

## Newsletter – April 2012

### First Quarter 2012 Market Recap

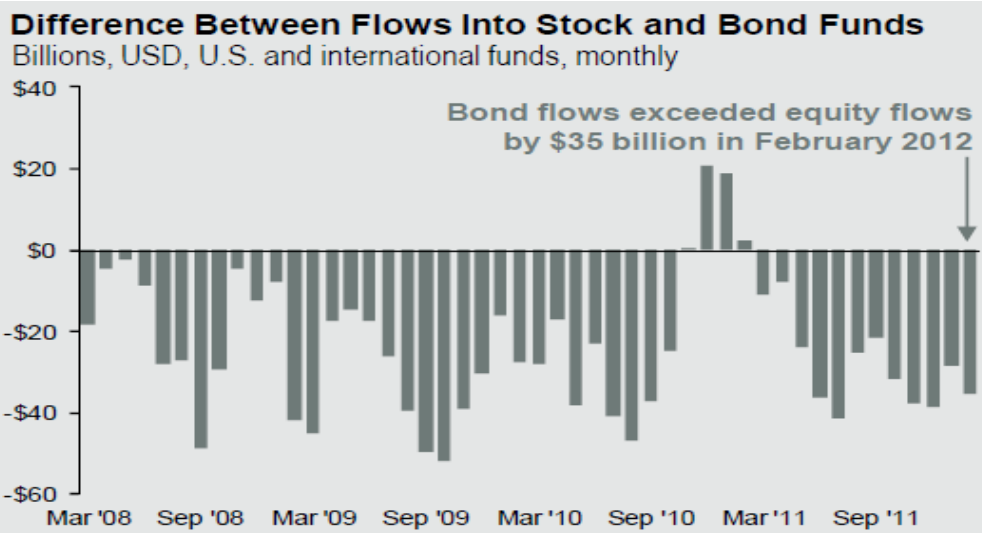
#### MARKET TRENDS 3/31/12

<b>US Stock Markets</b>	<b>Q1</b>	<b>12 Mos.</b>
S&P 500 Index	12.59%	8.54%
S&P MidCap 400 Index	13.50%	1.98%
S&P SmallCap 600 Index	11.99%	5.03%
<b>Int'l Stock Markets</b>		
EAFE Index	10.86%	-5.77%
Emerging Mkts Index	14.08%	-8.80%
<b>Fixed Income</b>		
Barclays Intermediate Gov't/Credit Bond Index	0.61%	6.09%
Barclays Capital Muni Bond 3 Year Index	0.76%	3.60%
<b>Commodities</b>		
SPDR Gold Shares (NAV)	5.49%	15.08%
Goldman Sachs Commodities	5.88%	-6.21%
<b>Real Estate</b>		
Dow Jones US RET Index	10.78%	9.59%
<b>Yields</b>		
	<b>3/31/2012</b>	<b>12/31/2012</b>
T-Bills	0.07%	0.01%
10 Yr UST	2.23%	1.90%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

Global equity markets continued their broad-based rally from the September 2011 lows as the U.S. economy continued to show signs of improvement, and fears of a debt crisis in Europe subsided. The S&P 500 Index quarterly return of 12.6% was the strongest first quarter since 1998. Major equity markets, domestic mid cap, small cap, developed markets and emerging markets all returned over 10% in the first quarter of 2012 with a sharp reversal in some of the 2011 poorer performers, such as financials and emerging markets. Even with ebullient equity returns, cash flows into equity mutual funds were flat in the quarter as investors maintained their “wait and see” approach to equity markets.

Domestic bonds eked out positive returns in the quarter and continued to receive the vast majority of new cash flow into mutual funds, even as yields remain at multi-decade lows. Money market mutual funds, with yields close to zero, continued to experience significant outflows – likely to bond mutual funds. Of the main investment alternatives, real estate had another strong quarter rising 10.8%, gold rebounded 5.5% from a weak fourth quarter, and the broader commodity basket was up 5.9%. Overall, market volatility was very low compared to 2011. During the last five months of 2011, the S&P 500 Index closed 2% higher or lower on trading days 30% of the time. The market did not move more than 2% on any trading days in the first quarter of 2012 and had 1% moves on only five days.



