



## Summary

The first revision for real gross domestic product growth in the third quarter of 2011 shows growth slowed slightly from the original 2.5% estimate to 2.0%. The principal reason for the reduction was a higher-than-estimated decline in inventories. While a lower level of inventories hurt the third quarter, it may turn out to be a positive for the upcoming quarters if companies readjust by adding to their stockpiles. Although the numbers released so far in the fourth-quarter indicate that the economy continues to expand, the strength and breadth of growth continues to be a concern.

It appears that November was more positive than October, especially where the consumer is involved. The Conference Board's consumer confidence index rose sharply in November with its biggest monthly gain since April 2003. This increase in confidence helped spur a large increase in sales for the first weekend of the all-important holiday selling season. With personal consumption expenditures growing faster than personal income, the savings rate declined, but this is not viewed as a large problem at current levels. In aggregate, consumers probably feel better due to an improved stock market in October and November and news of recent gains in nonfarm payrolls. The manufacturing side of the economy has also shown some growth, but the improvement in orders has been influenced by whether transportation orders are included or excluded. Trends in the manufacturing and nonmanufacturing segments of the economy remain positive, which should be a plus as we head toward the new year.

As we have said, GDP growth will most likely remain muted until there is strong improvement in the labor market, but slow growth can help keep inflation down and may make the recovery longer lasting.

### POSITIVES

- ❑ Strong increase in consumer confidence in November
- ❑ Gains in nonfarm payrolls and reduction in the unemployment rate
- ❑ Housing affordability index rose in October to a new record high

### NEGATIVES

- ❑ ISM nonmanufacturing index fell slightly in November
- ❑ Factory orders fell for the second straight month in October
- ❑ Reduction in savings rate may impact future spending

### UNKNOWNNS

- ❑ Impact on U.S. economy of European economic crisis
- ❑ Impact of Congressional Super Committee's disagreement on deficit-reducing measures



## Summary

The sharp rally on the last day of November erased almost all of the preceding 20 trading days' losses and rescued what would have otherwise been a dreary month for equities. The on-again, off-again hysteria which has epitomized the European debt crisis has effectively polarized the investment decision process between euphoria and despair.

For the month, the S&P 500 Index posted a loss of 0.22%. Not surprisingly, European markets closest to the epicenter of the debt crisis were affected to a greater extent, with the MSCI EAFE Index dropping 5.2%. Defensive sectors once again led our markets as consumer staples (+2.4%), telecommunications (+0.8%) and health care (+0.7%) all gained ground. The cyclical financial and information technology sectors fell hardest, losing 5.0% and 1.9%, respectfully.

The economic headwinds created by central bank policies to cool overheated economies have recently begun to ebb. Monetary policies in Brazil, China, Australia and the European Central Bank have all taken a decided turn toward easing. Thus, an important global impediment to advancing equity prices has been reduced.

With domestic economic growth at 2% in the third quarter, modest job creation, stable new construction markets, increasing auto and retail sales, and rebounding consumer confidence, the U.S. may be reemerging as one of the strongest markets in the developed market sphere.

Within an overall asset allocation which reflects the uncertainties before us, we remain positive toward those U.S. companies that have established strong global franchises and demonstrate investor-friendly dividend payment policies.

### POSITIVES

- ❑ U.S. economy still expanding
- ❑ Valuations attractive
- ❑ Dividend yields attractive

### NEGATIVES

- ❑ European debt crisis overhang
- ❑ U.S. political gridlock
- ❑ Job creation stagnant

### UNKNOWNNS

- ❑ Outlook for the eurozone



## Summary

Uncertainty prevails and bond markets love uncertainty. The glacial pace of European political leaders in dealing with their crisis has led to waves of uncertainty. It has become a big game of chicken: those with the resources (Germany and France) want to extract as much as they can in the form of fiscal austerity before agreeing to bail out their spendthrift brethren. Further fiscal integration that blurs the lines of sovereignty appears to be the only tenable solution. Political failure has been dealt with severely as witnessed by the leaders of Greece, Spain and Italy all being deposed. Europe is already in a recession that will likely get worse. The magnitude and duration of the contraction is uncertain, as is its impact on non-European economies.

Last month, interest rates ended near the levels at which they began, albeit with some significant gyrations during the final couple of weeks. The uncertainty regarding Europe's ability to avoid an apocalyptic meltdown pushed corporate bond prices lower and spreads significantly wider, again. Expectations for economic growth in the U.S. have been ratcheted down, though another recession is considered unlikely by most.

Until Europe sees a clear path to resolving its financial crisis, the uncertainty should keep interest rates in the U.S. from rising by a significant amount. With strong credit fundamentals and a continued dearth of supply, non-financial investment grade bonds will likely be the relative safe harbor for the coming year and perform reasonably well. But the opportunity for significant total return lies in the financial sector, as recent spreads have only been surpassed by those during the financial crisis between 2007 and 2009. If the crisis is averted, spreads could narrow significantly and lead to superior relative performance.

### POSITIVES

- ❑ Uncertainty in European financial crisis
- ❑ Non-traditional recovery in the U.S.
- ❑ Inflation outlook is benign

### NEGATIVES

- ❑ Rates already reflect slow growth and uncertainty and are at historic lows
- ❑ Most Treasury yields lower than the 12-month trailing rate of inflation

### UNKNOWNNS

- ❑ Investors continued flight from riskier asset classes
- ❑ Further Fed actions to stimulate the economy: QE3?