INNOVEST
INTEGRITY. BALANCE. OBJECTIVITY.

April 2012 Commentary

4643 South Ulster Street, Suite 1040 Denver, Colorado, 80237 303-694-1900 www.innovestinc.com

The Economy: Treading Water

The U.S.

April represented mixed results for the health of the U.S. economy. While the trends in growth are still positive, several economic indicators declined somewhat for the month. The second derivative of growth (the change in the pace of the economic expansion) has slowed since the end of 2011. Optimism was higher several months ago at the prospect of an accelerating expansion story for our country. Unfortunately, sustained and strong growth has yet to materialize on a broad scale. All of this provides support for our overall view of the U.S. economy: an improving economic picture that will take several years to return to a full recovery.

First, the bad news. Initial jobless claims rose slightly to 380,000 in March, while private payroll growth fell to 121,000 jobs. Companies across the U.S., both large and small, remain reluctant to return their staffing to 2007 era levels. We learned that U.S. GDP growth for the first quarter of 2012 was 2.2%, well below the 3.0% growth of the final quarter of 2011 and slower than expectations. According to Wells Fargo economists, real after-tax wage growth has been flat for the last two years, in spite of continued extraordinarily accommodative monetary policy.

The U.S. Fed is doing all it can to spur the economy to greater growth. Still, as John Maynard Keynes once noted, "you can't push on a string." It feels very much like we are pushing on a string to reflate the U.S. economy. Noted economist David Rosenberg of Gluskin Sheff & Associates remains decidedly bearish. According to Rosenberg, it is no wonder the U.S. has seen economic growth from our extraordinary fiscal and monetary policy. The wonder is how little growth we have seen for the drastic measures we have taken.

Now for some more encouraging data. New jobless claims are now 10% below the levels of twelve months ago. Companies added a robust 231,000 jobs per month from November through February. Meanwhile, manufacturing growth continues. For February and March, U.S. manufacturing grew by 3.9%. Personal consumption grew by 2.9% in the first quarter—a very healthy number.

Earnings season kicked off in an encouraging fashion, as companies continue to be more profitable than expected. Fully 74% of U.S. companies that have reported Q1 earnings have beaten consensus estimates, and the operating earnings of the S&P 500 registered their third-best quarter ever. . Large companies in the U.S. are not only surviving in this post-recession era, they are thriving. The continued health and profitability of

private enterprise in the U.S. is what will ultimately return the country to economic normality. The S&P 500, while essentially flat for the month of April, has gained 12.51% for the first four months of the year.

We developed a clearer picture of the Presidential race in April, as it looks increasingly likely that Mitt Romney will be the Republican candidate to challenge Barack Obama. Personal and corporate taxes have become an increasingly prominent part of the Romney/Obama debate in this election year. With Japan having lowered its corporate tax rate in April, the U.S. is now the "winner" of the dubious distinction of having the highest corporate tax rate in the developed world..

Most economists would point out that the health (or lack thereof) of the private sector will ultimately determine the fate of the U.S. economy in the long term. This sentiment reflects what Winston Churchill wrote long ago: "Some people regard private enterprise as a predatory tiger to be shot. Others look on it as a cow they can milk. Not enough people see it as a healthy horse, pulling a sturdy wagon."

The World

Pessimism is still in great supply in continental Europe. The U.K. and Spain are now both officially in recession, having experienced two consecutive quarters of GDP contraction. The U.K. unemployment rate stands at 8.3%, while Spanish unemployment has reached an astonishing 23.6%. Italian and Greek jobless rates ticked up as well. Yields on Spanish and Italian sovereign debt have risen recently, suggesting more concern to come for both countries' fiscal condition. These data all point to a gloomy economic picture for much of the Eurozone.

Credibility in the debt markets is extremely important. We hear much talk about the "bond vigilantes" who demand increasingly high interest rates from countries with deteriorating fiscal situations. There is fear that one day U.S. treasury rates may skyrocket due to an unsustainable debt load here at home.

The biggest reason for a rise in the yields of sovereign debt is investor pessimism that European countries will take the necessary steps to solve their fiscal woes. Austerity and budget-balancing are both difficult and politically unpopular. We already see changes afoot in France and Holland, where more liberal (and less fiscally austere) governments are likely to take power in the upcoming months. Will the Eurozone be able to save itself? The answer depends on the political will, which will become more apparent in the months ahead.

HSBC published a recent report entitled "Oil is the New Greece." The report highlights the recent run up in both WTI crude and Brent crude in the global markets. If sustained, the rise in crude prices represents a potentially damaging blow to the world economic recovery. Just as the problems in Greece have moved to the back burner, higher oil has replaced Greece as pressing concern. Moreover, the impact for emerging markets countries would be more serious. Inflation in the emerging markets is already a concern and could be exacerbated by higher energy costs in the short to medium term.

