



Market Perspectives

A Glance At How The World Affects You!

December 20, 2011

This will be the last edition of Market Perspectives for 2011.

This publication will return on Tuesday, January 3, 2012.

Merry Christmas and Happy Holidays from all of us at North Star Financial Group!

Domestic Economy, the Unexpected Shining Star of 2011?

Throughout 2011, Eurozone treaty talks have become more entertaining than effective. The latest efforts came up short on enforcement mechanisms, as well as a timeline for implementation. Following their usual urbane and categorical speeches, the Eurozone nations agreed on stricter policies, thus eliminating the threat of exceeding debt-to-GDP thresholds; without implementation, this became yet another hackneyed attempt at fixing their growing debt crisis. Over the last week, Europe continued to weigh on equities and that trend will likely continue, given their lack of follow-through.

Europe has two enormous issues (debt and debt-to-GDP controls) that have plagued the U.S. for nearly two years. With that in mind, extreme market volatility continues in spite of December's historically strong performance. Since late October, the S&P 500 raced more than 13% higher to end November just inches away from a net positive performance. This consequential strength was the product of a more forceful and fiscally disciplined European Union; that strength has turned to weakness and



Europe continues their circuitous journey to nowhere. This environment of risk-on and risk-off feels more like a game of ping pong. But just because Europe can't get its act together doesn't mean things are all bad.

Forgetting Europe for the moment, the overall picture shows that the U.S. economy is still moving at a moderately positive rate. A year ago, global growth themes were in favor. This year we can now see that those bets would have proved detrimental; particularly Russia and India, both down more than 15% year to date. China has also performed poorly over the last two years; down 17% in 2010, and another 15% this year. The U.S. continues to have its woes, both economic and political, but domestic equities were the better place to invest in 2011. Looking to leading indicators, such as technology, demand appears to be gaining. If transports, construction, and technology contin-

ue to outperform, we take it as a signal that investors are betting on better growth with continued recovery in 2012.

Coming into year end, the Christmas retail season has lost much of its steam as consumers are working to get their balance sheets back in shape; this won't be an easy process. Debts are still being slashed, mostly because of write-offs by banks, and credit is much less available when compared to pre-recession periods. In addition, home equity values have fallen and leave little room for borrowing. The reduction in consumer leverage is a long-term positive; but don't forget that consumer spending has been crucial throughout the recovery. Global growth estimates are coming down and commodity prices are picking up, again. As we turn the corner into 2012, these headwinds (in addition to Europe) will add to an already difficult picture. For that reason, we will continue to stay focused on fundamentally sound companies that provide free cash flow and rising dividends. As for a Santa Claus rally, it may not be over yet. This week is full of data and it only takes one positive to spur the bulls; though we reckon the sleigh bells are unlikely to ring.

A Recap of Last Week: Sentiment was negative the first three days of trading for the past week. Stocks dropped Monday after Moody's Investors Service and Fitch Ratings issued new warnings. They said that European leaders have failed to take the coordinated action necessary to tackle the region's debt crisis. The warnings come on worries that the previous Friday's European summit deal is insufficient. Stocks treaded water Tuesday until the Fed's policy announcement in the afternoon. Shares declined after the Fed left its policy rates unchanged and took no immediate actions to bolster the economy. Some had expected the Fed to expand on its communication policy. Also weighing on stocks were comments by German Chancellor Angela Merkel rejecting the idea of increasing Europe's bailout fund. At mid-week, fears about European debt pushed stocks down as rates on Italian bonds rose, boosting the odds of fiscal difficulties, including the ability for that country to afford its debt. A stronger dollar bumped down commodities prices and related stocks.

Equities generally made a partial comeback the last two days of trading. Economic news won out with a score of 3 to 1. Initial jobless claims unexpectedly fell sharply, Empire State topped expectations for December, and Philly Fed jumped for the same month. However, national industrial production for November declined modestly.

Stocks were mostly up Friday despite headwinds. After markets closed Thursday, Fitch downgraded several global banks, including Bank of America and Goldman Sachs. Fitch cited "increased challenges the financial markets face," including a rocky economy and regulatory risk. Also after Thursday's close, Research In Motion said its fiscal third quarter earnings dropped sharply. Stocks started Friday with notable gains with support from news that Congress was enacting another temporary boost to the federal debt ceiling. But the gains unwound, in part on concern about Europe, as Fitch Ratings lowered France's rating outlook to negative and put Belgium, Spain, Slovenia, Italy, Ireland and Cyprus on review for a downgrade. Fitch cited the reason as Europe's failure to find a "comprehensive solution" to the debt crisis. Friday also marked "quadruple witching," when four types of contracts expire—those tied to market index futures, market index options, stock options and stock futures. However, many traders take positions on Thursday for these expirations.

The Bottom Line: Extreme levels of market volatility for most of this year continue to weigh against investors but we are maintaining our current exposure for several reasons. In many ways, it would seem plausible to sell stocks and head to bonds for safety. However, stock valuations are low compared to bonds and offer significant value when comparing the two. Bonds are not likely to represent an asset that improves given their inflated prices and low yields. Based on positive earnings trends (these appear to be decelerating) our model assumes relative outperformance for stocks through 2012. Low interest rates (we expect these to continue for the next few years) and a downtrend in the dollar will likely drive investors to riskier assets as the panic around Europe begins to subside. With that being said, we are by no means taking our eyes off the road. We will continue our strategy of higher than normal positions to cash through year end.

A Look at This Week: The week is jam packed with economic news as the holiday schedule moved some releases forward to this week. Housing is a major focus beginning with starts (Tuesday), existing home sales (Wednesday), FHFA home prices (Thursday) and new home sales (Friday). GDP and personal income post on Thursday and Friday respectively. Durable goods orders Friday will wrap up the week.

Best Regards,
Phillip L. Clark, RFC
President/CEO

North Star Financial Group is a Registered Investment Advisor registered in the state of North Carolina. All notices should be sent to North Star Financial Group 101 Government Avenue SW Hickory, NC 28602. Please contact your financial advisor if there are any changes in your financial situation, or investment objectives. Our current disclosure statement is set forth in Part II of Form ADV and is available for your review upon request. This material has no regard to the specific investment objectives, financial situation, or particular needs of any reader. The North Star Market Perspectives are published solely for informational purposes and are not to be construed as a solicitation or an offer to buy or sell any securities or related financial instruments. References made to third parties are based on information obtained from sources believed to be reliable, but are not guaranteed as being accurate. Readers should not regard it as a substitute for the exercise of their own judgment. Any opinions expressed in this site are subject to change without notice and North Star Financial Group is under no obligation to update or keep current the information contained herein. North Star Financial Group accepts no liability whatsoever for any loss or damage of any kind arising out of the use of all or any part of this material. The purpose of North Star Market Perspectives is to provide general opinion commentary and should not be acted upon without first consulting your financial advisor, tax advisor and legal advisor.