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INSIGHTS

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2011 Q4

Written on December 30, 2011 with the S&P 500 at 1257.60

Many of the early 2011 themes continued in the fourth quarter. Overseas, the European debt crisis reached new heights as the crisis spread to Italy after affecting Greece, Portugal, and Ireland earlier in the year. Dictators continued to fall with the deaths of Muammar Gaddafi and Kim Jong-Il following the ouster of both Tunisia's Ben Ali and Egypt's Hosni Mubarak. There was also the death of Osama bin Laden earlier in 2011. Closer to home, the historical volatility in equity markets continued as well as the historical partisanship in the U.S. Congress.

It was believed that partisanship reached a crescendo in Q3 when Congress brought the U.S. to the edge of default (which then triggered a once unthinkable U.S. debt downgrade), but it continued in Q4 when in November, the Super Committee failed to reach an agreement on $1.2 trillion of budget cuts—pushing the burden to a later date. Then in December, the payroll tax cut was extended for a grand total of two months. Congressional posturing has been partly to blame for the weak economic rebound. The business community and capital markets are begging for some clarity out of Washington D.C.; without it, unemployment remains high as business owners simply do not want to risk capital by expanding operations or hiring new workers when the outlook is so murky and when the rules of the game are constantly changing.

EQUITY

While the whims of Congress are hard to foresee, two of our predictions for Q4 were accurate. The quarter was once again host to a market bottom (the S&P 500 reached the low for the year on October 4th at 1074) and was once again the strongest quarter of the year as stocks posted a near 12% gain. Although volatility settled down by New Years, the quarter was not immune to the wild swings that marked much of 2011. The S&P 500 recouped 130 points in Q4 after losing 190 points in Q3. The returns however were not in a straight line. An initial 17% rally off the October lows was followed by a 10% decline which included the worst Thanksgiving-week since 1932. Markets u-turned once again rallying 9% to finish the up-and-down year at the exact same level it started with the S&P 500 closing at 1257. Only after dividends are added do we get a total return of +2% for 2011.

But the good news was limited in equity markets as US Large Caps were the only major index to post positive 12-month returns. Small Caps lost -4% and International markets lost -16% as the anemic Q4 bounce was not nearly enough to offset a very weak summer. Emerging Markets fared worse as they lost over -20%. Taken all together, the Morgan Stanley All Country World Index (ACWI) which measures equities over the entire globe lost nearly -10%.

FIXED INCOME

U.S. Government Bonds, which make up over 73% of the Aggregate Bond Index, were quiet for the quarter as the yield on the Ten-Year Treasury fell a mere 5 bps over the quarter ending the year at 1.87%.

SECTORS

The common theme throughout capital markets in Q4 and 2011 was that the sectors that outperformed in Q4 were the underperformers over the whole year. With the large move

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upward in stock prices in Q4, it was no surprise that the more aggressive sectors in both the bond and equity markets outperformed. High Yield bonds outperformed Treasuries and offensive sectors such as Energy, Industrials, and Materials outperformed the S&P 500. This is in stark contrast to the year-end performance numbers as it was the more defensive areas that outperformed as Treasuries, Utilities and Consumer Staples were the big winners.

In a surprise to some, it was Value stocks that outperformed Growth stocks in Q4. Value stocks have been typically associated with "conservative" and Growth stocks with "aggressive" but the 2008 banking crisis made banks and insurers more volatile (aggressive) and the large cash-rich balance sheets of "old tech" stocks have become more staid (conservative). And to keep the theme going, it was indeed Growth that outperformed Value over the course of the entire year.

	Sector	Q4	YTD
Stocks	S&P 500 (Large Cap)	11.82	2.11
	Russell 2000 (Small Cap)	15.47	- 4.18
	World ex-US (International)	3.27	-16.13
	Emerging Markets Equity	4.08	- 20.41
Bonds	Aggregate Bond	1.12	7.84
	Short-Term Bonds	0.27	1.73
	High Yield	6.46	4.98
	Global ex-US Aggregate	- 0.36	4.36

OUTLOOK

The global slowdown in conjunction with the European debt-crisis and upcoming elections will most likely keep volatility elevated in 2012. Fortunately, we have seen better U.S. economic data here of late and the historically inexpensive stock market (and historically expensive bond market) may soon react to the actual fundamentals instead of the latest European news headline.

There are serious hurdles that we need to overcome on Wall Street, Main Street, Washington D.C. and Europe—not the least of which is continued weakness in real estate, a lack of consumer confidence, high unemployment and a burdensome overhang of government debt. However, most of that is already priced in. The time will soon be upon us when stocks again regain their status as king of the investment landscape, if only because the opportunity cost of not buying stocks is so enormous. Happy New Year!

For additional copies of *Insights* or the *SEIA Report* please contact Allison Crandall at (800) 723-5115.

We at SEIA thank you for your continued support.

Sincerely,
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