Altamont Wealth Management

First Quarter 2012 Performance

Many people take no care of their money till they come nearly to the end of it, and others do just the same with their time. Johann Wolfgang von Goethe

The year stated off with a spring. Equities across most of the globe continued to recover. Optimism over economic prospects increased across the Americas during the first quarter of the year, as economic data showed sustained improvement and global risks eased somewhat. The European fiscal crisis now appears less worrisome when compared to last year, while the slowdown in Asia has turned out to be milder than expected earlier.

The U.S. stock market had its strongest start since 1991 with the S&P 500 was up over 12%. Despite costlier fuel, consumer spending climbed in the U.S. Falling unemployment and strong corporate profits drove the market higher.

In contrast to the choppy markets of the last few years, the first quarter gains were steady, with monthly returns of 4.5%, 4.3% and 3.3% respectively. This reflects a dramatic decline in volatility with the VIX falling to 15.6% from 26.6% in the previous quarter. Below is a chart showing the VIX through the end of April from Yahoo.com. The VIX captures the implied volatility of the S&P 500 index through the use of options specifically SWAPS. The VIX is quoted in percentage points and translates, roughly, to the expected movement in the S&P 500 index over the next 30-day period, which is then annualized. A high index value does not imply that the market will fall. It merely shows that investors expect prices will move up or down dramatically in the next month.

First Quarter 2012 Benchmark Index Returns

	First Quarter	12 mos. Returns
Large-Cap Benchmarks		
S&P 500 iShares	12.6%	8.4%
S&P 500 Growth iShares	12.2%	11.5%
S&P 500 Value iShares	12.9%	5.0%
Mid-Cap Benchmarks		
S&P 400 Midcap iShares	13.6%	1.8%
S&P 400 Mid Growth iShares	14.0%	2.6%
S&P 400 Midcap Value iShares	12.8%	0.9%
Small-Cap Benchmarks		
S&P 600 iShares	12.1%	5.0%
S&P 600 Growth iShares	11.2%	5.4%
S&P 600 Value iShares	12.9%	4.5%
Other Benchmarks		
MSCI EAFE Int'l iShares	10.8%	-5.8%
MSCI EM Int'l iShares	13.2%	-10.1%
Vanguard Total Bond ETF	0.2%	7.8%
DJ-UBS Commodities iPath ETF	0.2%	-17.6%

For example, a value of 10% indicates that options traders expect S&P 500 index returns over the next 30 days will be between 10% higher or lower than the average expected return. So falling VIX indicates that the markets will be less volatile. Some people refer to it as the fear index since it shows investors perception of future risk. A high VIX (over 30) indicates high investor anxiety that there will be big price swings. The VIX hit its high in October 2008 during the financial meltdown at over 60%. While a VIX reading below 20 indicates low investors' fears and could signal complacency. In practice, the realized volatility will differ significantly from the implied standard deviation because there is no way to predict the future. Since the end the quarter the VIX spiked back up from 15% to over 20 and then fell again to 16. Volatility is currently low but could easily become more volatile depending on global events.

The S&P Mid and Small Cap indices also performed well and were up 13% and 12%, respectively for the quarter. Mid and Small Cap stocks had their best first quarter since 2006. The quarter's strength drove the twelve month returns into positive territory. Accordingly, the S&P Midcap 400 was up 13.6% for the quarter, driving up its twelve month return into positive territory (1.8%). S&P Small Cap 600 twelve-month return was even stronger at 5%.

The positive results for the quarter were not limited to domestic markets. The developed international markets index (MSCI EAFE) rose almost 11%. This was due to several comforting events in Europe. Greece fulfilled the pre-condition for securing its second bailout by convincing its private creditors to accept a 53.5% write-off on its debt. The deal eased concerns about a disorderly default by Greece on its sovereign debt. Following up on the liquidity-infusing program it introduced late last year, the European Central Bank (ECB) carried out another round of its Long-Term Refinancing Operation (LTRO), this time disseminating funds to about 800 banks. These events helped to assuage investors' concerns, allowing the European equity and bond markets to post positive returns.

Emerging Asia Pacific economies, which reported dismal economic numbers during the fourth quarter of 2011, recovered some lost ground. Export-led growth in many Asian countries such as Taiwan, Malaysia, South Korea, and China, witnessed slight improvements in 2012 thanks to moderating fears early in the quarter concerning the European Union sovereign debt crisis and stronger-than-expected recovery in the U.S.

