

A Year of Challenge & Change

I don't have to tell you that there is continuing concern about the economy and the financial markets - in this country and abroad. But I do believe there are some bright spots ahead in 2012, and that while our economy and financial markets will continue to face substantial challenges, we will begin seeing welcomed improvements in the year ahead.

You may not hear much about it on the news these days, especially with all of the political coverage in the run-up to the 2012 election, but the fact remains that what is happening in Europe is of great concern for us. And, quite frankly, it is not heading in the right direction.

Greece has been in trouble for many months and with its mounting debt, it's certainly possible that its economy will fall apart this spring. [Efforts in that country are intensifying now](#) to keep the economy from collapsing. And, there are [new warnings](#) that financial reforms must be put on the fast-track in order for Greece to avert disaster.

There are additional serious concerns overseas. The International Monetary Fund (IMF) repeatedly has cut its global forecasts for growth and has warned of a deeper downturn if Europe doesn't take stronger action to stem its debt crisis. The IMF now says [Europe's debt crisis could tip the world economy into recession](#).

[Unemployment in the 17 countries](#) that are part of the Eurozone monetary system is at an all-time high. [Manufacturing activity in Europe](#) continues to decline. Just last month, Standard & Poor's downgraded the financial ratings of 9 out of the 17 member countries.

The next two to three months will be critical in determining if Italy, Spain, and Portugal will be able to finance their government debt with successful bond auctions. To keep afloat, Eurozone governments must rollover 1.2 Trillion Euro's worth of debt in 2012.

Will the markets buy this debt? To make that happen, these countries will have to pay higher interest rates for their bonds to attract investors. It's a cycle of paying out more than you bring in - a scenario that most economists simply believe is not sustainable. The debt crisis facing these countries is crippling and has global ramifications.

Don't be fooled by what you hear in the news. Many say that what is happening in Europe really doesn't affect the U.S. economy. Not true. This is a global system. Our economy simply cannot be "uncoupled" from Europe.

Due to the problems in Europe, I believe we must continue to exercise caution with investments in the first and second quarters of this year.

That said, there are bright spots in the U.S. economy and signs that improvements may continue.

- Our economy saw better than expected growth in the 4th quarter of last year. [Manufacturing and construction are up](#). Auto sales are improving, with [Chrysler having its best January in four years](#).

- The stock market has surprised just about everyone this January with the S&P index gaining 4.8%.
- More than 90% of economists think home prices will finally bottom out by the end of this year.
- The Federal Reserve won't raise interest rates until at least 2013.

Don't get me wrong - there are still serious issues with our economy. [Unemployment](#) remains stubbornly high. U.S. debt is still a grave concern. With our debt at \$15 Trillion and growing, Standard & Poor's issued a [new warning](#) raising questions about whether it will once again downgrade U.S. credit, something that happened last summer for the first time ever.

With an election year, and an intense campaign for president, all eyes will be on Washington. Political gridlock will continue - likely resulting in ambiguity about healthcare, taxes, and trade policies.

Make no mistake about it, [the economy is THE issue this election year](#). As one financial analyst put it: "Not since the (Ronald) Reagan vs. (Jimmy) Carter election in 1980 have the stakes been so high for the markets and economy."

Historical data suggests that the stock market does well in an election year. [According to one financial almanac](#), election years have averaged a 5.8% gain in stocks. In fact, 29 out of those 44 election years have resulted in gains for the Dow Jones Industrial Average.

What will happen this year? There's no clear answer. Much depends on the growing economic problems abroad, a slowly strengthening U.S. economy, and a significant election. We now live in a financial world where so much can happen, so quickly.

If Europe can survive the upcoming economic storm, the second half of this year could provide some interesting investment returns. I believe that investments in defensive stocks that pay dividends will continue to be the bright spot for stock returns.

We will continue to provide you with the best information and advice available. We believe that the most important asset is you, our client.

If you have any questions or concerns, please don't hesitate to give us a call.

Sincerely,

George

George M. Kapusta, CFP
President