"Do Something!"

Scott Finlay
Q2 2012

The second quarter ushered in a wave of pessimism prompted by renewed concern over the challenges in the eurozone. While the situation in Europe is not as dire as what we witnessed during the same period last year, significant risks exist, and the uncertainty has cast a pall over the global markets. Despite the constant barrage of negative news, we continue to believe that there is slow but steady progress towards resolution. The ECB has stepped in to purchase government bonds in the secondary market of debt-laden countries in an attempt to provide liquidity and drive rates lower, and European leaders last month proposed setting up what may be the beginning of a European banking union, quite a change from just a few months ago. While the cost of Spanish government debt financing continues to rise, the increase has had the effect of forcing the acknowledgement of the precarious situation, requiring difficult political decisions that had previously been ignored. Incremental progress is also evident in the U.S. economy, but you wouldn't know it by reading the headlines, and it's important to look beyond the sound bites for the real story. U.S. economic growth, while slow, is still expected to come in at 1.5% - 2% for the year, not great but still positive. As for equities, values continue to improve as earnings hit record levels, and stock price appreciation remains modest. We are watching for signs of slowing earnings growth but don't expect material P/E compression from already low levels. Equities by most measures are inexpensive, but in the words of Warren Buffet, "*Stocks are the only thing that people don't like to buy on sale.*"

Last quarter we suggested that dividend-paying stocks would continue to do well in the ever-more challenging search for yield. The combination of their defensive nature and ample cash flow made this group one of the top performing sectors this past quarter. Despite the fact that valuations for this sector are currently higher than the market average, I continue to believe that this is the place to be for the foreseeable future, as the "safe" alternatives such as CDs, money market funds and Treasury bills currently offer negative real rates of return (yield minus inflation).

On to the Fed…In his most recent testimony, Chairman Bernanke suggested that they were looking for additional ways to stimulate the economy. It would seem to me that changes in fiscal policy might be more appropriate, as monetary policy options are running thin. The Democrats are unwilling to offer investment incentives to those with means for fear of alienating their constituency, and the Republicans will block any initiative that would make the Democrats look good in an election year, so expect continued gridlock and market volatility until November. Regardless of the post-election outcome, we expect that the

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politicians in both parties will feel the pressure from their constituents to "do something" in 2013, the likely result being a combination of spending cuts and tax incentives. Stay tuned!

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