The first quarter returns for the MSCI EM International Index was a strong 13.2%. But towards quarter end, emerging markets equity index prices saw a moderate correction. In March, renewed concerns that domestic consumption growth in some of the larger emerging economies could be lower than currently expected surfaced. Investors expressed concern that this could restrict aggregate economic growth in the coming quarters.

By quarter-end signs of the European fiscal crisis worsening again dampened investor sentiment. Worries that further economic weakness in the Euro-zone would cloud the export prospects of several emerging economies, especially China caused the markets to give back some gains. Also, slower inflation for the month of February and weaker retail sales growth have brought back apprehensions about slower Chinese growth. Though inflation picked up in March, it was mostly due to seasonal factors. Import growth for the month of March fell below expectations, and was significantly lower than the previous month, strengthening fears about weaker domestic demand in China. At the same time, private surveys contradict the official Chinese data that showed an increase in March industrial output. In fact, China recently signaled that it will accept a slightly lower growth rate of around 7.5% over the coming years. The Chinese economy grew at a pace of nearly 10% for over two decades. The fear is that China's economy will grow even slower than expected.

Commodity prices have recovered slightly after the correction during the second half of last year, rising as the outlook in global demand improved. Commodity prices are closely tied to China's manufacturing-based economy.

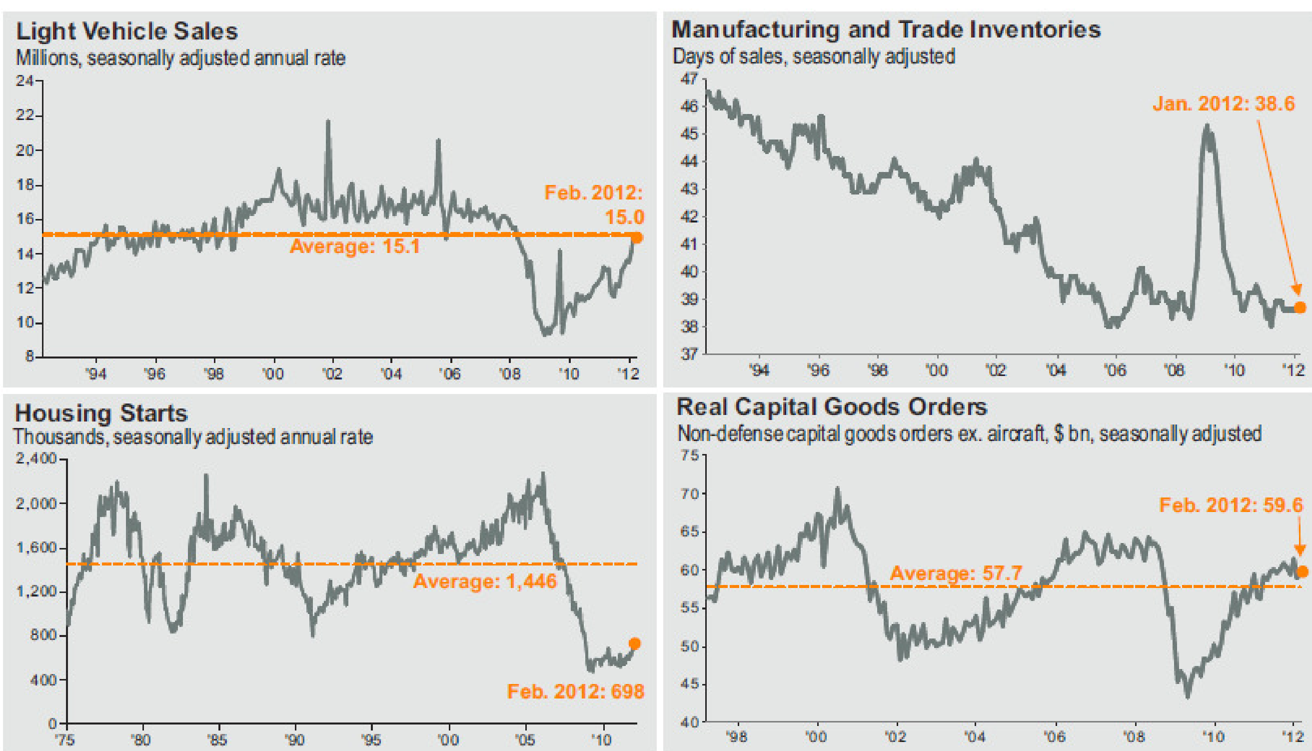
Cyclical Sectors of Economy

On the chart below are the four largest sectors that are the most sensitive economic cycles. Watching how they grow and contract provides critical information about the state of the economy. They are the sectors that get hit the hardest during recessions and they make up one-fifth of the economy. The left two charts (Light Vehicle Sales and Housing Starts) are items that consumers acquire while the right two charts (Inventories and Capital Goods Orders) are procured by businesses. So these sectors give insight into how both consumers and business are responding to current economic conditions.

