

Chapin Hill Advisors Market Comment 12-21-11

Did Santa Arrive?

Surprise Rally....

Another abysmal week ended on December 16th for the equity indices as the Dow finished down 2.6%, the S&P 500 dropped 3% while the tech-heavy Nasdaq fell 3.5%. Europe and Asia continued to give up ground and headline news continued to rule.

Monday brought the possibility of the European finance ministers announcing some type of liquidity program during their afternoon conference. The U.K. put the kibosh on any deal as they declined to participate in the 200 billion euro capital fund for the ECB (European Central Bank). The U.K. was estimated to contribute as much as 15% of the total fund so their lack of participation created a higher hurdle for the remaining countries in the EU (European Union). The euro fell and stocks followed with the Dow giving up another 100 points while the S&P gave up another 1.1% and the Nasdaq lost 0.8%.

Overnight markets turned around as an auction of Spanish bonds went very well with full subscriptions and a lower yield second time in a row. We were off to the races on the U.S. market as soon as the European markets opened and we really shot up as the markets opened for the day. Headline news was again driving a “risk-on” trade. The equity markets rallied between 2-3% across the board. Rumors that the ECB was behind the demand in the Spanish auction were ignored by the bulls.

It seems everyone is now aware of critical technical levels so when they break – on the upside or downside – continuation of the trend takes place. For the S&P 500, that level on the upside was in the 1225-1228 area. Monday’s trading saw a low of 1195 and some technicians were calling for 1180 as the next stop. However, trading over 1225 level neutralized their calls, short covering helped to fuel the rally and with volume painfully light it is easy to fuel a move.

Was Tuesday’s rally the beginning of the “Santa Claus” rally? Overnight, it looked like that might be the case as the S&P hit 1249 briefly in the week hours. An impressive rally of 4.2% from Monday’s intra-day low to early morning pre-market levels on Wednesday! As trading started however, the markets faded. Midday, the Dow was down over 100 points. But the trade pushed the market up to erase most of the losses over the afternoon and the Dow closed up 4 points.

The Euro and the S&P 500 have had a fairly tight correlation for most of the past year. On Wednesday, the Euro faded while the S&P traded essentially sideways. So it is possible that the S&P is consolidating and we may have one more push into the end of the year and possibly partway through January. The Euro remains under pressure and the powers that be in Europe do not seem to be acting quickly enough or with enough liquidity to dampen concerns.

Predictions.....

Although none of us have crystal balls, Wall Street is asked each year to predict the market for the next year. One must be very careful to “hang your hat” on these estimates no matter who makes the recommendation or how good their past predictions have been.

Just to give you a sense of 2011, JP Morgan predicted the S&P would close the year at 1350. Goldman Sachs called for 1250 while UBS was at 1350. Deutsche Bank predicted 1425 while Barclays estimated 1325. The S&P closed on December 21, 2011 at 1237.

Of course, it's not over until it's over and we have a week of trading left but so far JP Morgan and UBS are off by -8.3%, Goldman comes in closest as they are off -1% right now while Barclay's is missing by -6.6% and Deutsche Bank “wins” with a miss of -13%.

Once we close the year, the numbers are in black and white. And thanks to the internet, finding old data is a breeze. No one seems to hold anyone's feet to the fire as they are asked to make predictions but rarely are these revisited. You hear talking heads on the financial news channels with their predictions but no one comes back and reports whether they were right or wrong or by how much they missed (or exceeded) their target.

As I mentioned last week, these investment houses have a lot riding on investor confidence so they do not want to be very wrong if they can help it. They have a lot of cash available and with thin trading volume, it is possible to push the market up to the high 1200's and possibly low 1300's. That changes the picture quite a bit for these investment firms as they come a lot closer to their 2011 predictions if this scenario unfolds so I wouldn't count it out just yet.

This week's Barrons announced predictions for 2012. They surveyed 12 investment professionals and found a general consensus of more of the same in the first half of 2012 but they all called for a robust second half.

Those same firms above are fairly to very bullish. JP Morgan is looking for 1430 on the S&P. If we close at these current levels, that's a gain of 15.6%! UBS is more moderate with a call for 1325 while Barclay's is a hair higher at 1330. Deutsche Bank is very bullish expecting 1500 to be hit – a gain from these levels of 21%. Goldman is giving a range of 900-1400 with a year end target of 1237. That's quite a range as if they are right, we could see a fall of 27% to a gain of 13% but a finish of just 1% from current levels.

Only time will tell but if their past history is a gauge, you may want to exercise caution before you invest your assets with the bullish scenario in mind.

