Welcome to 2012!

We leave one crazy financial year behind and begin what should prove to be another!

There's an old adage about the safest way to commute being on a rollercoaster. Even though it goes through twists and turns, and can even go upside down, it is generally safe and always gets you back to where you started. Unfortunately, at the end of the commute you have not advanced at all and the ride cost you money. Looking back over 2011, this seems like an appropriate description. Looking forward to 2012, it looks like more of the same, without knowing exactly where it will end!

While unemployment has fallen slightly, the US economy is replacing high paying jobs with low paying jobs. A recent study from Rutgers University ("Out of Work and Losing Hope", Zukin, Van Horn, and Stone, September 2011) shows that of the people who lost jobs in 2008-2009, 52% of them took a pay cut when they found a new job. Of course, this only applies to those that found a new job, which was roughly 43% of the group. That's not good news for those who lost their jobs, and it is terrible news for those just entering the workforce. It is this pressure that is keeping wages low, which ripples through the economy in the form of lower spending, less use of credit, and a generally higher level of repayment delinquencies and foreclosures.

On the real estate front there are competing forces. Builders have been selling more new homes, but at lower prices. This could be the normal outcome of having builders sit on empty land for years. Eventually they have to build homes in order to get rid of their raw land. If the way to do this is by selling at lower prices, then so be it. However, this has a huge side effect; it puts even more downward pressure on existing home prices, which have continued to fall in price for another year.

These types of macroeconomic issues would generally be enough to cause a stall in equity prices, but lately there has been an up-tick as large companies have posted decent profits. Among these companies are large multinational firms that earn significant portions of their revenue outside of the US. With Europe on the ropes and China slowing down, the outlook for foreign revenues has dimmed.

What all of this means is that the financial crisis of 2008 has yet to be fully addressed. There have been continual government programs meant to push the economy higher, only to have limited, if any, success. The same is true in Europe and even in China. The secret source of all of our woes is not very secret at all – it's debt. We have too much debt in the US, the Europeans are certainly weighed down by it, and the Chinese are just now revealing the massive amounts of debt that were used to propel their economy higher over the last few years. Until there are clear plans for dealing with all of the debt, the rest of the programs that are being implemented or discussed will have limited positive affect. To us as investors, this means another crazy year of tumultuous market moves, punctuated by government pronouncements and, most likely, more failed policies.

The act of investing has become much harder in the last four years, but that does not mean that we can shy away from it. Now, more than ever, investment discipline and the hard work of research and education show their worth.

Sincerely,

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