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Weekly Investment Commentary

10 Predictions for 2012: Mid-Year Update

July 2, 2012

At the midway point of 2012, it seems an opportune time to review the predictions we made at the beginning of the year. Although much could change, at this point it appears that the majority of our predictions are on track.

1. The European debt crisis begins to ease even as Europe experiences a recession.
The second half of this prediction has already come true as Europe is mired in a recession. The recession, so far at least, looks to be reasonably mild for core Europe though more significant for peripheral Europe. The critical question is whether or not the debt crisis will begin to ease and obviously the jury is out on that one.

2. The US economy continues to muddle through yet again.
We have been calling for a 2% real growth rate in the United States, and that appears to be about where we are. We would categorize such growth as acceptable but not exceptional, and it appears that US growth will be muddling through for some time.

3. Despite slowing growth, China and India contribute more than half of the world's economic growth.
Both China and India have been slowing in terms of economic growth. China has, so far, been able to show some resilience while India, in contrast, has weakened more than most expected. In any case, however, given that there is little robust growth anywhere in the world, China and India do appear to be set to generate more than half of the world's growth this year.

4. US earnings grow moderately, but fail to exceed estimates for the first time since the Great Recession.
This is another prediction that appears on track. Earnings have been growing at a decent pace this year, but it does seem that expectations were too lofty at the beginning of the year.

5. Treasury rates rise and quality spreads fall.
At this point, we would score this one as half-correct. Notwithstanding a noticeable spike in yields that occurred in the spring, Treasury rates are lower now than they were at the beginning of the year as investors have remained highly risk-averse. Spreads for other fixed income assets, however, have fallen as credit sectors of the fixed income market have performed reasonably well.

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6. US equities experience a double-digit percentage return as multiples rise modestly for the first time since the Great Recession.

Price-to-earnings ratios have advanced since the beginning of the year and should that trend continue, we'll get the second half of this one right. For the first half to be correct, the S&P 500 Index would need to close the year at 1,350 or higher. After a strong last trading day of the second quarter, that's about where we are and we think stocks have a good chance of advancing further in the second half of the year.

7. US stocks outperform non-US markets for the third year in a row.

Thanks in large part to solid earnings and strong cash flow yields, US stocks have been outperforming so far in 2012. On a year-to-date basis, US stocks are up around 7%, while non-US markets are down slightly.

8. Company dividends and share buybacks hit a record high.

We haven't gotten there yet, but this prediction has a good shot. Companies are still hoarding extremely high levels of cash and we expect they will continue to deploy that cash in a variety of shareholder-friendly ways.

9. Healthcare and energy outperform utilities and financials.

We are on the wrong side of this prediction at the midway point of the year. On an equal-weighted basis, healthcare and energy are up only modestly, while utilities and financials are up in the mid-single digits.

10. Republicans capture the Senate, retain the House and defeat President Obama.

This prediction remains a huge wildcard, with questions over the economy, the budget and the looming fiscal cliff likely deciding this year's election results. Regarding Congress, we think there is a better than 50% chance that the Republicans capture the Senate and a much better than 50% chance that they retain the House. At this point, the presidential election looks as if it could go either way.

A "Muddle-Through" World Should Still Allow Stocks to Outperform

Although conditions have gotten tougher as the year has progressed, the summary view we offered at the beginning of the year has not changed. We believed in January that conditions should be "good enough" for stocks to outperform in 2012, and we are holding to that view.

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