Lassus Wherley ...a view from the top

Building Better Futures

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Risk On Again……….

A Good Start for 2012!

Stock markets globally have been in "Risk On" mode so far this year. In our October VFT we discussed risk on - risk off which means that the market is being dominated by macroeconomic news (big picture) rather than by microeconomic news (company fundamentals). This macroeconomic focus continues. The upward movement of the markets over the last few months has been a needed break from the roller coaster ride of most of last year. Politicians on the other hand seem to be digging more holes for themselves and us. I will be very happy when this election is over and we know who we are dealing with for the next few years. In many ways the unknown increases the stress of daily decision-making for all of us. The biggest unknown concerns what might change if President Obama is not re-elected.

Recent employment news has certainly been positive. The January jobs report released on February 2, 2012, showed stronger than expected payroll gains and a dip in unemployment. Payroll jobs advanced 243,000 in January after moving up by 203,000 in December and 157,000 in November. Unemployment moved down to 8.3% from 8.5%. Stocks moved up on this news as the report showed that progress is indeed being made in reducing unemployment. This is obviously important for those who have been impacted personally and is a good sign for the economy overall.

We are watching closely right now because it may be time for the market to take a break based on our strong run so far this year. There is an old adage that "Trees don't grow to the sky." While we believe that stocks will give us positive returns in 2012, there are a few factors which could bring about a pause in the current rally. Some of these factors include increasingly bullish sentiment, lukewarm fourth-quarter 2011 earnings and the continued potential for problems in Europe.

And the Beat Goes On

In 2012, stocks have rallied mainly because investors are focusing more on the positives of easy money worldwide and slow growth in the US and less on the continued potential for bad news out of Europe.

The rally was helped by the LTRO (Long Term Refinancing Operation) of the European Central Bank (ECB) which began in December. In this program, the ECB offered loans to European banks at 1% for three years. This support greatly reduced the stress on the liquidity in the European banking system and gave investors the courage to invest not just in the US but internationally as well. The program signaled that the ECB was ready to act to support eurozone banks and thus reduce the chances that the issues with sovereign debt would lead to a financial meltdown.

Meantime, in the US, the statement released after the January meeting of the Federal Reserve Open Market Committee (FOMC) indicated that the Committee was prepared to continue to provide easy money (federal funds in a target range of 0 to ¼ percent) until at least the end of 2014. The committee also left open the door to a third round of Quantitative Easing (QE3), if needed to support the economy. The Fed continues to push investors into stocks, commodities and other riskier assets by keeping the returns on cash depressed in order to stimulate the economy. There is a risk that, at some point down the road, this very easy monetary policy could lead to inflation as the economy recovers. For now, investors are choosing not to "fight the Fed" and continue to bid up the prices of riskier assets. We are preparing for the potential return of inflation with gradual additions to TIPS (Treasury Inflation-Protected Securities), real estate and commodities asset classes in portfolios. We know that at some point in the future, inflation **will be** an issue.

The Next Chapter in Europe

Markets have been trading this year as if Greece and its problems have been successfully isolated from the rest of Europe. We see this reflected in the way in which rates have come down on the sovereign debt of Italy and Spain this year. This is largely due to the LTRO referred to above. The LTRO seems to be reducing the risk that the liquidity problems in Greece will spill over into Italy, Spain or Portugal through the European banks. This has been one of the most important benefits of the program. While the countries on the southern periphery of Europe are not yet out of the woods in terms of their levels of indebtedness, there is reason to hope that the problems can be contained.

There was also an austerity package approved by the Greek Parliament that was aimed at averting default by March 20th. The spending and salary cuts that form this package were required by the Troika of international lenders (International Monetary Fund, European Union and European Central Bank) before the funds in the second bailout of €130 billion ($172 billion) could be disbursed.

Greece is also restructuring outstanding debt in order to get these bailout funds. What the markets are most concerned about is Greece having an actual or hard default, which would occur if Greece were to miss the payment on a bond.

Greece, Portugal, and Ireland to a lesser extent, are being forced to pay rates on their sovereign debt which are well above levels that can be sustained due to the skepticism that investors have about their ability to actually pay their debts. In the very near term, austerity is the last thing that is needed, as these measures will only hamper growth. Greece and Portugal are simply not competitive enough to grow their economies without financial help from the stronger members of the eurozone. Each one of these countries also needs time to implement the structural changes that will enable them to grow.

In spite of the progress made, there is still a lot of skepticism among the stronger members of the eurozone that the Greek government will be able to implement the austerity measures called for by the package which has been enacted. Greece is due to have general elections in April, and there remains the chance that a new government will not honor the commitments made. The austerity measures agreed to include €300m in pension cuts and a 22% reduction in the minimum wage. About 150,000 public sector jobs would be cut over the next three years. Given the difficulty of implementing these measures, there is a real possibility that implementation will not occur and that at some point, Greece will leave the eurozone.

We are hopeful that the ECB stands ready to support the banks with further injections of liquidity. The LTRO should continue to ease credit conditions among the eurozone countries. Markets on both sides of the Atlantic have reacted positively to LTRO, in the same manner that they reacted to QE1 and QE2.

