MARKET PERSPECTIVES

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Written By: *Peter J. Altman, President*

33 Witherspoon Street
Princeton, NJ 08542
Tel: 609-252-0048
paltman@altman-investment.com

Although Cash is tempting during times of uncertainty, a willingness to act on long term conviction rewards patient investors - otherwise we are at the mercy of fashion.

While some investors will move money in and out of various securities in an attempt to position their portfolios in the best way possible given a particular political outcome, others may be so fearful that they decide to go to cash. However, the current negative real interest rate environment (after accounting for inflation) ensures that investors who choose cash as an alternative are locking themselves into a negative return. The macroeconomic outlook in the U.S. has improved over the past several months and risk aversion has declined as policymakers have made further progress in Europe. However, we believe that significant challenges, such as banking sector deleveraging and fiscal policy constraints, continue to be a drag on the global economy and put a cap on equity markets in the shorter term.

A Stable and Improving Macroeconomic Outlook:

The U.S. economy has grown below trend by an annualized rate of 2.0% quarter over quarter in Q3, as measured by real GDP growth, versus a 1.3% rate in the second quarter. The report, however, suggests to us that U.S. activity remains positive in the context of a modest growth environment. Many statistics related to consumption (70% of the economy), as well as housing, have been stronger recently whereas capital spending related statistics have been weaker, including corporate profits. After eleven quarters of increasing earnings, the third quarter is expected to show a modest decrease in profits of about 2% from year-ago levels. The more cyclical sectors would be somewhat more vulnerable in the short run as materials and energy companies could report larger decreases. One might add that the rapid change in technology to mobile devices from personal computers has also led to some significant earnings revisions in sub-industries, with increases in mobile device manufacturers and decreases in personal computers. Many companies are also experiencing modest declines in revenues for the first time since the economy began its recovery in June 2009. As a result of the above forces, combined with the political need to address the fiscal cliff against the background of the election, the economy still faces significant challenges.

Our expectation remains that economic growth will regain its footing and approximate 2.3% for the year. The Federal Reserve's recent announcement of additional quantitative easing places an upward bias on the inflation rate. The fall in the U.S. dollar index also supports the case that the rate of inflation should move higher as we move into next year. The current monetary expansion by the Federal Reserve reinforces Chairman Bernanke's stance to continue this course until he believes that the unemployment mandate has been fulfilled. At present, the price stability mandate has been capped at 2% inflation. As a side note, it will be interesting to see what happens to the Federal Reserve monetary policy if inflation rises significantly above that level. The European recession and the slowdown in China have contributed to the inflation rate moderating in 2012, as well as acting as headwinds for economic growth in general.

The Conference Board's index of leading U.S. economic indicators in September reversed the prior month's trend by rising 0.6%, its largest increase since February. After some weakness over the summer, industrial production also picked up modestly in September for a gain of 2.8% year-over-year. Capacity utilization improved to a rate of 78.3% - just 2% below the long-term average of 80%.

The unemployment rate fell to just below 8%, with a higher labor participation rate. We are expecting that the labor market improvement should begin to pickup momentum heading into the fourth quarter, although we would not be surprised to see some volatility in upcoming jobless claims and payrolls as a result of Hurricane Sandy. Any improvement in hiring and the declines in the unemployment rate should not change the Federal Reserve policy at this stage. The Fed's desire for both a substantial and sustainable improvement in labor market conditions is likely to be viewed as a positive step on the longer path to economic prosperity. The central tendency of FOMC projections continue to focus on a long-run rate of unemployment at 5.2-6.0% and suggests that the majority of the committee members still believe that the U.S. economy has a long way to go before reversing the current policy stance. As a result, we continue to expect that the Fed will extend its purchases of long-term Treasuries and agency MBS at a rate of $85bn per month after the expiration of the maturity extension program at year-end.

Other positive economic reports showed that recent factory orders rose 4.8% month-to-month in September, with core capital goods orders and shipments and inventory levels remaining mildly positive. This confirms our GDP forecasts for year end. The ISM Manufacturing Index, Consumer confidence (Conference Board Survey) and retail sales were all up in September as well. Personal income is running 3.5% ahead of year-ago levels with disposable income up 3.3% as of August. This positive backdrop was supported by improving leading indicators increasing year-over-year by 2.9%.

