

GUARDIAN

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Market Commentary

by Bill Whatmough

U.S. STOCKS WENT ON A WILD AND ROCKY RIDE IN 2011 and after all the bumps and bruises suffered along the way ended up on balance just about where they started the year. For those keeping score, it paid investors to own the safest stocks as the high quality, blue chip Dow Jones Industrial Average was able to squeak out a 5.5% gain aided by a late Santa Claus rally to close the year. On the other end of the spectrum, the more speculative Russell 2000 Index of small cap stocks neatly offset the Dow by losing 5.5% for the year. Smack dab in the middle, the S&P 500 Composite, after putting on lots of frequent flyer miles surging up and down, ended almost exactly where it started losing a miniscule 0.003% for the year. The Nasdaq Composite also finished in the red, falling 1.8% in 2011 thanks again to a furious December rally that just fell short of pushing the technology heavy average into the black.

The flatline result masked the market's sharp ups and downs. The S&P Composite which was up a solid 8.4% in late-April, then plunged to a loss of almost 13% in early October before recovering virtually all of those losses by year end. European stocks meanwhile were clobbered by the debt crisis, with most indices posting double-digit losses. Most Asian and emerging markets also suffered sharp declines. U.S. Treasury bonds again proved to be a safe haven for investors in spite of already low yields entering 2011. Downgraded expectations for economic growth pushed the U.S. Treasury 10 year yield down 1.4 percentage points to a record low 1.9%. Global uncertainty also fueled a stampede into gold as the price of gold soared to a record high close of almost \$1,900 an ounce before backing off late to close up 10% around \$1,566 at year end.

News from the U.S., which for decades has been the driving force for other stock markets around the world, played second fiddle in 2011 to Europe. Abrupt about-face moves in asset prices were common as the U.S. was hostage to the latest news (or rumors) emanating from Greece, Italy, Spain, and the rest of the European Union and the handling of its debt crisis. Frustrated traders swung wildly between "risk on" and "risk off." Reflecting the volatility, the S&P 500 closed up or down by 2% or more on 35 days in 2011, up from 22 days in 2010. By contrast, the S&P didn't post a single move of more than 2% in 2005 and only two such moves in 2006.

As we turn the page into 2012, it is becoming clearer that Europe's sovereign debt problems are nowhere near resolved. In addition to those lingering fears, the partisan divide in the U.S. Congress that took the country to the brink of default on its debt payments and led to a downgrade of the U.S. credit has not been corrected. Magnifying this uncertainty for the coming year will be the Presidential elections and a renewed "throw the bums out" mood by the electorate. This has led to a defensive posture for most investors heading into 2012 with heavy concentrations of assets in low-paying money markets, t-notes, and defensive stocks.



With the economy showing some signs of modest recovery, the defensive posturing poses a question for investors. How much bad news is already factored into the markets? Pimco's pre-eminent bond manager and analyst Bill Gross three years ago correctly predicted that markets were set to move from "normal" returns (8%-10% per year as had been case for the previous several decades) to the "new-normal" which would result in significantly lower returns (perhaps averaging 3%-5%) in the future. Gross, in his latest prediction, believes we are now entering an era of "paranormal" returns. He predicts that the returns over the next few years will be marked by a "fat-

tailed distribution" rather than a "normal distribution." By this, he means that he expects annual returns could widely swing from outsized gains to huge double-digit losses dependent upon how effective the U.S. and the rest of the world's leaders are in handling their debt problems.

If Bill Gross is correct that we are entering a "paranormal" period (and we agree), then the "buy & hold" strategy still touted by much of Wall Street is even more likely to fail than it has over the past decade. We continue to believe that low correlated strategies like the ones PSI offers serve an important role in protecting investor capital in the turbulent markets that may lie ahead. ❁

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New Year's Resolution—Put Your Financial House in Order

TWENTY TWELVE IS UPON US WITH CONTINUED MARKET turbulence, a Presidential election, the ongoing European financial crisis, high unemployment, expanding U.S. government debt and more issues than we care to list. What's an investor to do to cope? Start by making certain you have your financial house in order. With that advice, we offer a list of Financial Resolutions for the New Year.

1. Know where you are with respect to your personal finances.

If you don't have one, create a personal net worth statement. If you have one, update it. A personal net worth statement itemizes your assets and liabilities. It provides you, in one glance, an understanding of what you are worth, where your assets and debts are concentrated, and how your personal net worth has changed from prior years.

2. Create a rough budget for the year ahead.

This budget should include non-discretionary spending as well as discretionary spending. On the non-discretionary side are loan payments, utilities, insurance, property taxes, memberships, etc. These are costs that it would be difficult to eliminate. Discretionary includes costs you could cut back on if necessary.

3. Assess the strengths and weaknesses of your financial position given your budget.

Play "what if." What if real estate values continue to decline? How will this affect your financial security? What if interest rates increase, or inflation begins to have a greater impact? What returns can you expect from your investments in different scenarios?

4. Set up a meeting with your financial advisor.

You should meet at least once a year with your advisor to review your financial situation, but this year it's particularly important. Review with your financial advisor where your assets are invested, expectations for 2012, and where opportunities and pitfalls may

exist in the year ahead. If there have been any changes in your life, such as a new job, new family member, loss of income, or anything else that may affect your financial plans, you need to discuss these changes with your advisor.

5. Review your estate plan in light of your updated net worth and any changes in your life.

Are beneficiaries up to date? Have your assets and their desired disposition changed? Have there been changes in your life that should be reflected in your will? Also, make sure you have a power of attorney and a living will to assure that your wishes are followed should you become seriously ill or incapacitated.

6. Fund retirement accounts for 2012.

The reason for funding a retirement account early in the year is based largely on when the market tends to realize its greatest gains—the period from December through May. If your employer provides a matching contribution, you want to put those funds to work for you as soon as possible. Retirement contributions can also help lower taxable income and build financial security. So pay yourself first by funding retirement plans early rather than later.

7. Review your credit reports.

At least once a year, review your credit report and make certain that the information on the report is accurate. You are entitled to do so without charge once a year. Request your free credit report at www.annualcreditreport.com, or by calling (877) 322-8228. If you find inaccuracies in your credit report, talk with a representative of the credit bureau immediately to find out what needs to be done to correct the information. But don't stop there. Notify any creditors you don't recognize that there is a problem with the account. If you suspect identity theft, contact the fraud departments of the credit agencies and file a report with your local police at once. ❁

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