

The French mathematician and philosopher Blaise Pascal once said that contradiction is not a sign of falsity, nor the lack of contradiction a sign of truth. Considering that most national and international news has been filled with contradictions for the past few years, this perspective gives us hope that not all is lost. Yet, it is still hard to know whether to feel frustrated and skeptical, or hopeful and excited, about the year to come. As 2011 came to a close, positive news about the economy had Americans feeling upbeat. GDP expanded at a rate of 1.8% in the third quarter, consumer spending was on the rise, and initial jobless claims were down significantly in the week ending December 10. The unemployment rate declined to 8.5% in December. Housing starts were up 9.3% for November compared to the prior month and building permits were up 5.7%. The elation was tempered by the likely possibility of a recession in Europe and global economic woes. GDP expanded, but not as much as analysts were predicting. The lower unemployment rate could be partially explained by the fact that Americans have become discouraged and have stopped looking for work altogether. The housing market is still shackled by foreclosures. Economists predict that consumer spending will slow considerably in 2012 as growth in personal income should remain fairly flat. No matter which way you slice any of these topics, it is a mixed bag.

### Investment Scoreboard

Despite the rallies and retreats of 2011, the market ended the year no worse off than a year ago. The Dow Jones Industrial Average (DJIA) gained 5.5% and the S&P 500 stayed put with a negligible loss of 0.003%, while the Nasdaq Composite slipped 1.8%. In relative terms, U.S. markets outperformed other developing markets with many European and Asian markets experiencing double-digit declines. The following table highlights the average annual returns for various indices:

Index	4th Qtr	1 Year	5 Year	10 Year
S&P 500 (Composite Total Return)	11.82%	2.12%	-0.25%	2.92%
Russell 2000	15.48%	-4.18%	0.15%	5.62%
MSCI EAFE (Price)	2.86%	-14.82%	-7.40%	2.03%
Barclays Aggregate Bond	0.93%	7.67%	6.55%	5.66%

*The S&P 500 is a commonly used measure of common stock total return performance, the Russell 2000 is a commonly used measure of small capitalization stocks, the MSCI EAFE is a commonly used measure of common stock total return performance of international markets, and the Barclay's Aggregate Bond Index is a commonly used measure of the bond market. All referenced indices are unmanaged and not available for direct investment. Past performance is not a guarantee of future results.*

### Occupy Wall Street

One of the major polarizing topics of the fourth quarter of 2011 was the Occupy Wall Street movement. What started as a small gathering in Zuccotti Park (NY) quickly expanded to over 100 other cities, from Boston to San Francisco. "We are the 99%" became the political slogan for the movement intent on drawing attention to economic inequality, the impact of corporate power over the democratic process,

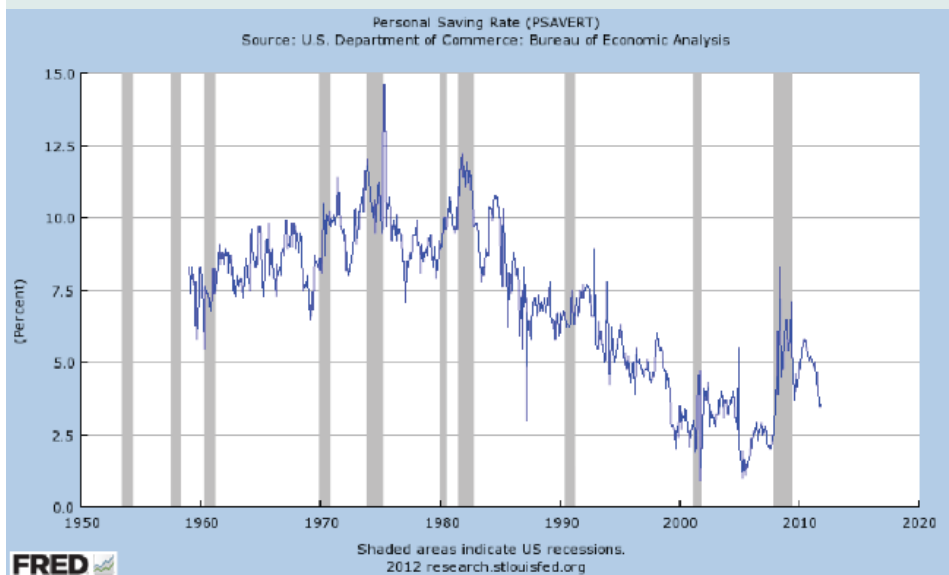
### Deficit Supercommittee Fails to Agree