Emerging markets provide hope for the global economy. China has been able to manage its current economic slowdown, at least so far, with the right amount of policy response. The Chinese long-term outlook remains bright. Brazil and Indonesia are both poised for sustainable long-term growth, building on encouraging fundamentals. The continued emergence of the middle class in places like China, India, Mexico and Malaysia should fuel consumption and economic growth for many years to come, both domestically and globally.

The Markets: A Flat April

The U.S. equity markets were down slightly in April, cooling off after the near record gains of Q1. For the month, the S&P 500 was down 0.63%, bringing the year-to-date return to 12.51%. Markets needed a breather after the large rally of the first quarter. The most recent, surprisingly positive Q1 earnings season has improved valuations and provided an anchor for U.S. stocks.

Global equities were down in April. The liquidity provisions set forth in the Eurozone's LTRO were enough to provide relief to markets in the first quarter. European debt and equity markets reflected an increase of unease in April. The MSCI EAFE Index lost 1.96% for the month. Emerging markets equities were also down in April, registering a 1.2% loss. Following a massive first quarter gain of 14.08%, it is unsurprising to see the emerging markets take a pause.

Bonds were up in April, as yields came down from March's short-terms highs. The Barclays U.S. Aggregate Index was up 1.11%, and the Barclays Global Aggregate rose 1.18%. The U.S. corporate bond index was up 1.40%, while the high yield index rallied 1.05%.

The Dow Jones UBS Commodity Index was down for the month, losing 0.42% in April. The commodities index is flat for the year on competing bullish and bearish themes. On one hand, rising energy prices, renewed economic optimism in the U.S., and the potential for another round of quantitative easing have all provided support for commodity prices. On the other hand, new economic concerns from Europe and a slowing China has cooled forecasts for raw materials.

April 30, 2012

	Performance(%)				
Equities Index	1 Month	Year To Date	1 Year	3 Years	5 Years
S&P 500	-0.63	11.88	4.76	19.46	1.01
S&P MidCap 400	-0.23	13.24	-0.94	22.65	4.11
S&P SmallCap 600	-1.26	10.57	1.07	21.95	2.90
MSCI EAFE (net)	-1.96	8.69	-12.82	11.78	-4.72
MSCI EM (net)	-1.20	12.72	-12.60	18.34	3.48
Fixed Income Index					
Barclays Capital Aggregate	1.11	1.41	7.54	7.06	6.37
Barclays Capital Global Aggregate	1.18	2.06	3.30	7.62	6.39
Barclays Capital 1-10 Yr. Muni	0.92	1.46	7.08	5.25	5.45
CSFB Leveraged Loan	N/A	N/A	N/A	N/A	N/A
Barclays Capital US Corp: High Yield	1.05	6.44	5.92	19.65	8.05
Other Index					
HFRI Fund of Funds Composite Index	N/A	N/A	N/A	N/A	N/A
Dow Jones-UBS Commodity Index	-0.42	0.46	-19.42	8.63	-3.08
Wilshire US REIT Index	2.93	14.04	10.28	32.89	-0.08
S&P Developed Property	2.09	15.15	0.43	24.76	-3.83
LPX 50 TR	-2.68	14.64	-19.62	23.21	-11.59
Citigroup 3 Month T-Bill	0.01	0.01	0.03	0.09	1.03

Closing Thoughts

The "Hunger Games" was April's top grossing movie both domestically and globally. In the adaptation of the bestselling book, protagonist Katniss Everdeen is placed into a post-apocalyptic, winner-take-all contest in which she must compete with other children for survival. Katniss is faced with a seemingly endless set of challenges, both from a harsh environment and from other participants within the Hunger Games. When one problem is settled in the movie, inevitably another arises to take its place.

It feels like the global economy has been going through its own version of the "Hunger Games" since the recession of 2008. If it's not a fiscal crisis in Europe, it's a potential war with Iran over their nuclear weapons program. If it's not a tsunami in Japan, it's a real estate bubble in China.

And yet, equities registered huge gains in the first quarter. The U.S. and the emerging markets are both up in the double digits, year-to-date. Western European markets are up about 8.45%. While the headlines reflect a worrying amount of risk in the world, markets continue to rise. It is because the markets take a forward-looking approach to earnings and risk. The rise in equities across global markets indicates the expectation of continued improvement in economic conditions.

It is important to keep a high-level view and stay the course in our investment portfolios, particularly in light of the myriad concerns that exist today. As John Kennedy noted: "There are risks and costs to a program of action. But they are far less than the long-range risks and costs of comfortable inaction." In this case, the right action is to stay invested for the long term.