Newman Dignan & Sheerar
INVESTMENT ADVISORS

ECONOMIC & CAPITAL MARKETS REVIEW

NEWMAN DIGNAN & SHEERAR, INC.

A SERIES OF UNFORTUNATE EVENTS

4th Quarter 2011

ECONOMY & MARKETS

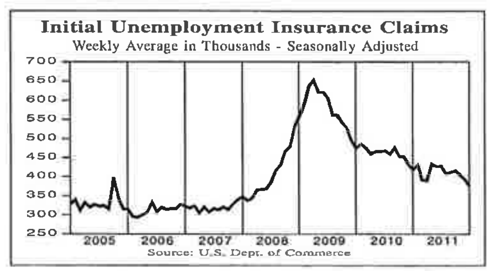
What a year! One unfortunate event after another seemed to keep investors on edge throughout the year – the Japanese earthquake and tsunami, the U.S. ratings downgrade by S&P, stalemates in Washington *(Caution: Children at Play)*, the Arab Spring, unrest in Moscow, the slowing of China's economic growth, the passing of North Korea's leader, Hurricane Irene, Iran's saber rattling over the Straits of Hormuz and the European sovereign debt crisis. We suspect that 2012 will offer a host of surprises as well … doesn't every year?

A strong fourth quarter rescued an otherwise miserable year. For the fourth quarter of 2011, the DJIA moved higher by 11.9% while the S&P shot up by 11.2%. The NASDAQ finished ahead by 7.9% for the quarter. International markets jumped higher as the EAFE Index advanced by just 2.9% for the quarter. Bond returns were just fine as the Barclay's Aggregate Bond Index inched up by 1.1% for the quarter.

Yearly performance numbers for equities were a mixed bag with domestic equities holding their own while international equities struggled. The DJIA was up 5.5% for 2011 while the S&P 500 finished flat. The NASDAQ was lower by 1.8%. International markets were disappointing as the EAFE posted a 14.8% loss for the year. Bonds, once again, finished the year higher by 7.8% in 2011. Bond investors benefited from continuing low rates and a flight to safety by investors, but the 30-year party is slowly ending.

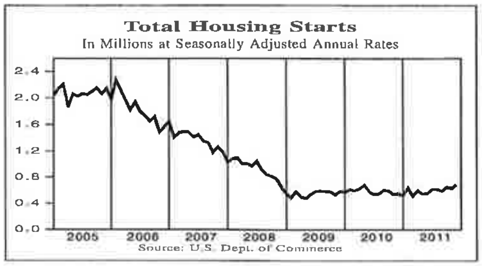
Although the S&P 500 finished the year essentially flat, it was anything but a calm year. Interestingly, the S&P was up on 55% of the days in 2011 and down on 45% of the days. The volatility of the markets throughout the year was very unsettling for investors. *Of the more than 200 trading days, the DJIA moved triple digits 100 times.* The CBOE Volatility Index (VIX) reflected an enormous amount of volatility and uncertainty. The good news is that fear and chaos do not dictate long-term returns. Investors are reminded to stick close to asset allocation guidelines rather than trading based on emotions and fear. As we've said before, the world doesn't end that often. Except, of course, if you consider that the Mayan calendar ends (time runs out) on December 21, 2012. We suspect, however, that we will all wake up the next morning *(at least we hope we will)*.

The U.S. economy *(the best house in a bad neighborhood)* is showing signs of resilience. Among the improving signs are: improved **industrial production**, better-than-expected **retail sales**, falling **jobless claims** *(see chart below)*, moderate **inflation** *(so far)*, solid **productivity** numbers, strong **auto sales**, high **rail car loads**, improving existing **home sales**, and declining mortgage **delinquency rates**.



Improving unemployment claims *(above)* are critical to a recovery in the U.S. economy. After spending 28 months above 9% *(the longest such stretch since World War II)*, unemployment fell from 9% to 8.6% in November. Spain, by contrast, is dealing with unemployment rates north of 20% - ouch! Structural issues with the unemployment rate may keep rates higher for quite some time, but more people should be working as the year progresses.

The U.S. housing decline seems to be nearing its end. Recent gains in housing starts and building permits point to a slowly improving economy. Low mortgage rates, slowly improving employment, rising rental rates, and improved housing affordability are all putting a floor below housing. The housing starts chart below shows gradually improving starts off of the 2008 low.