On November 21, 2011, the supercommittee tasked with cutting an additional \$1.2 trillion from the deficit announced that it had failed to reach an agreement. "After months of hard work and intense deliberations, we have come to the conclusion today that it will not be possible to make any bipartisan agreement available to the public before the committee's deadline," said co-chairs of the supercommittee, Rep. Jeb Hensarling, R-Texas, and Sen. Pat Murray, D-Wash. The fallout of this announcement was felt far and wide, leaving an unsettled political picture. Wall Street also reacted strongly to the news with the DJIA losing more than 248 points. Democrats and Republicans disagreed on several issues, but the main roadblock was taxes. The debt panel's failure triggers deep, automatic cuts to the Pentagon's budget, beginning in 2013. Medicaid and other domestic programs will bear cuts as well. Some members of Congress talked of writing up a bill to unwind the automatic spending cuts, but President Obama pledged to veto any such attempt: "I will veto any effort to get rid of those automatic spending cuts to domestic and defense spending. There will be no easy off-ramps on this one. We need to keep the pressure up to compromise, not turn off the pressure," he said in a press conference held after the announcement. "The only way these spending cuts will not take place is if Congress gets back to work and agrees on a balanced plan to reduce the deficit by at least \$1.2 trillion."

and the role of Wall Street in the recession of 2008. As the movement grew, so did the tensions caused by disruptive protest tactics and mounting violence in some of the Occupy camps. Some of those who opposed the Occupy movement created a group of their own called “We are the 53%” which focused on stories of personal responsibility and work ethic. The “53%” number stems from an estimate from the non-partisan Tax Policy Center that roughly 47% of Americans did not pay federal income taxes in 2009, leaving 53% to pay taxes that support government assistance programs. Despite the simplistic math on taxation, this group’s overall message is that Occupy Wall Street protesters failed to take personal responsibility, and blame their economic troubles on others at the taxpayers’ expense. Interestingly, data from a Gallup survey conducted between November 28 and December 1 indicates that while 46% of Americans believe it is important that the federal government reduce the income and wealth gap between the rich and poor, 70% say it is important for the government to increase equality of opportunity, and 82% say it is important for the government to grow and expand the economy. A separate Gallup survey question addressed whether “the fact that some people in the United States are rich and others are poor” is a problem that needs to be resolved. The survey found a slight majority of Americans (52%) now say that this gap is an acceptable part of our economic system compared to the last time Gallup asked the question in 1998, when a slight majority of Americans said that such inequalities needed to be fixed.

## Holiday Spending

Record Black Friday sales numbers and a last-minute surge in spending were the hallmark of this holiday shopping season. However, sales barely simmered in the weeks between Thanksgiving and Christmas. Even so, consumer spending was up compared to the same period in 2010. As 2011 came to a close, Americans seemed less inclined to accumulate a “rainy day” fund, as depicted in the following graph from the Federal Reserve. Albeit not at its all-time low, the personal saving rate is significantly lower than it has historically been.



During a recession, the personal saving rate (as a percentage of disposable personal income) typically goes up as consumers reign in on discretionary spending. With holiday sales up more than 3% compared to last year, and personal incomes remaining essentially flat, some economists worry that consumers are spending beyond their means. How this will impact spending in 2012 is anybody’s guess, but forecasters predict that consumers will feel the need to bank more of their pay, and spending may suffer in 2012.

## Economic Outlook

The operative word used abundantly in recent news articles is “modest”. The words “strong” and “robust” have essentially been eliminated from many economists’ vocabulary when used to describe the economy. There is a general consensus that the economy will pick up slightly in 2012, but only “modestly”. The biggest hurdles to recovery in 2012 are slow job creation, government cutbacks and weak global economic growth.

Job growth remains a central focus of the economic recovery. Positive news about the employment situation at year-end was somewhat tempered by the fact that sixteen states noted a decrease in the number of people looking for work, which produced the largest declines in their unemployment rates. Furthermore, the sagging housing market has heavily impacted job growth; states that have been hit the hardest by the housing slump continue to experience elevated unemployment.

Despite being battered and bruised, the U.S. economy just keeps getting back up. The Conference Board’s Consumer Confidence Index® closed 2011 at 64.5 (1985=100), up from 55.2 in November. Americans’ confidence about the future course of the economy has improved since the August debt ceiling debate; however, it is too early to tell whether this represents a true shift in attitudes.

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