

## MARKET TRENDS 6/30/12

<u>US Stock Markets</u>	<u>YTD</u>	<u>Q2</u>
S&P 500 Index	9.49%	-2.75%
S&P MidCap 400 Index	7.90%	-4.93%
S&P SmallCap 600 Index	7.98%	-3.58%

<u>Int'l Stock Markets</u>		
EAFE Index	2.96%	-7.13%
Emerging Mkts Index	3.93%	-8.89%

<u>Fixed Income</u>		
Barclays Intermediate Gov't/Credit Bond Index	2.10%	1.48%
Barclays Capital Muni Bond 3 Year Index	1.29%	0.53%

<u>Commodities</u>		
SPDR Gold Shares (NAV)	1.33%	-3.94%
Goldman Sachs Commodities	-7.23%	-12.38%

<u>Real Estate</u>		
Dow Jones US REIT Index	15.02%	3.83%

<u>Yields</u>	<u>6/30/2012</u>	<u>12/31/2011</u>
T-Bills	0.08%	0.01%
10 Yr UST	1.58%	1.88%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

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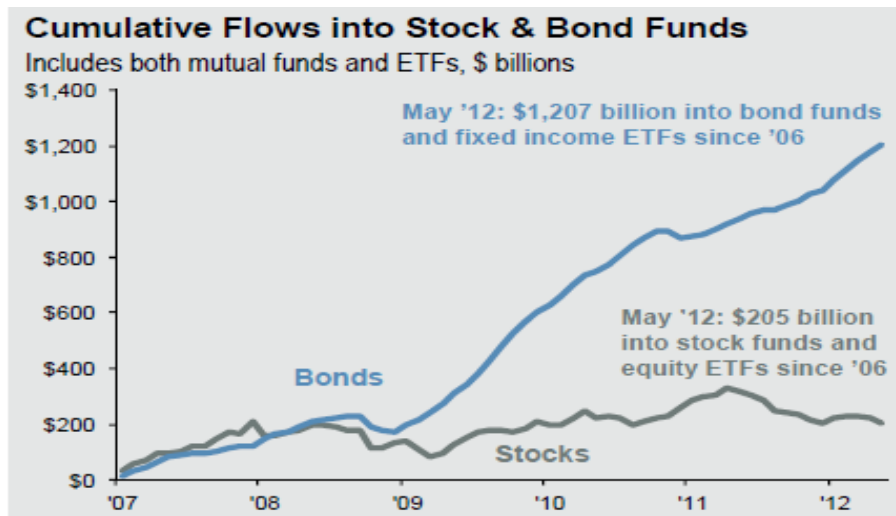
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## Newsletter – July 2012

### Second Quarter Market Recap

As we mentioned in the last newsletter, an unsurprising correction (a 10% drop in the S&P 500 from its 2012 highs) occurred in the second quarter. The main causes of the pullback were increasing evidence of slower global economic growth and sovereign debt concerns spreading to Spain and Italy with 15 Spanish banks downgraded recently by Moody's. Elections in France and Greece highlighted the political discord in Europe and the conflict on how to address the debt crisis – austerity and/or tax increases.

Domestic equity markets were led down by mid caps -4.9% and small caps -3.6%, while the S&P 500 Index was -2.8% for the quarter. However, all three are solidly up for 2012 with the S&P 500 Index +9.5%, S&P Mid Cap Index and S&P Small Cap Index +7.9%. International equity markets suffered the steepest losses in the quarter with developed markets -7.1% and emerging markets -8.9%, while still in positive territory for the year, +3% and +3.9% respectively. Overall, domestic equity mutual flows continue to be negative, which has been a 7 year trend!



Source: Investment Company Institute, J.P. Morgan Asset Management.

Domestic bonds produced relatively strong results in the quarter and continued to receive the vast majority of cash flow into mutual funds, even as yields remain at multi-decade lows. Money market mutual funds, with a yield close to zero, continued to experience significant outflows – likely to bond mutual funds. Of the main investment alternatives, real estate had another strong quarter, rising 3.8% and up over 15% for 2012. Gold retreated -3.9% and seems to be more highly correlated to the equities markets than expected. The global economic slowdown hit commodities severely with the broader commodity basket -12.4% in the quarter and oil -25% from its 2012 April high.

