

## Weekly Investment Commentary

A Recap of 2011

December 19, 2011

### The Year in Review

Although 2011 started off on a relatively strong note for the global economy and markets, the past year was dominated by fears that contagion from the European debt crisis would derail the recovery. Overall global economic growth struggled in 2011 as most areas of the world experienced growth slowdowns (the notable exception being the United States). Emerging markets were also faced with some mounting inflation pressures, which presented a challenge for policymakers. Although there have been some signs of progress regarding the debt crisis, uncertainty levels remain high and this issue will no doubt remain of paramount importance into 2012.

Given this backdrop, risk assets struggled through 2011 as the year saw a renewed flight-to-quality theme. Equity markets are down for the year in most regions, although US stocks are roughly flat thanks largely to better economic conditions in the United States. Looking ahead, we continue to believe that value can be found in equities, particularly if policymakers can act decisively to manage the ongoing debt crisis.

With that background, following is a look back at the predictions we made at the beginning of the year. It looks at this point that we'll get six and a half of our predictions correct, and while that is somewhat below our long-term average of between seven and eight, it is nevertheless a better score than we were expecting a couple of months ago.

#### 1. US growth accelerates as US real GDP reaches a new all-time high.

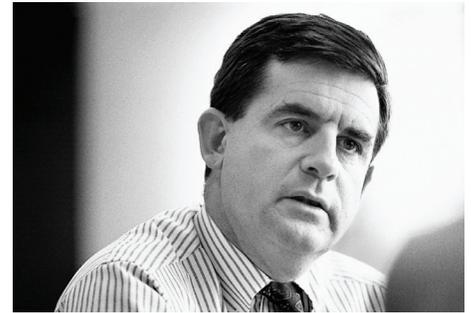
Several months ago it would have been nearly impossible to imagine that this prediction would have come true, but as the year draws to a close it appears that this did, in fact, come to pass. Growth was at a near-zero stall point in the first quarter of the year and accelerated noticeably each subsequent quarter. At this point, it looks as if the fourth quarter of the year will see gross domestic product growth come in at around 3%. Additionally, on a real basis, GDP did reach a new high in the middle of the year.

#### 2. The US economy creates 2 million to 3 million jobs in 2011 as unemployment falls to 9%.

This is one we'll mark as half-correct for the year. Unemployment fell below 9% in November, although jobs growth for the year as a whole was less robust than we anticipated.

#### 3. US stocks experience a third year of double-digit percentage returns for the first time in over a decade as corporate earnings reach a new all-time high.

This is another half-correct prediction. Earnings did reach a new high in 2011, but equities obviously did not experience double-digit gains.



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#### 4. Stocks outperform bonds and cash.

Given where markets are today, it appears we will get this prediction wrong. US stocks are down marginally for the year and have underperformed bonds and cash.

#### 5. The US stock market outperforms the MSCI World Index.

This prediction is on track by a wide margin, given that US stocks have, so far, outpaced international stocks by around 10% for the year.

#### 6. The US, Germany and Brazil outperform Japan, Spain and China.

Barring some significant changes, this one will come true as well, mainly thanks to the strength of the United States relative to the rest of the world. Of the remainder, Brazil performed the worst, but all of the markets outside of the United States were down in the double digits.

#### 7. Commodities and emerging market currencies outperform the dollar, euro and yen.

This one should be half-correct by year's end. The average commodity outperformed developed market currencies, but emerging market currencies underperformed.

#### 8. Strong balance sheets and free cash flow lead to significant increases in dividends, share buybacks, mergers and acquisitions (M&A) and business reinvestment.

Despite the relatively weak economy, corporations continued to perform well in 2011, which helped promote high levels of dividend growth, share buybacks, business reinvestment and M&A activity.

#### 9. Investor flows move from bond funds to equity funds.

This is one we were very wrong on. Given the flight-to-quality trade that dominated 2011, bond funds saw greater inflows than did equities.

#### 10. The 2012 presidential campaign sees a plethora of Republican candidates while President Obama continues to move to the center.

This past year saw a number of GOP candidates announce their intention to run and it has been a relatively crowded field. On the other side, President Obama has been taking a more partisan approach in recent months, but for most of 2011 he adopted a relatively centrist stance.

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