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## 2011: A Nutshell Review

Last year saw natural and nuclear disasters in Japan, financial near-disaster in Europe, political tumult across the Middle East, the recognition that the US really isn't actually a triple-A credit but is nonetheless the best credit going, and the beginnings of recognition that China isn't actually an infallible economic miracle but is nonetheless the closest thing we have to one (so let's not examine its problems too closely please, seems a common analytical attitude). The Federal Reserve wound down one round of quantitative easing (QE2) and brought another program out of the attic (Operation Twist 2); the former had sparked a perishable rally in stocks, and the latter has driven a yet-to-perish rally in long US Treasury bonds. Meanwhile the US wound down its combat operations on the ground in Iraq and closed the year by beefing up its naval potential in the Straits of Hormuz.

I know that's a flabbergasting summation to read, but it was a turbulent year made all the more flabbergasting by the fact that the S&P 500 finished precisely where it started.

Between New Year's Eves, the US stock market jitterbugged up on light volume, swooned low on heavy volume, and felt steady enough about incremental improvements in the domestic economic picture to finish flat. The S&P 500 opened 2011 at 1,257.6. It closed at 1,257.6.

The finish wasn't so rosy for other stock indices. Small stocks as represented by the Russell 2000 lost -4.2% on the year, foreign developed markets -14.8% (MSCI EAFE USD), emerging markets -20.4% (MSCI Emerging Markets USD), and global real estate -5.8% (FTSE EPRA/NAREIT Global USD).

Altogether, growth beat value, big beat small, and

here (USA) beat there (most everywhere else).

Bonds performed solidly, with the Barclays Capital Aggregate Index clocking a total return of +7.8% on the year, and municipal bonds fully recovering from their late 2010 drop. The yield curve flattened, with the short end still pinned near zero, the benchmark 10-year Treasury making 2% its new ceiling, and the 30-year Treasury bobbing below 3% (!!!). Altogether, quality beat junk, longer beat shorter, and fixed beat variable. While it was great from an appreciation standpoint, to our minds, this menu of coupons offers negative real yields at every maturity going forward, unless the world is tipping toward depression.

Precious metals served up a multiple personality melodrama, with the price of gold bullion returning +10.1% while silver lost -9.9% and platinum -20.9%, and the ARCA Gold Miners Index slipped badly at -16.2%. Notably, gold traded through platinum for the first time in memory, and closed at a 1.1 ratio whereas it has historically priced at a fraction of its quiet cousin. Whether or not this means gold is coming into its own as an alternative currency I'll let others debate; certainly it signals that industrial demand for useful metals (silver and platinum) slackened on the year, while faith in global central bankers waned (and paranoia, perhaps, waxed).

In all, we enter 2012 expecting that volatility won't retreat this year either, and that short-term thinking by others will enable us to secure long-term opportunity for your portfolios. Areas we've been buying include those self-same beaten down precious metals miners, established information technology companies, energy services, and quality-biased long-short; in bonds, we like foreign issues, short corporates and long munis. Among the areas we're eyeing if the markets backslide in a new panic are emerging markets, foreign multinationals, and US regional banks.

Remain steadfast and we'll do the same. Thank you for your trust.