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*“...why put money to work in stocks:*

- *stocks are hated*
- *clients need income*
- *other asset classes look worse.”*

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### Commentary

The primary catalyst for the second quarter correction was the continued fear regarding the ill health of sovereign balance sheets in Europe and Germany's stand-off with the various debt-laden countries needing support - Spain and Italy most recently. In addition, the US has shown significant, disconcerting data on the short term health of its economy, which seems to be at least sputtering, as evidenced by the weakening jobs and manufacturing reports heading into the summer. Moreover, corporations are reducing their sales and earnings expectations for the second quarter and for the rest of 2012 due to weak global demand primarily in Europe and the strength of the U.S. dollar. Another major worry is the deceleration in China's economy, although still a strong 7.6%, as weak global demand is taking a toll on China.

With no particular positive catalysts upcoming, we are often asked why we would be putting money to work in stocks, a question for which we have many answers:

- **Stocks are hated** - As we mentioned, the seven year outflow from stocks is not sustainable, valuations for the S&P 500 Index are already factoring in a recession and Wall Street analysts are very bearish – these are all contrarian indicators and generally a good time to be buying/adding to stock positions of high quality, dividend paying stocks.
- **Clients need income** - The aging and retirement of baby-boomers is increasing the need for income in this low interest rate environment. Dividend paying stocks are paying higher dividends than interest on government bonds and cash with the opportunity for dividend growth. Also, dividend paying stocks have outperformed the broader market and provide more stability and lower volatility over the long-term. We have begun to show the projected income of accounts on our quarterly report and online on the Tamarac reporting system.
- **Other asset classes look worse** - Cash earns zero; US Treasuries are paying interest at a 50 year low, and they trade at a value almost 5 times that of stocks; bonds are vulnerable to higher rates and lower prices as are real estate investment trusts due to their historically low yields.

At times like these we often turn to Warren Buffett to keep our heads. He has said over the years that investing is simple, but it is not easy. The Buffetts buy hamburger meat when it goes on sale, and they try to do the same when stocks are cheap. Most Americans do just the opposite as May equity fund outflows demonstrate. They sell when prices are falling. Most individual investors do considerably worse on their own because emotion is a key component of investing. Our emotions are constantly churning and often cause us to make poorly timed choices with our own money.

## Identifying Opportunity. Navigating Risk.

***“The current valuation of stocks is below recession levels.”***

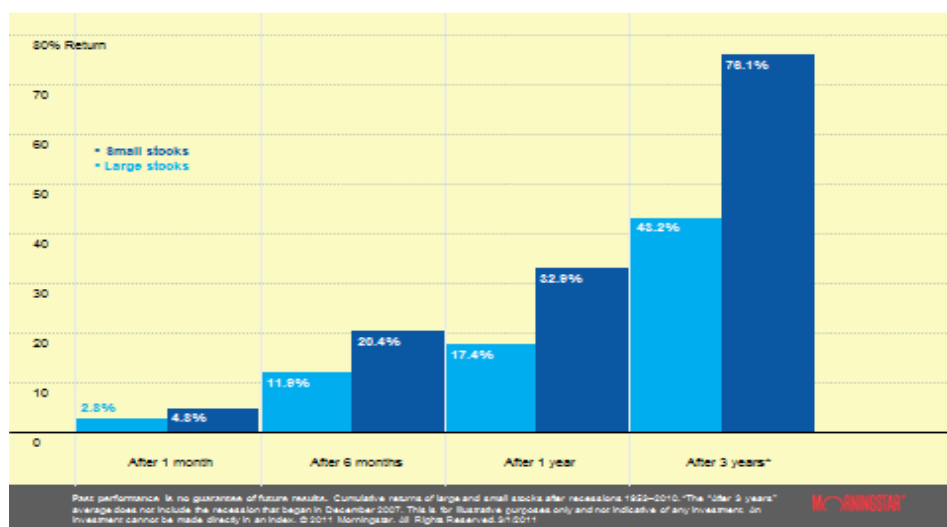
***“...you hired us to look after your interest over the long term and not to ‘time the market’- something we do not think can be done effectively and consistently over time.”***

***“The popular financial press seldom helps individual investors, and that frustrates us because it is counter to what we try to do each day.”***

