



BE CAREFUL

January 30, 2012

If we have learned one thing over the past 12 months, it is to exercise care in taking on risk when sentiment is positive as it was in the first quarter of 2011 and to be a more aggressive risk taker when sentiment is downbeat as it was in August and September. Currently, consumers and investors seem to be feeling better. Recent surveys of consumer confidence suggest a more positive tone yet real wage growth is slow and savings are down from the peak of recent years. For investors, purchases of stock mutual funds recently reached the highest level since the April, 2011 stock market peak. Current surveys of investors' sentiment show high levels of bullishness. The put-call ratio is relatively low suggesting more buyers represented by call option purchases than sellers reflected in the purchase of put options. The volatility index (VIX) is at 18 down from the mid 40s in August and September of last year. In 2010 and 2011, it paid to take on risk at 40 and to be more risk averse under 20. While the S&P 500 has climbed 4.8% in January compared to 2% for 2011 and market breadth has been quite positive, stock volume has not been very strong. Historically volume has been the weapon of the bull whether it be markets or individual stocks.

Fundamentally, it is important to note that economic growth in the U.S. and overseas will remain slow through 2012. In fact, the Federal Reserve recently indicated that short term interest rates are likely to remain low through 2014. Consequently, there will be ample opportunities for perceptions about growth to shift from time to time. At the moment the secular fundamentals which support slow growth are stronger than the cyclical fundamentals. The recent report of a 2.8% increase in fourth quarter U.S. GDP reinforces the point. Most of the strength in the economy came from inventory building while final demand was reported as slowing. First quarter GDP is likely to do well to exceed 2% growth. We maintain a 2% growth estimate for the year.

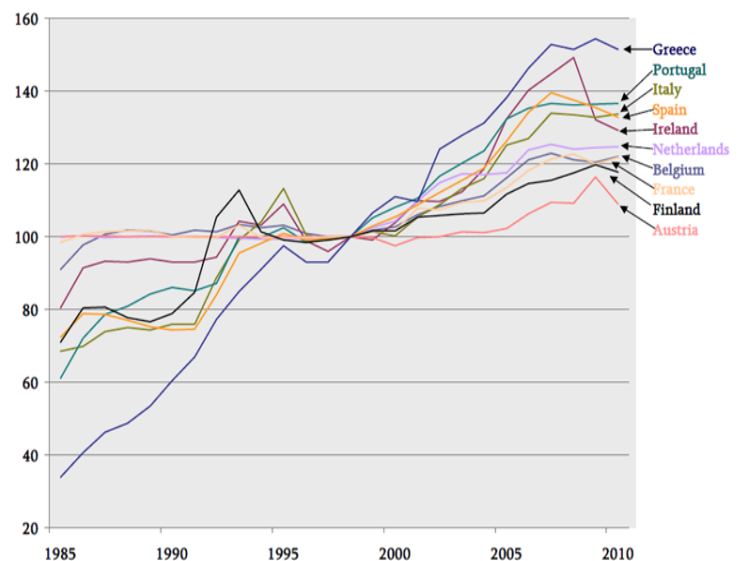
The rest of the world is slowing down. Europe, because of austerity measures, is projected to enter a recession this year. The remainder of the developed world is also realizing moderating or slow growth. Most of the emerging countries are experiencing or will experience varying degrees of moderating expansion.

In the previous Leading View, we noted that profits and profitability are historically high. And unless top line growth picks up significantly, we doubt that these levels of profits and profitability can be sustained. Slower global growth is likely to have some degree of impact on the revenue and profit lines for U.S. multinational companies. Fourth quarter reports are indicating that

top line performance for a number of companies is not as strong as it had been. To some degree, valuations of stocks are reflecting moderate revenue and earnings growth. Unfortunately, we do not know how much is being discounted and may not know until later in the first half of 2012. Any further shortfalls in revenue and earnings could be a source of volatility in equities prices.

Of course, the elephant in the room for the markets remains Europe. In the past month or so, the European Central Bank has provided a substantial amount of liquidity to European banks. However, this additional liquidity is only a short term measure. It does not deal with solvency. Consequently, the needs for recapitalization of sovereign debt remain great, especially in view of deteriorating growth and structural challenges, such as relatively high labor costs. Even if some of the sovereigns, such as Greece, Portugal, Italy and Spain, are able to recapitalize and/or add new debt their underlying economic competitiveness is not very good. This situation is concerning. To get to greater competitiveness is likely to trigger worker unrest. To not improve their competitive positions will lead to recurrent financial problems which also may produce changes in political leadership. Most of the Eurozone is a secular problem. While additional measures may be put in place to alleviate short term pressures, we believe longer term structural issues will be difficult to manage.

Unit Labor Cost as a Ratio to Germany for Several European Nations

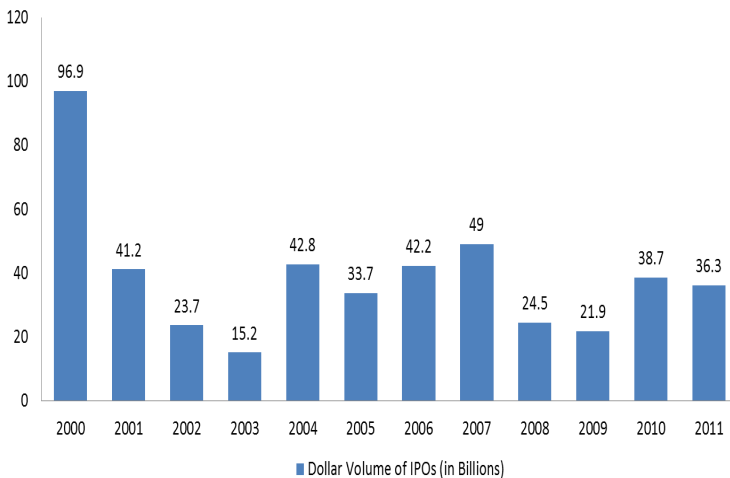


Source: Bloomberg, IMF, Greenspan Associates (1998+100).

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Reports are that Facebook will be coming public in the months ahead. It is estimated that its initial public offering may raise \$75-\$100 billion. If that is the case, then the accompanying graph suggests that 2012 may be a bigger year than 2000 was for IPO dollar volume. The size of the Facebook offering could also be a drain on the availability for funds to purchase existing public equities. Something to think about.

Annual Dollar Volume of U.S. IPOs From 2000 to 2011



Source: Renaissance Capital, Greenwich, CT (www.renaissancecapital.com)

With slow growth, little inflation, and periodic worries about governments, etc., high grade corporate bonds remain appealing. High yield bonds also are attractive as long as U.S. growth is positive. Supply increases may put some pressure on municipal bond prices in the months ahead and present a buying opportunity. Emerging market bonds are worth a look. With real interest rates likely to remain low and the continuing potential for geopolitical shocks, gold and gold stocks are attractive on price setbacks. Selected emerging markets will capture increasing interest in the months ahead. Yield and growth will remain strong themes in the U.S. stock market.

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