Overseas markets...

We are very U.S. centric and many people have trouble recognizing that what happens in Europe will have an effect on both our markets and the global economy. Through 12/20 the S&P has a slightly negative return of (1.3%), the Nasdaq is down 1.8% while the Dow is up 4.54% (driven by good performance on IBM which is up 26% through the end of 12/20).

However, the foreign markets tell a very different story. In Europe, the FTSE (Britain's index) is -8%, CAC (France) -19%, DAX (Germany) is -15%. Asia got hit much harder as the Nikkei is down -17%, Hang Seng -20%, Shanghai SE (China) -22% and the MSCI world index is -9%.

We are a global marketplace and Europe's problems will be our problems. This is not going away overnight. Asia is slowing down and that will affect the world as well. Yes, India and China are still a force and the very wealthy in those countries continue to consume luxury goods. But overall there are systemic problems and I believe we are set for a global slowdown and the equity markets will continue to be both volatile and likely to fall in 2012.

Housing Market...

Tuesday's existing home sales number was initially greeted with enthusiasm as it was +9.3% for November and permits rose almost 6%. This was part of what triggered a triple digit rally in the equity markets. However, when you read what the experts had to say after reading through the report, that number was perhaps "padded" by builders releasing the multi-family units which rose by 25%. It is clear that there is a shift away from home ownership and into the rental market however, this rise in multi-family was considered an anomaly by many analysts.

The housing market is still sluggish for many reasons and there is definite trend to rentals. In some cases, people cannot swing the downpayment and pass the stringent credit requirements. In others, they see homes on their block not selling or reduced in price drastically and if they were lucky enough to sell they don't want the risk again. Others do not have the job security to be able to own a home.

We are seeing a trend in both developers and pension funds moving away from malls and large commercial buildings in to the apartment market. Rentals have been strong, rents are rising and demand continues.

Wednesday's housing number (new home sales and permits) was less rosy as the National Association of Realtors admitted that they "counted incorrectly" and home sales have not been as good as has been reported. While we saw an uptick to 4.03% in November from 1.4% in October and inventory declined. The fact that the overall number since 2007 was revised down by 14.2% shook up the markets.

According to Jack Bouroudjian, at the peak, housing comprised 6% of GDP. Today it is only 2%. Banks are afraid of new regulations coming down the pike, specifically the Dodd Frank ruling and they may need to keep higher levels of capital. Therefore, they are hesitant to open the lending spigot and only the best credit risks are finding loans. While rates for the 30 year actually dropped below 4% this week, if you cannot get a loan, low rates do not help you.

Interesting but not such fun facts....

Value-Walk.com reported "50 Facts about the U.S. Economy that will Blow Your Mind" on their website today. I've listed a random 10 facts below and they are sobering.

1)48% of Americans are considered either low income or below the poverty level.

- 2)57% of children in the U.S are living in low income or impoverished homes.
- 3)A recent survey of small business owners says that 77% have no plans to hire anyone.
- 4)We have fewer payroll jobs in the U.S. than in 2000 while we have added 30 million to the population.
- 5)A recent Gallup Poll shows that 1 out of every 5 Americans who do have a job are under-employed.
- 6)BlackRock Investment Institute reported that the ratio of household debt to personal income has reached 154%.
- 7)The median price of a home in Detroit hit \$6000.
- 8)19% of American men aged 25-34 are living with their parents
- 9)1 out of 7 Americans have 10 credit cards.
- 10) The retirement crisis in the United States just continues to get worse. According to the Employee Benefit Research Institute, 46 percent of all American workers have less than \$10,000 saved for retirement, and 29 percent of all American workers have less than \$1,000 saved for retirement

Read more: <http://www.valuewalk.com/2011/12/50-facts-about-the-u-s-economy-that-will-blow-your-mind/#ixzz1hD9lZQzI>

Higher taxes for the wealthy...

Much is being made of the difference between the 1% and the 99%. Many of the investment journals I read are coaching advisors on how to prepare their clients for the eventual hit to their incomes as they take on a higher tax burden.

Local municipalities counted on sales of homes to help fund their budgets. With the slowdown in housing sales, these are unlikely to come to fruition and many people may face a double or even triple whammy as income taxes (possibly both State and Federal) rise and local school taxes or town taxes continue to rise.

There is little we can do and one may just want to count their blessings if they are in the 1%. But the entire picture means we are more likely to continue to see a tough equity market going forward and protection of principal is the mantra we suggest people adopt.

As always, feel free to call us with questions or comments.

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