Additional positive development was reflected in the October reported University of Michigan's Index of consumer sentiment, rising well above the consensus expectations and placing the index at its highest level since September 2007. The upward movement in sentiment was broad based in several respects. Both the current conditions and economic outlook components rose significantly; sentiment also rose for families making less than $75k/year. Perceptions of the labor market also improved. On the whole, this is an encouraging report, especially given that the gains were spread out across components of the index, income groups, and geographies. We expect that consumer sentiment will continue to move higher as the labor market recovery picks up and income trends improve.

Almost all the housing statistics have significantly improved, including an improving trend in the sales of existing homes and median home prices. Both figures are above those in recent reports and consistent with our view that home prices nationally should finish the year modestly higher. It is important to note that the pace of sales stands at 11% above year-ago levels and is near the highs since the first-time homebuyer tax credit spurred housing activity in the middle of 2010. Other housing statistics showed notable progress, such as starts, building permits and reduced inventory levels. Housing starts for instance were up 82% from the recession low of 478,000 in April, 2009. Keeping these numbers in perspective, starts exceeded two million during the peak of 2007. Although inventory levels have improved falling to a 5.9-month's supply at the current sales rate, keep in mind that housing has no doubt been aided by the Federal Reserve's monetary policy of quantitative easing which has reduced mortgage rates to 3.5% and firmed up prices. We continue to see conditions in the existing home market as putting downward pressure on inventories and supportive of a gradual recovery in the housing markets. The pace of this recovery will continue to be restrained by the availability of credit, the pace of improvement in labor market conditions, and the overhang from distressed and foreclosed properties.

Fed Policy, Interest Rates and the "Fiscal Cliff":

The new program of quantitative easing in monetary policy, outlined by Chairman Bernanke of the Federal Reserve on September 13th, moved financial markets and provided a floor in stock prices around the world. The European Central Bank also has a program of monetary easing in place. The U.S. dollar index has been weak while gold ($1725 per ounce) advanced by 8.7% year-to-date. Although the CRB Index of commodities declined and West Texas Intermediate Crude fell to 88.73 a barrel (a decline year-to-date of 12%), there were special circumstances applying to their aberrant behavior, such as drought relief impacting food commodities and oil prices reflecting Saudi production increases. Over time, commodities should rise with quantitative easing unless there are unique supply and demand conditions. If, for instance, China was to weaken substantially following Europe on the path to recession, such weak demand conditions might overcome the positive force on prices associated with quantitative easing.

Interest rates on bonds fell modestly, both before and after quantitative easing was announced. The yield on the long Treasury bond, currently 2.75% is virtually unchanged from the beginning of the year; whereas the yield on long high grade corporates declined from the start of the year at 5.13% to 4.40%. Yields on long-term municipal bonds fell to 3.33% from 4.83%. This analysis demonstrates that the policies of the Fed have been successful in pushing investors into riskier debt instruments. Investors in bonds must weigh the risk of higher inflation, which might result from quantitative easing, versus the power of the Federal Reserve's ability to mitigate systemic risk in the market place.

Lastly, the Federal deficit for fiscal 2012 came in at $1.1 trillion, the fourth straight year of trillion dollar deficits. That was approximately 7% of GDP, down from 10% in 2009. Obviously, fiscal reform is badly needed given the size of fiscal deficits. We are maintaining our forecast of 2.3% real GDP growth for 2012 with corporate profits up 7.0% and CPI inflation of 2.5% (down from 3%). Until the political outlook clears, we will maintain a similar forecast for 2013. As next year approaches, it would seem that some form of austerity will be imposed no matter which party wins the election.

