

Fourth Quarter 2011 Summary Recap & Outlook

February 06, 2012

(These views are those of the Baird Family Wealth Group and may or may not be reflected directly in the Baird "Review and Outlook.")

- As has been widely reported, equity markets rebounded in the fourth quarter of 2011. While most major equity asset classes were positive in the quarter, only U.S. Large Caps, as measured by the S&P 500, moved up enough to recoup all of the losses with a fourth quarter return of 11.8%, eking out a positive return for the year of 2.1%. Other "more risky" assets did not fare as well for the year, the worst being the more volatile emerging markets which declined just over 18% in 2011. Developed international fared slightly better declining just over 13%. In general, "less risky" assets (bonds and cash equivalents) helped balance out portfolios in 2011 with positive returns across the board.
- The year was marked with uncertainty and volatility in most every asset class. Historically high debt, at the Government level, was the focus around the globe. Political fighting over who was responsible for the debt and who should shoulder the burden was the norm whether watching the news in Greece, Italy, France, Germany or here in the United States. It was our high debt level that first caused the ratings agency, Standard and Poor's, to evaluate the credit rating of the United States, but in the end it was political gridlock that caused it to lower the credit rating of the United States in August of 2011.
- Interestingly, global investors must have perceived the political and economic uncertainty to be greater in foreign countries as, even after being downgraded, U.S. Treasuries remained sought after. Overseas investors clamored for the dollar which they once shunned, using it to buy U.S. debt obligations (Treasury Bonds). This buying pushed up the value of the dollar and correspondingly the value of U.S. Treasuries. As bond prices rise, yields fall and using the 10 year Treasury as an example we saw yields drop from 3.3% to 1.89% over the course of 2011. This outcome is indicative of the fear being more focused on deflation due to contraction than inflation. It may also provide room for the FED to add additional liquidity (print more dollars!).
- The positive returns for large U.S. companies and improvement in the dollar may also have been reflective of the somewhat overlooked fact that the U.S. economy has been showing some signs of improvement. The unemployment rate has now dropped to 8.5%, the lowest level since February of 2009. The domestic manufacturing industry posted data in December that showed the best activity in six months. Holiday retail sales were fairly strong and corporate earnings are expected to be solid into 2012.
- In spite of the positive data, Wall Street has adopted a sour tone. Unlike the start of 2011, it is difficult to find a strategist at any of the major firms with a solidly bullish forecast for 2012.
- The negativity is understandable given that it will be difficult for our domestic economy to go unscathed should Europe tilt into a full scale recession. As their politicians wrangle over a more permanent solution to their debt problem, anxiety levels will most certainly rise. It won't be easy to forget that 2012 is an election year here at home, so we will experience our own wrangle and anxiousness.
- Wealth preservation requires a cautious view of risk. As contrarians, we prefer to be more cautious when others are not so we were cautious at the beginning of last year. This year, with so much negativity to start the year, we are feeling a bit more optimistic.
- There are many hurdles yet to jump over and most start with debt, but there seems to be some momentum building in our economy. Any of the hurdles could be too high for the current level of economic strength to overcome. We are adapting to this environment of volatility and the market may do much better than expected, at least until it garners more believers.
- **While the economy is not out of the woods just yet and in spite of the politicians, there is evidence that it may be moving in the right direction. Although we expect more volatility, we also expect the markets to build on the momentum from the fourth quarter as we move through the first half of the year.**

Baird Family Wealth Group
www.BairdFamilyWealthGroup.com