



**2012: A First Quarter Review**

*A quick summary of economies & markets for you.*

Dow, +8.14%. S&P 500, +12.00%. NASDAQ, +18.67%. These numbers resemble a good year on Wall Street – and these were simply the advances from the first quarter. While stocks may or may not climb higher for the rest of the year, investors could certainly cheer the opening quarter of 2012 – the best quarter for U.S. equities in nearly 14 years.

**The quarter in brief.** In addition to remarkable stock gains, Q1 2012 was also notable for an ascent in oil futures and retail gas prices, resilience in consumer spending and the service and manufacturing sectors, and lingering ambiguity over the real estate market. The debt issues and apparent recession in Europe, the concerns over factory output worldwide, the uninspiring earnings season stateside – these concerns seemed to matter less this quarter as investors grew more optimistic.<sup>1</sup>



**Domestic economic health.** America was seeing job growth. The unemployment rate dipped 0.2% to 8.3% in January and stayed there in February – and 8.3% was the lowest jobless rate since February 2009. Non-farm payrolls swelled by 227,000 positions in February – the third month in a row with net job gains of more than 200,000 – and economists polled by Reuters think that the March report will show 203,000 new jobs in the economy. Four months in a row with 200,000 in net job gains? If it happens, that will be a factoid unmatched since 1999<sup>2,3</sup>

Consumer inflation rose 0.2% in January and 0.4% in February. By February, annualized inflation was running at 2.9% with annualized core CPI at 2.2%. Producer prices were up 0.1% for January, 0.4% in February and 3.3% annually in February (the smallest 12-month increase since August 2010). Fuel costs played a big role in all this.<sup>4,5</sup>

As pump prices climbed higher, consumer spending increased. Commerce Department data showed personal spending advancing 0.8% in February, with the January gain revised up to 0.4%. By February, the personal savings rate was down to 3.7%, the lowest since August 2009. Consumer confidence also rose in the quarter, with the final March University of Michigan survey coming in at 76.2 (a 12-month peak) and the Conference Board's March consumer confidence index at 70.2 (down 1.4 points from February).<sup>6,7</sup>

The Institute for Supply Management's manufacturing and non-manufacturing indices both stayed above 50. ISM's manufacturing gauge came in at 52.4 in February and 53.4 in March; its service sector index was at 56.8 in January and 57.3 in February. Federal government figures showed that durable goods orders were up 1.3% in February after falling 1.1% in January. Speaking of hard goods, Chrysler and General Motors reported U.S. sales respectively up 34% and 12% in March, while Ford recorded its best March sales since 2007.<sup>8,9,10</sup>

For once, Capitol Hill was a relatively quiet place. The big economic news item was the introduction of President Obama's 2013 federal budget proposal, which formally presented some of the ideas he (and his advisors) had talked about for months – a "Buffett Rule" that would set income taxes at 30% for Americans making more than \$1 million annually, increasing the top two tax brackets to 36% and 39.6%, limiting itemized deductions for those falling into those tax brackets, taxing dividends as ordinary income, hiking capital gains taxes to 20% for all taxpayers except those in the 10% and 15% tax brackets, and resetting the estate tax to 45% while keeping the personal exemption at the current \$3.5 million.<sup>11</sup>

**Global economic health.** Eurozone finance ministers arranged a third (and presumably final) rescue package of €237 billion for Greece in February – €107 billion in haircuts to Greece's bond investors plus €130 billion in loans to its government. Moreover, two cash infusions by the European Central Bank to the EU's commercial banks – one in December, another in March – aided the global stock rally seen in the first quarter. So on and off the continent, there were sighs of relief. Yet economists were in agreement as the quarter ended: the Eurozone seemed to be tipping into a recession or was already within one. The EU jobless rate was 10.8% in March (Germany, the EU's prime economy, was faring better with only 5.7% unemployment). The EU's Markit PMI was below 50 for the eighth straight month in March.<sup>12,13,14</sup>



Were Asian economies slowing down? In March, the Chinese government lowered its GDP target for the first time since 2005, projecting 7.5% growth this year as opposed to 2011's 8.0% target. China's actual GDP was 8.9% in 4Q 2011 (the smallest in ten quarters), and its inflation rate had reduced to 4.5% from the 37-month high of 6.5% set last July. As for manufacturing, key PMIs were above 50 as the quarter ended: 53.1 in China, 54.7 in India and 52.0 in South Korea.<sup>15,16</sup>