We believe that Europe will continue to muddle through their issues without a major financial meltdown. We do not, however, expect to see either a dramatic resolution to the problems in the eurozone or dissolution of the eurozone. These issues will remain in the news for some time to come, but we remain hopeful that they will occupy investors' attention less and less as time goes on. While we remain frustrated with the slow pace of progress in the eurozone, we do not underestimate the issues with which they are dealing.

At the end of the day, we continue to invest our clients' portfolios according to the target asset allocation we have agreed upon. Having a balance among asset classes remains key, even as markets normalize and volatility declines. If indeed markets take a breather over the next few months, we will take advantage of that opportunity to accumulate assets at more "interesting" prices. We continue to watch markets closely and try to keep an open mind to all possibilities. While nothing would make us happier than to reach DOW 15,000 by the end of next year as predicted in last week's cover story in Barron's magazine, we aren't quite that optimistic.

Results of the Client Survey….

We want to sincerely thank all those who responded to the survey. Here are some of the highlights:

Response rate of 50% which is a great result for this type of survey.

Satisfaction rate of 4.8 out of a possible 5.0. 99% of our clients are somewhat or very satisfied with their overall relationship.

Our clients indicated they are comfortable working with team members other than the lead advisor. This speaks to the degree of professionalism of our staff and indicates that we have a successful team approach.

We have done a good job of positioning ourselves as our clients' primary advisor. A majority of our clients indicated they have more than 75% of their investable assets with us.

We have a high percentage of long-term, loyal clients. Overall, 84% have been with us more than 5 years. The vast majority have indicated a willingness to support the growth of our business either through referrals or use of additional services.

We did receive some very valuable feedback on ways we can improve and have already begun the process of analyzing these results and identifying next steps.

And the winners of our survey drawing are…..Rosemarie and Chuck Gelber.

A $500 contribution in Rosemarie and Chuck's name was made to Healing the Children® New Jersey (HTCNJ), a 501(c)3 nonprofit organization dedicated to providing donated medical care to children in need throughout New Jersey and internationally. This is accomplished via three programs:

Domestic Aid
For New Jersey children, HTCNJ purchases medications, eyeglasses, hearing aids and other adaptive equipment; and funds special-needs care, therapy and camp for children with developmental disabilities.

Medical Teams Abroad
HTCNJ volunteer teams travel throughout the world to provide donated surgery and other medical care to children. In 2011 we hosted four volunteer medical trips to the Dominican Republic, Peru, Ecuador, and Vietnam.

International Inbound
HTCNJ hosts international children in New Jersey to receive surgical and medical care not available to them in their native countries. HTCNJ arranges the child's visa, air travel, flight escort, volunteer host family, and donating medical professionals and hospitals.

HTCNJ has helped more than 32,000 children, traveled to 16 countries, and welcomed children to the US from nearly 100 countries.

Rosemarie, who is an active volunteer with Healing the Children® New Jersey, asks that anyone interested in this organization please call 973-949-5034 or visit HTCNJ's website at http://htcnj.org.

Here are some questions from clients. Let us know if you have any questions you would like to share with others.

Question: *I keep hearing the TV folks talk about sentiment. Should I pay attention to it?* **Answer:** One of the measures of investor sentiment that we pay attention to is the CBOE Market Volatility Index (VIX). As stocks have moved up this year, volatility has moved down. The VIX (as we discussed in VFT #36) is the most commonly used gauge of market volatility. The VIX closed on February 23rd at 16.80. The VIX hit a 52-week high of 48 on August 8, 2011, soon after the contentious debate in Congress on the debt ceiling and the subsequent downgrade of US debt by Standard & Poor's. The VIX bottomed at 14.27 on April 28, 2011, just prior to the market peak.

What is clear is that when investors are bullish, volatility declines and then peaks when investors are fearful. In fact, when volatility is high and investors are fearful, it is often a good time to put money to work. When investors are most confident, the market can come up with some nasty surprises. To quote Warren Buffett, "Be fearful when others are greedy, and be greedy when others are fearful." We are not predicting nasty surprises, but we are monitoring the VIX and other sentiment measures for excessive levels of optimism or complacency. Either one would cause us to consider slowing down the speed at which we commit new dollars to equities.

Question: *What is happening with earnings? Is there reason to worry?* **Answer:** The fourth-quarter 2011 earnings season has been mixed so far with fewer upside surprises than we have seen in recent quarters. With about 70% of the S&P 500 having reported, we are looking at the first sequential decline in operating earnings since the economic recovery began. Expectations for fourth-quarter earnings had been cut over the last few months, so negative surprises have not been huge. As of February 2nd, about 56% of companies have beaten these lowered expectations, 32% have missed and 12% have met their operating earnings estimate. While earnings are continuing to grow year-over-year, the pace of growth is decelerating. Current estimates also point to a decline in the S&P 500 profit margin. It is interesting to note that Apple has had an inordinate influence on overall S&P 500 earnings growth. According to UBS, for all the companies in the S&P 500, earnings are on track to post a 6.6% year-on-year rise in the fourth quarter. Once Apple's earnings are factored out, the expected fourth-quarter gain shrivels to just 2.8%.

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Stay warm and enjoy an interesting winter.

Diahann

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