The current valuation of stocks is below recession levels. P/E's (price to earnings ratios) are indicating that the stock market anticipates the US heading into a recession. If one watches CNBC, or other popular financial television, one would expect us to say we should be heading to the sidelines for stocks. You can hear these types of “market calls” at any moment from allegedly professional investors. In fact, this type of short term mentality finds voice from white shoe investment firms like Goldman Sachs, a firm which recently called for its clients to consider shorting the market because the firm expects a 5% drop before the end of 2012. We at Shorepoint think this type of investing is lunacy for individual investors with serious long term capital on which they depend. We are contrarian by nature and by discipline. We are willing to risk looking wrong in the short term, if we believe that it is the right thing to do for you, our clients. After all, you hired us to look after your interest over the long-term and not to “time the market” – something we do not think can be done effectively and consistently over time.

Recessions are often periods in which we do better to at least hold stocks until rational pricing returns, or even, gasp, to buy more equities. We realize that our view is not in common with the trading mentality that currently rules the airwaves. But the number of decisions made once one starts trying to time the market compound. When do you get out? When do you get back in? Do you get back in all at once (rarely) or in some faux scientific incremental process? What about the transactional cost of moving in and out of the markets and the potential for unwelcome tax effects? Short term gains are taxed at around 40% which sets an even higher hurdle for an approach to investing that we consider fraught with danger. The popular financial press seldom helps individual investors, and that frustrates us because it is counter to what we try to do each day. Better to think of ourselves as gardeners weathering storms and drought, paring back the mint when it grows too wildly and making small adjustments to plantings, soil and exposure to the sun with knowledge gained over years rather than micro-seconds.

**Stock Performance After Recessions  
1953–2010**



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*“The Euro Zone seems intent on addressing these problems only when absolutely at the brink.”*

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We are not calling for a recession, but we aren't sure that the cataclysmic view of what will happen to us and our investments if a recession occurs is warranted- in fact just the opposite. Again, we understand that our view is not common or supported by shouters on CNBC, but we think it is right and appropriate and serves clients well over time. Our knowledge isn't faith based – see the previous graph. Stocks tend to bounce back nicely after hard times. We think the odds of the contrarian approach working are high over time, offering hard wrought success borne from simplicity. People are most emotional and wrong as a group at extremes. It should be simple to buy when others are selling. Is it lonely? Yes, and not easy to do.

The main risks to our positive view have not changed:

- **Global Economic Slowdown:** Economies in the US, Europe, and Asia have all shown signs of a slowdown, but the magnitude is unknown at this point. This was a primary reason for the second quarter corrections in global equity markets and remains a risk. The China slowdown continues to be a concern with the latest quarter coming in at 7.6%, which is strong by global standards, but a three-year low for China.
- **European Debt Crisis and Economy:** Debt crisis concerns resurfaced again in the quarter, but instead of worrying about Greece, investors focused on Spain and Italy, which are much larger economies and thus potentially much more significant problems to address. Both countries have seen their government bond interest rates approach 7%, which, if sustained, would impair their ability to fund government expenditures. The Euro Zone seems intent on addressing these problems only when absolutely at the brink. We continue to monitor the situation and believe that Europe will be forced to address and solve the issue, but we will have periods of increased volatility.
- **US “Fiscal Cliff” and Presidential Election:** As of now, the US is set to experience a “fiscal cliff” at the end of 2012 – a significant tax increase and required spending cuts. If no action is taken, the results of these fiscal actions would likely push the US into a recession. We expect that the political posturing will subside, but probably not before the election, and some compromise will be enacted to head-off this “fiscal cliff”. The contentious US Presidential Election will also add to market volatility, and the level of uncertainty has heightened and is further slowing the economy. The NFIB Small Business Optimism Index in June dropped across the board for the first time since the 2008 recession – dampening business hiring and spending.

### **Conclusion**

With the many factors facing the markets in 2012, we would not be surprised to see the market end the year at about the current level but with many ups and downs. We will be disciplined and try to identify opportunities to position your portfolio for the future with consideration of your individual goals and objectives. We continue to favor owning and adding on pullbacks to high quality dividend-paying stocks that we believe will perform better in a slow economic environment.