

Healthier economic data and Europe's efforts to contain the debt crisis have helped turn equity markets around over the past few months. No region has benefited as much as emerging markets. Fixed income is another avenue to emerging markets. From the debt perspective, emerging markets look perhaps even more attractive. With U.S. Treasuries and the U.S. investment-grade corporate market yielding extremely low returns, there is a risk of a painful correction should interest rates or inflation move higher. Meanwhile most emerging-market debt offers yields above 5% as well as diversification from the U.S. dollar.

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There has been talk of a hard landing for China because of falling exports, slowing retail sales, and downgraded growth targets. While these indicators are signs of a slowdown, China's economy continues to operate at a very high level. Its industrial production increased by 11.4% year-over-year, according to the National Bureau of Statistics of China. Although this number is below its typical pace of 15%, it is still far ahead of the production levels of many other developed nations and a long way from signaling a recession. Overextended banks and a housing market bubble do pose risks to China's economy, however the health of Chinese households, which boast low debt levels and high savings rates are likely to extinguish economic woes. Unlike the economic health of many U.S. consumers which were negatively affected during the banking crisis of 2008, Chinese households are generally in better fiscal shape to withstand calamity. All told, China's middle class continues to expand, which will likely give its economy more wherewithal to withstand a correction in the housing and banking sectors than perhaps it's had in the past.

Other emerging markets share similar characteristics. Brazil and India, for example, also boast a growing middle class that continues to spur growth and economic independence. Even Central and Eastern Europe, considered weaker regions in emerging markets, have weathered the Euro crisis relatively well, with exports holding up in the face of slackening Western European demand.

Potential Potholes Ahead

Uncertainties of 2012

The uncertainty that made 2011 such a wild year very much remains in the marketplace. The developed world is still figuring out how to handle its debt hangover and the U.S. continues to battle budget deficit woes and the ever lingering concern of higher income tax rates. Growth concerns keep popping up in China and elsewhere, and elections across the globe could have an impact on investor confidence going forward. Although things are looking brighter in Europe, many of the underlying issues remain, and the crisis can flare up in the months ahead.

The rising price of gas may threaten to slow the economic momentum. Tensions in the Middle East have caused oil prices to escalate. Talks between Iran and Israel have become increasingly hostile, as Israel has threatened to make a preemptive strike against Iran's nuclear program. In the event of an attack, Iran has pledged to close the Strait of Hormuz, an action that could drive oil prices considerably higher. Higher oil and gasoline prices are among the most significant risks for both financial markets and the world economy in 2012.

Keep Expectations Realistic

Investors in almost every corner of the world are going to be happy when they open their quarterly investment statements. Is this growth sustainable? It seems unlikely that there will be too many more quarters where broad equity markets are up more than 10%. The year has certainly started with a bang, but investors looking for peace and quiet in the financial markets may be unlikely to find it in 2012 because of the aforementioned uncertainty. Nevertheless, though volatility can be expected to persist, the global outlook is showing signs of improvement and that is always welcomed.

Disclosure: Certain sections of this commentary contain forward-looking statements that are based on our reasonable expectations, estimates, projections, and assumptions. Forward-looking statements are not guarantees of future performance and involve certain risks and uncertainties, which are difficult to predict. Past performance is not indicative of future results. Diversification does not assure a profit or protect against loss in declining markets. All indices are unmanaged and investors cannot invest directly into an index. The Dow Jones Industrial Average is a price-weighted average of 30 actively traded blue-chip stocks. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. The MSCI EAFE Index is a float-adjusted market capitalization index designed to measure developed market equity performance, excluding the U.S. and Canada. The MSCI Emerging Markets Free Index is a market capitalization-weighted index composed of companies representative of the market structure of 26 emerging market countries in Europe, Latin America, and the Pacific Basin. It excludes closed markets and those shares in otherwise free markets that are not purchasable by foreigners. The Barclays Capital Aggregate Bond Index is an unmanaged market value-weighted index representing securities that are SEC-registered, taxable, and dollar-denominated. It covers the U.S. investment-grade fixed-rate bond market, with index components for a combination of the Barclays Capital government and corporate securities, mortgage-backed pass-through securities, and asset-backed securities. The Barclays Capital U.S. Corporate High Yield Index covers the USD-denominated, non-investment-grade, fixed-rate, taxable corporate bond market. Securities are classified as high-yield if the middle rating of Moodys, Fitch, and S&P is Ba1/BB+/BB+ or below.

Solid Bar	Annual Return for 2011
Diagonal Bar	YTD Return as of 3/31/2012