

Fourth Quarter 2011 Client Commentary

December 31, 2011

A World of Uncertainty: George Pierce, CFP®

The U.S. equity markets ended a volatile year at about the same place they began (as measured by the S & P 500 Index), which when compared to many others around the world (Britain, -5.6%; Germany, -14.7%; France, -17%; and China, -22%), may be seen as a blessing. LPL Financial's Chief Market Strategist, Jeff Kleintop, CFA®, in his 2012 Outlook believes that markets will stabilize, Gross Domestic Product growth (GDP), though tepid, will remain positive at around 2%, equity markets will rise 8-12%, and 10 year Treasury yields will rise a bit more than 1%. While we have the greatest respect for Jeff, and are not disputing the possibility of this outcome, we would like to add another scenario or two to the coming year's outlook.

As we enter the year 2012, the developed world finds itself at a tipping point that could have a profound impact on the quality of life for its populous for years to come. Not unlike any new year, we face an abundance of geopolitical instability. The recent death of North Korean dictator Kim Jong-il, renewed rioting in Egypt, Iran closing in on the development of a nuclear weapons capability and threatening to close the Strait of Hormuz through which 1/3 of the world's oil supply passes, to name just a few. Despite the challenges noted above, the tipping point for which I am most concerned pertains to the debt crisis, both here and in the European Union (EU).

For decades, the developed nations of the world have run up enormous deficits as government expenditures have grown at significantly higher rates than their respective economies. The EU is at the epicenter of the problem as it grapples with the real possibility of a wave of defaults by a number of fiscally irresponsible members (namely Greece, Portugal, Spain, and Italy). The affected parties (major European banks, EU members, the European Central Bank, and the International Monetary Fund) continue to squabble over who is going to foot the bill. Meanwhile, as decisions are delayed, the ability of these countries in distress to pay their bills is becoming more and more tenuous, and the risk of one or more of these nations defaulting rises. If Europe cannot find a way to resolve the fiscal imbalances among its members forcefully and soon, the impact could likely push the EU and, possibly, the rest of the world, into a global recession. Unfortunately, Europe is not alone with its deficit challenges.

The problem here in the U.S., as in Europe, comes down to one word, *debt*. GDP is \$15 trillion but the U.S. national debt is even higher and growing. It is widely believed in academic circles that once the ratio of debt to GDP reaches 100%, economic growth slows by at least 1%. If the U.S. economy is expected to grow 2% in 2012, we could assume then that after a slowdown, it will grow at only 1%, barely sustainable and dangerously close to recession. This year alone, the U.S. will spend \$3.6 trillion but is only bringing in \$2.3 trillion in receipts, requiring the need to borrow \$1.3 trillion more than it takes in to pay its bills. A combination of cost cutting and revenue increases are necessary, but the solutions are not simple nor will they be without pain. Congress and the President are unable to come to any compromise and as time marches on, the problem grows. The U.S. must begin to take substantive steps soon towards reducing its deficits in a meaningful way or the financial consequences could be severe. Too dramatic a cut in government spending could drive unemployment significantly higher and the economy in to a deep recession. Too little could send a message to the financial markets that the political will to reduce the deficits is not serious and could thus drive interest rates up significantly. Every 1% increase in interest rates would add approximately \$140 billion to our deficit.

We have taken the view that Europe will fall into recession but the U.S. will barely avoid one. We see a year of significant volatility and continued slow growth stateside. Although our client's risk tolerance and objectives vary considerably, we

George R. Pierce & Associates, LLC
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have chosen to take a multi-faceted approach to our investment strategy for 2012:

1. Our core strategy will focus on Jeff Kleintop's view of a stable outcome and modestly rising equity prices and interest rates.
2. Additionally, a barbell approach will be deployed, taking into account the possibility of:
 - A) A global recession
 - B) A rising interest rate inflationary outcome should central banks worldwide decide to reflate (print money) themselves out of their dilemma

Our core general equity strategy continues to emphasize dividend paying companies with strong balance sheets and an emphasis on revenues derived from global markets. In our fixed income portfolios, we continue to like high yield bonds as well as a globally diverse position with a likely increase in our emerging market debt positions as their respective economies slow. We will also be elevating portfolio positions that enable managers to add treasuries, cash, and even short the market. In anticipation of a reflationary outcome, we have added unlevered 'hard' assets including commodities and real estate.

Do I have Enough for Retirement?: Ross Snyer, CFP®

For many, if not all of our clients, the single overriding concern in retirement is the possibility of outliving their hard-earned wealth. This is particularly true given the extreme volatility we have experienced in the markets over the past few years, as well as ongoing worries regarding the stability and likelihood of receiving Social Security and Medicare.

How much income will my wealth provide in retirement? A variety of factors need to be considered to determine a sustainable withdrawal rate, including your assets, your investment mix based on your risk profile, desired age of retirement, life expectancy, current and expected tax rates, inflation, healthcare, lifestyle patterns, and future expense needs, etc.

Over the past several years, we have continued to refine and improve our financial/retirement planning process. In our upcoming reviews, we'll be sharing our thoughts for providing you the assistance you need to make informed decisions regarding your future financial picture. In the meantime, please feel free to call our office for a complimentary assessment of your needs.

Paperless Options: Elaina Shemeta, CFP®

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