

HIGH FALLS ADVISORS



OUTLOOK

“Good Riddance to 2011”

By James H. McBride
Managing Partner

December 2011

We have been expecting a fourth quarter rally in the equity markets that seems never to come. We got several mini-rallies that raised our spirits briefly, but each was followed by a market sell-off that sent the equity markets spiraling down to their starting points, or even lower in some cases. The extreme volatility in the equity markets this year is simply put the physical manifestation of the fear of uncertainty that exists today all around the world. Can we expect 2012 to be any better for us long term investors?

Last night the NBC national news reported that roughly one half of we Americans are now poor or low income families. This, of course, supports the pundits' cry of the widening gap between the ultra rich and the shrinking middle class. This “do nothing” congress seems only to react with the necessary compromises as deadlines loom – will we shut down the government today or worse, just “kick the can further down the road” with another short term fix? We expect that they will - after all, they want a Christmas vacation as much as the rest of us!

So what is the outlook for 2012? It is, after all, an election year and the rhetoric is bound to add to negative feelings of our populace, and perhaps those of the entire world. However, in spite of all the fear that currently exists, there are more hopeful signs today than any time so far in 2011. That said, the crucial element in any recovery is a belief that the excesses of the past will be overcome and the future offers hope for a better market environment. We see several factors that point to a better market opportunity in 2012.

First, U.S. multi-national corporations are doing just fine and the U.S. economy is still the best and safest place for the entire world to seek security in their investment portfolios. The European debt crisis debacle has caused most of the volatility in our markets, yet even if Europe encounters a recession, it will have only a modest effect on the U.S. Granted that our multi-national corporations' revenues will be impacted, but as the Wharton Business School reported in its 12/07/2011 white paper for Advisor Perspectives, “a fall-off in exports to Europe would harm our economy, but not be devastating.” They conclude that even a 10% reduction would only reduce U.S. production by 0.2%!

Second, the U.S. economy is improving just too slowly for a society that has learned to expect instantaneous gratification. It took us over 10 years to get ourselves into the current “debt crisis” and after the 2008 near collapse of our economy, we cannot expect to fully solve the problem in three short years. Our national fear continues to be stoked by high unemployment, real estate foreclosures and a badly damaged banking system. Couple that with ineffective leadership in both the executive and legislative branches which garners most of the media attention and we get an extreme measure of fear as we wait for the next shoe to fall. It is now clear that we have avoided the dreaded “double-dip” recession, but that has done little to mitigate future dread!

Finally, the war in Iraq is over. Most estimates put its cost to the American economy between \$800 billion to \$1 trillion. Redeployment of such a vast amount of money will help our deficit problem and help us reinvest in our own country. Once again the old economics #101 axiom that you cannot have “guns and butter” proves true.

2012 will prove to be a year of continued market volatility but also see substantial improvement in our economic status, and ultimately in equity market performance. Caution is advised, but as the year progresses the markets will improve as uncertainty wanes. We expect that depending on the speed of the economic recovery we could finally see a double digit gain in the major U.S. equity indexes. It is an election year, so caution is advised due to the headwind that always accompanies the presidential debates. Invest initially in good dividend paying S&P 500 stocks and high quality corporate debt (the S&P index has been range bound for over a decade now, crossing the 1250 mark on numerous occasions). Avoid Europe and China for the moment until they too have dealt with their current issues. Invest a modest portion of portfolios in emerging market equities.

Good riddance 2011! We expect 2012 will finally be our positive breakout year and expect that by year-end much of today’s uncertainty will have been minimized in favor of future growth.

The projections of returns for specific investment types are estimates and projections and therefore prone to error. Actual returns may differ significantly from projections. Your experience will differ from the performance of specific asset types to the extent that several types exist in your account, and to the extent that your specific investments perform differently than the average of that asset type. Whether any of the asset types mentioned above are suitable for your account must be determined individually, and your portfolio may not contain some of the asset types described. These views represent an appraisal of possible events. Outcomes and performance is not guaranteed. The investments listed may go up or down in value, and they are not suitable for all investors. Securities offered through Wall Street Financial Group, Member FINRA (formerly the NASD, SIPC).