Europe

Washington and Europe are critical to market returns in 2012. We expect more contentiousness in Washington as the year progresses *(particularly in an election year)*. Europe has major problems that will likely be solved, but only after more pain and finger-pointing. *European banks will have to take massive write-downs on sovereign debt.* We doubt that Greece will be able to finance its debt load as the year goes on. Both Italy and Spain have had decent bonds auctions recently, but we suspect more pain is ahead for Europe.

OUTLOOK

Valuations matter

Bottom Line – Economic and market consensus is almost always overly optimistic at the beginning of each year. However, the optimism seems to be a bit subdued as we enter 2012. We think that is a good thing. The U.S. will not enter a recession in 2012. With 2012 consensus earnings estimates for the S&P 500 around $104, the market is selling at a very reasonable valuation of 12X … cheaper than the historical average of 15X. However, we expect earnings numbers to come down to around $100 – thus bringing valuations closer to 13X *(still reasonable)*. Stocks are cheap … according to Professor Jeremy Siegel at the Wharton School of the University of Pennsylvania, the equity risk premium *(the difference between the expected return on stocks and bonds)* is more than twice its historical average. Given decent valuations, solid balance sheets, increasing dividend payouts, increasing consumer confidence and mild inflation, *we expect the S&P 500 to close 2012 in the 1350 - 1425 range (7% to 13% higher).* Given the continuing headwinds around the world, we expect *continued volatility* in the markets.

More… volatility

We see 2012 US GDP growth coming in around 2.5% … not bad given all of the headwinds that exist. Europe, on the other hand, will likely struggle with negative growth throughout the year (of course, market valuations are beginning to reflect that outlook). Emerging market GDP growth should be roughly 3 – 7% *(thus our increasing exposure to emerging/developing markets)*.

Bond prices should generally move lower over the course of the year. U.S. Treasuries will be challenged as investors sell bonds and re-allocate to other fixed income instruments and higher dividend-paying equities. We anticipate keeping average durations in the short-to-intermediate range … we are not willing to take on much interest rate risk given the likelihood of higher rates. We are, however, willing to take on more credit risk as corporate balance sheets are improving nicely. *Floating rate funds*, *mortgage-backed debt*, *less-than-investment grade debt* and *emerging market debt* ought to provide reasonable returns for fixed income investors.

Small and mid-cap equities still add value to an overall asset allocation strategy, but we would underweight the group as valuations appear fairly priced. We continue to be underweight *developed international equities* while adding to *emerging market equities.* Again, we believe that *large-cap companies with higher quality attributes* should begin to play a more significant role in market leadership over the next several years (they're relatively cheap and they've underperformed for nearly 10 years … we expect mean reversion to be alive and well). We like companies with excellent dividend growth potential *(not necessarily just high dividend yields)*. *Commodities* offer investors some protection from potential inflation and dollar weakness. *Alternative assets* will continue to provide good risk-management for portfolios.

Of course, markets can and will pullback on any given day, but a fully diversified portfolio consistent with one's longer-term objectives and risk tolerance is the best strategy to manage through the day-to-day noise and fears of the markets. *Let's make it a good year.*
Happy New Year!

If history is any guide...

Election-Year Stock Markets

S&P 500 Stock Market Returns During Election Years

Year	Return	Candidates
1928	43.60%	Hoover vs. Smith
1932	8.20%	Roosevelt vs. Hoover
1936	33.90%	Roosevelt vs. Landon
1940	-9.80%	Roosevelt vs. Willkie
1944	19.70%	Roosevelt vs. Dewey
1948	5.50%	Truman vs. Dewey
1952	18.30%	Eisenhower vs. Stevenson
1956	6.50%	Eisenhower vs. Stevenson
1960	0.50%	Kennedy vs. Nixon
1964	16.50%	Johnson vs. Goldwater
1968	11.10%	Nixon vs. Humphrey
1972	19.00%	Nixon vs. McGovern
1976	23.80%	Carter vs. Ford
1980	32.40%	Reagan vs. Carter
1984	6.30%	Reagan vs. Mondale
1988	16.80%	Bush vs. Dukakis
1992	7.70%	Clinton vs. Bush
1996	23.10%	Clinton vs. Dole
2000	-9.10%	Bush vs. Gore
2004	10.90%	Bush vs. Kerry
2008	-37%	Obama vs. McCain
2012	?	Obama vs. ?

