Q1 2012 Commentary

The stock market just had its best first quarter in 14 years. The Dow was up 8%, the S&P increased 12% and the NASDAQ was up nearly 19% in what turned out to be a truly remarkable quarter.

Stock performance was driven by a stream of favorable U.S. economic data that was much better than expected. A seemingly overnight drop in the fear factor of a European financial melt-down diminished, and the market rallied as a result. The market's performance is somewhat perplexing in that nothing fundamentally changed over the New Year holiday. The same headlines (i.e. Greek debt crisis, fear of China's economy slowing and high domestic unemployment) are still in the news, but the market's reaction was vastly different than in 2011.

Fourth quarter 2011 corporate earnings were again very robust. Corporate profits have been strong for the past three years. Companies have been operating as leanly as possible, and it is getting more difficult to get profits through cost cutting measures. We may see profit margin expansion slow as companies will be forced to hire more workers to keep up with sales. This is good for the overall health of the economy. We may already be seeing the employment picture improving as more than 200,000 jobs were added in the last three months, with broad based gains across all industries.

Toward the end of the quarter, the Federal Reserve suggested that improvement in the job market might not be sustainable without stronger economic growth. The Fed signaled it would work to keep interest rates low. As a result, the market rallied behind the notion that the low rate environment will continue.

In mid-March, the health of China and the broader Asia Pacific region took center stage. Signs of economic fatigue and worries of a "hard landing" in China weighed on stocks. China trade numbers were disappointing; domestic car sales were lower, steel and cement production were down and an increasing fear of a property bubble were on the minds of investors. China is facing some hurdles in its export driven economy and is looking internally to consumer demand to help growth. Any additional signs of China weakness could send shudders through the global stock market.

For the first time since 2005, investment in residential real estate (home building and renovation) actually contributed to U. S. economic output. This is positive, but as housing is now a much smaller part of the U.S. economy after the 2008 financial crisis, the actual effect from improvement has much less impact.

Over the years, technology has been one of our mainstay investment themes. The proliferation of mobile devices, laptops, ultra books and the adoption of "cloud computing" will definitely keep that theme intact and present numerous new investment ideas going forward. The strong market in 2012 has also encouraged many companies to go public. We welcome these new public companies as they present new cutting edge technologies.

Despite disappointing news from China and Europe, the market was never down more than 1% in a trading session. That is a far cry from last year's unsettling trading volatility.

Risk still remains in the market. Risk associated with a European debt crisis flare-up, less stimulus from the Federal Reserve, consumer spending pressure associated with higher gasoline prices and a resurgence in political headwinds as we head toward the Presidential elections could stall the rally.

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