Tim Vanech  
Tvanech@shorepointpartners.com

Luis M. Raposo, CFA  
Lraposo@shorepointpartners.com

Main 781 341 7250  
Fax 781 341 7246

14 Page Terrace  
Suite 2 C/D  
Stoughton, MA 02072

shorepointpartners.com

## A Look Forward

*“Markets don’t typically rise without a pause or correction.”*

*“U.S. large cap stocks still remain historically cheap and are trading at recession levels...”*

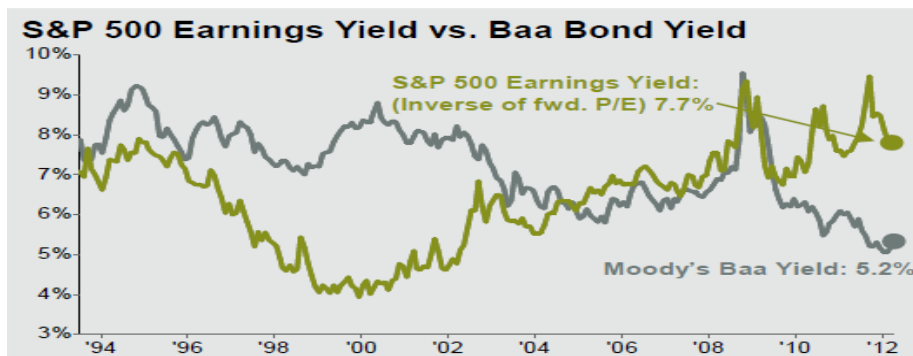
*“So far in 2012, corporate earnings have been robust...”*

*“...the S&P 500 has a 7.7% earnings yield ...while corporate bonds (Moody’s Baa) yield 5.2%.”*

Markets don’t typically rise without a pause or correction. After more than six months of progress, we would not be surprised by a correction as defined by a short-term price decline of 5% to 20%. The “reasons” for a correction given by the media are hard to predict in exact detail. Perhaps it will be fears of European debt issues spreading to Spain and Italy, saber rattling in Iran and/or North Korea, rising gas prices at the pump, fear of weaker corporate earnings, or the specter of American political dysfunction leading to a weakening or declining economy.

Despite all of these well placed concerns and exogenous shocks that we can’t foresee, we are heartened by several factors:

- **Equity Valuation:** U.S. large cap stocks still remain historically cheap and are trading at recession levels (using price/earnings (“PE”) ratios) even with the sharp rally in the first quarter. The S&P 500 Index is trading at the average PE for the market *during recessions* over the last 50 years. Although the domestic economic growth is anemic, especially coming out of the “great recession”, we believe the domestic economy, though fragile, is unlikely to head into another deep recession. So far in 2012, corporate earnings have been robust, and the majority of stocks are surpassing expectations.



- **Equities vs. Bonds:** The dividend yield on the S&P 500 Index is equivalent to the yield of 10 year U.S. Treasuries. Historically this has been positive for stocks and negative for bonds. On a relative valuation basis, the S&P 500 has a 7.7% earnings yield (inverse of forward PE) while corporate bonds (Moody’s Baa) yield 5.2%. Effectively, one has the potential for a higher total return from stocks versus the interest from bonds. Corporate profits continue to grow, and balance sheets are flush with cash. Dividend increases are accelerating, but with low payout ratios, which

Tim Vanech  
Tvanech@shorepointpartners.com

Luis M. Raposo, CFA  
Lraposo@shorepointpartners.com

Main 781 341 7250  
Fax 781 341 7246

14 Page Terrace  
Suite 2 C/D  
Stoughton, MA 02072

shorepointpartners.com

### Main Risks:

- **2012 Presidential Election**
- **European Debt Crisis and Economy**
- **China Economic Slowdown**

leaves room for additional dividend increases. With the accommodative Federal Reserve, interest rates are likely to remain low, leaving idle cash with paltry yields, which is also constructive for equities.

- **U.S. Economy:** The domestic economy is growing, although slowly, in the 2% range. Recent data on manufacturing looks solid, auto sales are improving, and the unemployment rate is gradually moving lower, although this is admittedly helped by the lower participation rate. There is mounting evidence that workers are dropping out of the workforce and turning to social security benefits. This trend does not bode well for overextended government programs such as Medicare, Medicaid and Social Security.
- **Improving Consumer:** Consumers have made sizeable financial improvements to lower their debt service (debt payments as % of disposable income) and increased personal savings rates. The University of Michigan Consumer Sentiment Index is showing some improvement although still below a 50 year average.