**World markets.** What was the world's best-performing major index in Q1 2012? Would you believe the Nikkei 225? The Japanese benchmark rose 19.3% for the quarter, according to the Wall Street Journal. Other benchmarks rising in double digits for Q1 2012: Bovespa, 13.7%; RTSI, 18.5%; DAX, 17.8%; KSE 100, 21.3%; PSE Composite, 16.8%; Sensex, 12.6%; Hang Seng, 11.5%; Dow Jones Global Indexes, 11.5%. Other gains from the quarter: Australian All Ordinaries, 7.5%; TSX Composite, 3.7%; Shanghai Composite, 2.9%; CAC 40, 8.4%; FTSE 100, 3.5%. The MSCI World Index rose 10.9% on the quarter; its sibling, the MSCI Emerging Markets index, climbed 13.7%.<sup>17,18</sup>

**Commodities markets.** On the whole, Q1 2012 was quite good for the broad commodities sector. Gold went +6.7%, silver +16.4%, platinum +17.0%, and copper +11.3%. Palladium actually pulled back a bit, losing 0.3% for the quarter. Gold ended the quarter at \$1,671.90 on the COMEX. NYMEX crude advanced 4.2% last quarter, which paled compared to the Q1 gains for heating oil (8.9%), RBOB gasoline (24.5%) and retail gasoline (19.8%). Natural gas futures dropped 28.9% with the warmer winter. Oil ended the quarter at \$103.02 a barrel, unleaded gasoline at \$3.93 a gallon. As for headline crops, wheat went +1.2%, cotton +2.4%, corn -0.4% and coffee -19.4% in the first three months of 2012. The U.S. Dollar Index (though it strengthened in March) lost 1.7% for the quarter.<sup>19,20</sup>

**Real estate.** Was the market improving? Or at least ready for a turnaround? Optimists could take heart in some compelling statistics. By February, existing home sales were up 8.8% year-over-year and 13% improved from July, according to the National Association of Realtors. NAR also found that the sales pace in January was the strongest since May 2010, and home prices rose for the first time in four months in February. The Commerce Department noted that February's new home sales were up 11.4% from 12 months ago; February also brought the greatest number of requests for building permits since October 2008. By February, NAR had pending home sales 9.2% improved from a year prior. However, the January S&P/Case-Shiller Home Price Index (which came out last month) showed that home prices had fallen 3.8% year-over-year, with prices essentially resetting to early 2003 levels.<sup>21,22,23,24</sup>

Across the quarter, there was really very little change in mortgage interest rates. Comparing Freddie Mac's Primary Mortgage Market Surveys of December 29 and March 29, we see mortgage interest rates moving like so: 30-year FRMs, 3.95% to 3.99%; 15-year FRMs, 3.24% to 3.23%; 5-year ARMs, 2.88% to 2.90%. Interest rates on 1-year ARMs were averaging 2.78% in both snapshots.<sup>25,26</sup>

**Looking back ... looking forward.** Climbing above 3,000 for the first time since the dot-com boom, the NASDAQ had its best quarter since 1991. The Dow ended the first quarter by advancing for a sixth straight month. The Russell 2000 gained 12.06% for the quarter and the CBOE VIX (the "fear index") fell 33.76%.

% CHANGE	Y-T-D	1Q CHG	1-YR CHG	10-YR AVG
DJIA	+8.14	+8.14	+6.97	+2.70
NASDAQ	+18.67	+18.67	+11.34	+6.75
S&P 500	+12.00	+12.00	+6.04	+2.28
REAL YIELD	3/30 RATE	1 YR AGO	5 YRS AGO	10 YRS AGO
10 YR TIPS	-0.09%	1.00%	2.21%	3.48%

Sources: cncb.com, bigcharts.com, treasury.gov, treasurydirect.gov - 3/30/12<sup>1,27,28,29</sup>  
Indices are unmanaged, do not incur fees or expenses, and cannot be invested into directly.  
These returns do not include dividends

So how much of these gains can stocks hold? It may be that the momentum generated by the market in the first quarter persists – appetite for riskier assets has increased worldwide along with investor optimism, and it may not be easily or readily doused. Then again, the data stream from the U.S. is really encouraging for foreign investors at a time when indicators from their regions are underwhelming. Spain and Portugal are still question marks in the Eurozone, even after the two sizable cash injections into the European banking system by the ECB and March's hike in the region's bailout fund reserve to €700 billion. So fingers are crossed that the U.S. bull market can weather a potential Iberian debt debacle come spring and summer.<sup>1</sup>



Can the market keep this up for just a little longer? At the start of July, We'll send you a second quarter review looking back at what might be a pivotal quarter for stocks this year. Should you have any pressing financial questions or concerns in the meantime, feel free to contact us at 425.455.6623.

Sincerely,  
Larry (Lars) Knudsen and Dan Stober



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