What makes these sectors so cyclical? These are the items that consumers and businesses put off buying in a downturn and then begin to purchase only when they feel confident that the economy is recovering. Unlike groceries consumers can delay buying a new car or home when times get rough. Just the same way businesses shrink inventories and delay large capital purchases during recessions.

During a recession, cyclical sectors of the economy contract. As expected, these four sectors shrank during this last recession. Light Vehicle sales fell to a 27 year low in 2009. Housing Starts hit an all-time low. In fact, if you look at the seven recessions we have had over the last 50 years, these four sectors are responsible for more than 100% of the decline in GDP and more than 60% of the recovery.

The good news is that these sectors are recovering. Light Vehicles Sales have recovered to its average seasonal rate. So consumers are buying cars again. Real Capital Goods Orders have rebounded to above its seasonally adjusted average showing that business are back to investing in their future growth.

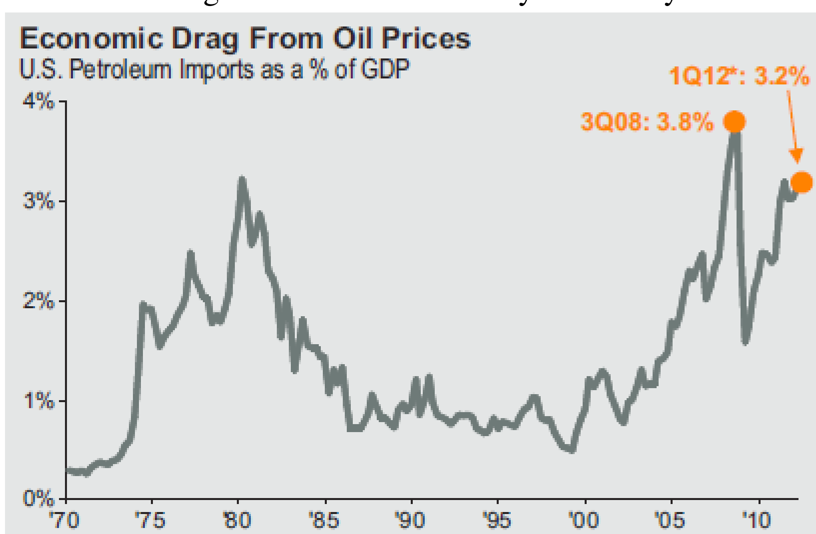


Source: (Top left) BEA, FactSet, J.P. Morgan Asset Management. (Top right) Census Bureau, FactSet, J.P. Morgan Asset Management. (Bottom left) Census Bureau, FactSet, J.P. Morgan Asset Management. (Bottom right) Census Bureau, FactSet, J.P. Morgan Asset Management.

Both Housing Starts and Manufacturing Inventories have a long way to run before they have recovered. The recent uptick in all these sectors and the recent Durable Good s Orders are a hopeful sign that the economy is truly recovering. This increase in economic activity now needs to create jobs to reach a sustainable growth level.

The next question, is the rest of the world recovering? The Eurozone is still a concern and will experience a recession this year and maybe next. The fiscal austerity that European governments have had to impose is hurting its already weakened economies. It is likely that more European country sovereign debt will be downgraded. Standard & Poor's rating company recently downgraded Spain's government bonds. When bonds are downgraded (because the risk of default is perceived to be higher) its value falls and interest rate rates rise (increasing the cost of borrowing). The situation in Greece still remains critical. Portugal also has clear solvency problems. As Europe pays off and reduces debt it is exacerbating its recession. It is clear that the struggling Eurozone will hurt the U.S. economy since they purchase more U.S. goods than any other region.

The other big concern is rising tensions in the Middle East between Israel and Iran. This potential conflict must be addressed by global leaders in a unified fashion. The increasing instability is exerting pressure on the price of oil which could destabilize the global economic recovery. Currently the value of oil imported in the first quarter was 3.2% of all goods and services (GDP). This is not close to the high reached in 2008 of 3.8% but it is high enough to cause concern that oil is becoming a drag on the economy. If prices were to spike higher it would cause our economy's fledgling growth rate to slow precipitously or stall completely.



While the first quarter of 2012 was stellar the rest of the year could still be stormy. A sustainable resolution to the Eurozone sovereign debt crisis, continued gains in U.S. employment and consumption and a peaceful resolution to Middle East tensions are all necessary if the year is to end on a positive note.
