Parker Carlson & Johnson

# Quarterly Review

Knowledge • Experience • Integrity

## January 2012: Fourth Quarter

| ASSET CLASS | TOTAL RETURN |
|---|---|
| **Stocks** | |
| S&P 500 Index | 2.0% |
| Russell 2000 US Small Cap | -3.6% |
| MSCI Global Developed Markets | -5.4% |
| MSCI Asia ex-Japan | -14.6% |
| Japan Nikkei 225 | -17.8% |
| MSCI Int'l Emerging Markets | -18.3% |
| **Bonds** | |
| US 10-Year Treasury | 16.7% |
| German 10-Year Bund | 13.7% |
| JPM EMBI Emerging Debt | 8.4% |
| ML Global Corporate Bonds | 4.0% |
| ML Global High Yield Bonds | 2.4% |
| Italian 10-Year Bond | -8.2% |
| **Commodities** | |
| Brent Crude Oil | 13.9% |
| Gold | 8.9% |
| CRB Commodity Index | -8.4% |
| Silver | -10.1% |
| Copper | -23.1% |

Avoiding risk was the overarching theme for investment returns in 2011. By surveying the returns across various asset classes we can see that straying too far from the safest, largest U.S. markets proved costly. Hardest hit were the classes associated with the concept of growth in the emerging market economies. For example, emerging market stocks and industrially-oriented commodities experienced double-digit declines for the year.

We started 2011 innocently enough. Our economy appeared to be picking up steam. Consumer spending was accelerating and unemployment was declining. Some economists were raising their estimates, calling for growth in real GDP of 2.5% or more. Then Japan was hit with a tsunami. The resultant damage to several nuclear reactors caused shutdowns of major production facilities, disrupting supply lines across the globe. Then, instead of confirming acceleration in our U.S. economy, data that came out in Q2 2011 started to point to a slowdown. The Purchasing Managers Index (PMI) dropped 15 points during the quarter, falling from 69 in March to 54 in June. (Levels about 50 indicate an expected expansion in production.) The unemployment rate started to increase again. And finally, the monthly change in personal consumption expenditures flatlined.

Meanwhile, all was not quiet on the European front. Growing concerns about the soundness of the European banking system combined with speculation by some economists that the U.S. economy had already slipped back into a recession sent global financial markets into cardiac arrest. Traders went into “risk off” mode, seeking safety in gold and U.S. and German government bonds. They sold about everything else: U.S. and foreign stocks, most other bonds and industrially-oriented commodities like copper and oil. In just 10 trading days from late July through early August, the S&P 500 Index fell 16%. Europe became the center of the trading universe, causing stock price swings that looked like an EKG. Some asset classes managed to recover by the end of the year following news of an improving domestic economy and programs out of the Euro-zone that were designed to shore up the finances of the banking sector. Encouraged traders tiptoed out the risk spectrum with buy programs that produced positive returns for a few market segments, ranging from 2% to 8% for the large-cap U.S stock market measured by the S&P 500 Index and many global bond sectors. Non-U.S. markets did not participate in the recovery, closing down double digits, along with commodities. Even domestic mid and small-cap stocks turned in negative returns for the year. Oil prices turned higher at the end of the year due to fears of a Middle East supply disruption with Iran threatening to block shipments from the Straits of Hormuz.

We begin the New Year with a constructive view on the stock market. Although we cannot close the book on the European debt crisis, we have a clearer picture of the European Union’s strategy for managing the problem – in return for more help from the European Central Bank (ECB), members must agree to adopt stricter fiscal policies and penalties. Valuation levels on stocks look attractive relative to bonds, assuming a manageable slowing in Europe’s economy and muddling progress in the U.S. A hard landing in China spilling over into the emerging market sector would change our assessment. But unlike the developed economies that have spent a lot of their fiscal and monetary capital these last few years, China’s financial resources provide them with a large tool chest.

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