Economic challenges continue. Yet it is a new year, with new promises for peace and prosperity from new [or newly refurbished] politicians. Can they possibly improve the mood of the electorate [and market participants]? The adjacent chart (http://moneyover55.about.com/) shows encouraging results, with only 3 down years since 1928. However, this 4th year of the cycle only averages 7.5% over the last 110 years [down from 12.6% in the third year of the President's term]. Moreover, recent results have been below the long-term averages, no doubt because of the aforementioned afflictions. The point is that it is dangerous to predict the future. As behavioral finance has reminded us, there may be patterns, but that does not mean they are relevant to the decision making process. While the qualitative and quantitative studies of the market continues, ND&S will abide by our proven investment process of understanding risk and return, performing detailed financial analysis, diversifying portfolios and knowing our clients. Our process works, no matter who wins the election.

2011 Income & Capital Gain/Loss Reporting

Virtually all of our clients use Charles Schwab Institutional as their custodian. Starting with the 2011 tax year, all custodians, including Schwab, will be required to report 1099 income/dividends along with security gains and losses to clients and the IRS. Schwab will also be reporting investment fees. Our staff has been working closely with Schwab specialists to ensure that their reporting to you will be timely and accurate. Please contact us or Schwab at 1-800-515-2157 for any questions you or your tax preparer may have.

Compliance Update

Pursuant to the ongoing written disclosure requirement placed upon registered investment advisers, we are required, on an annual basis to make available to our clients, on an annual basis, our most recent written disclosure statement as set forth on our Form ADV Part2A (our *"Brochure"*). As such, please contact ND&S should you wish to receive our most recent *Brochure*.

ND&S maintains a proxy voting policy that highlights our handling, research and voting of proxies. Please contact ND&S should you wish to receive a copy of our Proxy Policy. *As always, we ask that you also notify us of any significant changes to your financial situation.*

A mixed bag...

Go Pats!

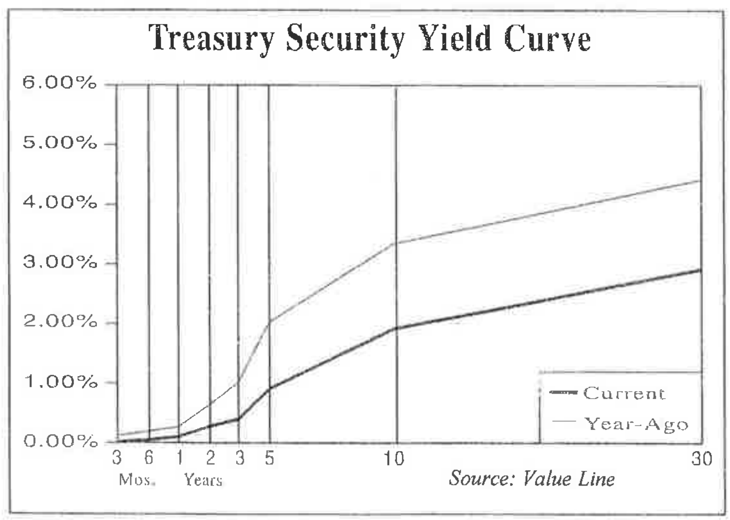
4th QUARTER 2011 SCOREBOARD

Index	Close	4th Quarter % Change	Year-to-Date % Change
DJIA	12217.6	11.9	5.5
S&P 500	1257.6	11.2	0.0
NASDAQ	2605.1	7.9	-1.8
Nikkei	8455.4	-2.8	-17.3
MSCI EAFE	1412.6	2.9	-14.8

3 Month T-Bill	0.02%	Fed Funds Rate	0 - 0.25%
5 Year T-Note	0.84%	Prime Rate	3.25%
10 Year T-Note	1.87%	Gold	$1565.00
30 Year T-Note	2.89%	Oil	$98.95

Oil was up 8% in 2011

Consensus is that rates stay low... we see a gradual move higher



We at Newman Dignan & Sheerar, Inc. wish to extend to our clients and friends our best wishes for a happy, healthy and prosperous New Year.

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