The main risks to our positive view have not changed:

- **2012 Presidential Election:** A notable year for the U.S. may have epic implications to the economy and our political system, as will the consequences of the impending 2013 tax increases. Is the economy strong enough to withstand the negative impact of the expiration of the “Bush” and payroll tax cuts which will remove hundreds of billions from the economy?
- **European Debt Crisis and Economy:** Debt crisis concerns seemed to lessen early in the year after Europe took some action to address Greece’s issues. However, the volatility in much larger countries like Spain and Italy are reigniting fear that resolving these major economies’ financial deficits will not be as “easy” to address or resolve as Greece and the negative economic impact could spread to worldwide. However, so far in 2012, these concerns have had minimal impact on U.S. markets, but this can change quickly.
- **China Economic Slowdown:** A major concern for global markets, as China is a key driver of demand for multi-national companies of good and services. China recently reported GDP growth of 8.1% which is robust by any measure.

Tim Vanech  
Tvanech@shorepointpartners.com

Luis M. Raposo, CFA  
Lraposo@shorepointpartners.com

Main 781 341 7250  
Fax 781 341 7246

14 Page Terrace  
Suite 2 C/D  
Stoughton, MA 02072

shorepointpartners.com

***“Mutual fund flows signify that people remain nervous.”***

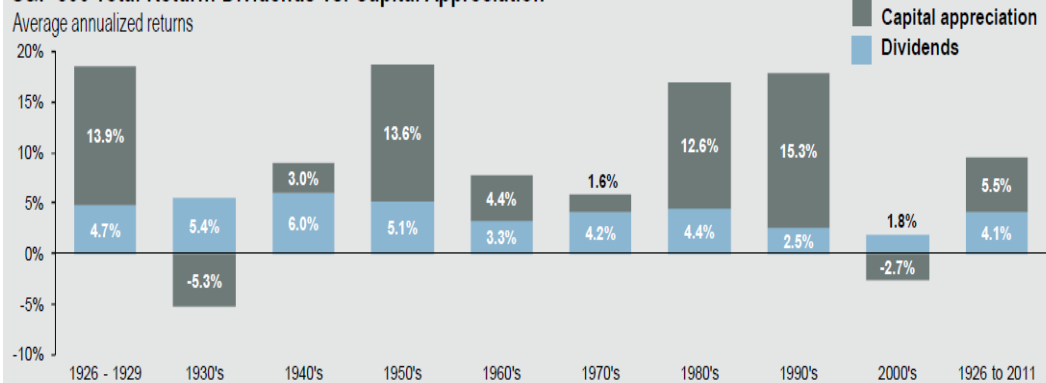
***“Investors have an opportunity to replace declining bond income with equity income...”***

***“We advocate an equity income approach and believe that it will become more prevalent and important especially with the aging baby boomers’ need for income in their retirement years.”***

We are contrarian by nature and experience, so we still feel compelled to present the more bullish case as investor sentiment remains quite the opposite. Mutual fund flows signify that people remain nervous. Bonds are still receiving the majority of new dollars invested. The 10 Year Treasury yields are around 2%, which means investors are still focused on return **of** their principal over return **on** their capital. As would be expected, the fall of stocks in 2008 and even the recent correction of 2011 have made people leery of volatility. However, a simple fact remains. If one had invested consistently through this period without major changes to their allocation, they would have done quite well in a balanced portfolio.

A recent paper entitled “*What if the Market is Revaluating Dividends?*”, authored by James Morrow, CFA and Neil Nabler, CFA, suggests an interesting theory. “Investors have an opportunity to replace declining bond income with equity income, swapping interest-rate risk for the moderate risk of high-yielding, low-payout stocks at attractive relative valuations. And as inflationary pressures build, earnings and dividends move higher with nominal economic activity. Dividend-oriented equities may thus play an important role in income protection.” Historically, dividends have been a greater component of S&P 500 annual returns. We advocate an equity income approach and believe that it will become more prevalent and important especially with the aging baby boomers’ need for income in their retirement years.

### S&P 500 Total Return: Dividends vs. Capital Appreciation



### Conclusion

As we have said over the past several years, we still maintain a constructive view of stocks and would pursue adding quality names possessing good balance sheets on weak overall market performance. That said, we will be carefully watching the earnings quality and margin strength during the reporting period of the upcoming weeks. We anticipate strong earnings for the overall U.S. stock market but are analyzing the potential effect of slowing earnings growth with overall markets still about 10% off their all-time highs. At this writing, we would place ourselves in the camp of seeing “pauses” as ones that will refresh.

Tim Vanech  
Tvanech@shorepointpartners.com

Luis M. Raposo, CFA  
Lraposo@shorepointpartners.com

Main 781 341 7250  
Fax 781 341 7246

14 Page Terrace  
Suite 2 C/D  
Stoughton, MA 02072

shorepointpartners.com