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Greetings,

In 2011, very little if anything worked. With all the negative headlines coming out of Europe as well as the total dysfunction with the politicians in Washington D.C., equities didn't trade on their fundamentals. In 17 years as a professional investor, I was more active than I ever was. I made a bold call to raise a significant amount of cash at just the right time. If I hadn't made that call, your returns would have been worse than it was. Since 1928, in a given year, the S&P 500 has only had a -5% or plus 5% return nine times. The average S&P 500 return in years following those nine flattish years was 26.3%.

The negative headlines continue to come out of Europe almost every day. As bad as things are in Europe, there are signs of stability. One of the problems is that the steps that are being taken over there aren't being taken quickly enough. People want instant gratification. What market participants wanted from the ECB (the ECB is the European Central Bank) was the Big Bazooka. The market wanted something at least remotely similar to what Ben Bernanke did 2 ½ years ago as the domestic economy was on the verge of collapse. It wanted something that resembled TARP or some kind of quantitative easing where the ECB would buy the sovereign debt (bonds of the countries like Italy and Spain) to add liquidity to the markets and bring down the interest rates of the European countries. What the market got was mostly a lot of talk from the European bureaucrats rather than decisive action. What little action that was taken resulted in the best day that the market had in several years. That action was that the Federal Reserve would join with China, Canada, the U.K. and over a dozen other countries to provide necessary liquidity to the European banks, which are in big trouble. When the market rose by 400 points in one day in the middle of November as a result of that announcement, it was a pleasant reminder that all the market needs is just some decent news out of Europe to send it soaring.

While things don't look promising in Europe, the U.S. economy continues to show steady improvement. The labor market has even showed some modest improvement. Jobless claims have been decreasing each week. The unemployment rate dropped to 8.6% last month. Believe it or not, it's the first time that the unemployment rate is below 9% in more than two years. The sudden drop is deceiving because more people are leaving the work force. Nevertheless, the number of jobs that are being created each month continue to rise so the trend is up. There are also other areas of the economy that have shown more improvement than the labor market. Retail sales are looking better as the past Christmas season was the best since 2007. New building permits and new home sales are at their highest levels since March 2010. Existing home sales rose by 4.0% in November which was much better than the 1.6% that was expected. The November index of leading indicators rose by 0.5% which was better than what was expected. The Commerce Department just reported that durable goods sales jumped 3.8% last month which was also much better than the 2.2% that was expected. Consumer confidence is improving. Just a few days ago, I had an interesting conversation with a good friend of mine and I mentioned all of this better than expected news and he couldn't understand how things could be improving. One answer I was able to give him is that the comparisons to the previous year are easy since things were much worse in 2010. Let's face the facts; if your child (or grandchild) came home with all C's on his or her report card, you wouldn't be very happy. But if his or her last report card had all D's, then all C's would be some improvement. That is the way I look at the economy now in that while it isn't good, it is a heck of a lot less bad than it has been the last couple of years. Personally, I would give this economy a C+. Another answer that I thought of is that things are improving because the consumer is pretty much done deleveraging. Much of the reason why the economy was so bad in 2009 and 2010 was that instead of spending much of what was earned, they were paying down debt because people got so much into debt from 2004-2008. Now that the consumer has spent a couple of years or more paying down debt, there is more cash flow from earnings available to be spent and to be put back into the economy, hence the improved news. That is why, among other reasons, I find this stock market so frustrating. There is now only a remote chance of the U.S. economy going back into a recession. The trend in all areas of the economy is up, despite the dysfunctional political environment. When I was growing up, I remember my Dad more than once liked to use this expression in reference to other people (he still does now, on occasion) "don't confuse me with the facts because my mind is already made up". That seems to apply to the way that many people feel about the stock market now. Despite all the positive signs of improvement in the domestic economy, all of the focus now is on the yields of Italian and Spanish bonds. What is even crazier is that consumer confidence in Germany and the U.K is improving. What is happening is that very few people want to be confused with all the facts that show that the U.S. economy is improving, because the vast majority of people have made up their minds that everything is horrible, and the economy and the stock market will continue to stay horrible. The economic data (translation, the facts) show otherwise.

Believe it or not, the mess in Europe has been going on for a year and a half. When it first started, I couldn't help hearing all the prognosticators, talking heads and naysayers predict that corporate profits would suffer in 2011. Well, lo and behold, corporate profits in 2011 were better than ever. Guess what? The same people along with some other naysayers who like to pile on, who said a year ago that corporate profits would be disappointing in 2011 are saying that corporate profits won't meet expectations for 2012. Since things have been so bad in Europe for the past year and a half, you would think that if corporate profits would have gotten hit, then they would have gotten hit already, right? If not, then what am I missing here?? If anything, with the U.S economy showing signs of life and Europe possibly showing signs of stability sometime in 2012, I don't see any reason why corporate profits won't do better than the expectations as they have been doing the last two years as opposed to being a disappointment. As an example, Federal Express recently reported better than expected earnings and gave very good guidance for 2012. Many people consider Federal Express a proxy for the global economy. Let's put our thinking caps on for a minute. If things were so horrible with the global economy, then how could Federal Express possibly be putting up such good numbers and give good guidance? It just makes no logical sense. The main reason the market is doing so poorly is that instead of focusing on how well companies like Federal Express are doing, the focus has been on the yield of Italian bonds and the slowdown in China.

Ultimately, stocks do trade on their fundamentals. It's a matter of when, not if. Unfortunately, since so many people are losing patience and are so frustrated with the stock market (and rightfully so), they are letting their emotions get the better of them. I wish that I had $10, or in Mitt Romney's case, $ 10,000,(if you don't get this line, let me know because it was from one of the debates) for every person that I have heard say that I will go into the market once I see things get better in Europe, or when the U.S economy improves, or when we know what is really happening in China. While that strategy may sound wise in theory, in reality it is counterproductive to making money. It is counterproductive because the market is not only forward looking but it moves very quickly. The people who are waiting, which are the masses (that is why there is so much cash on the sidelines while cash has a zero return and one reason why stocks are so cheap) will wind up eventually buying companies at expensive prices (a few lucky ones may buy a company or two at reasonable prices) as opposed to buying them at cheap prices which is what we have done. As the market rebounds, we are in a great position because we purchased so many quality companies at cheap prices.

If you have any questions or if you have anything that you want to discuss, please either call me or send me an email.