Market Perspective:

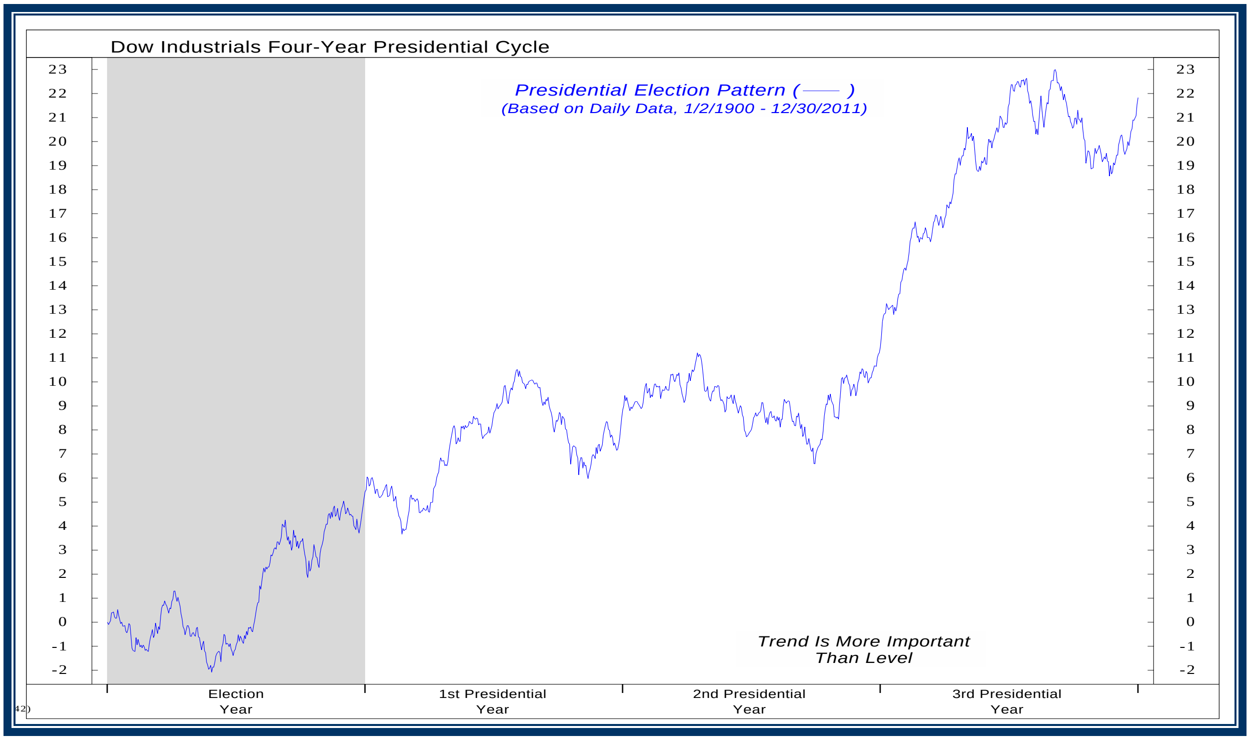
The aforementioned economic and financial problems, particularly the loss of momentum in corporate sales and earnings, have caught up with the stock markets as volatility has returned. Over the past four weeks, bond prices have been remarkably stable, with a mild uptick in Treasury yields and a modest decline in high quality corporate bond yields. The modest decline in commodities is somewhat surprising, given the announcement of further quantitative easing by the Federal Reserve and the more recent favorable statistics on the Chinese economy suggesting that the slowdown is over.

At present, the S&P 500 Stock Index sells at 13.6 times our $105 per share estimate of earnings for 2012. This represents an earnings gain of 7% from 2011 levels. Unless 2013 ushers in a recession, stocks and commodities would appear to offer greater opportunities for gain than would bonds at current yields. Our current forecast is for equity earnings to advance about 5% in 2013. While both commodities and stocks are known for high volatility, one should point out that at present, a 10-year Treasury bond yielding 1.75% would result in a 7.5% loss of capital if the yield were to rise to 1.85%. The reaction of many investors to the stock market collapse of 2008 was to invest money in bonds. Flows of money since 2008 overwhelmingly favored bonds over equities. While both equities and bonds have performed well since 2008, the question at present is which asset class will do best in the future? Since our forecast is for continued gradual growth, as opposed to recession, we would favor equities. As global economies recover, we expect interest rates to rise despite the presence of quantitative easing. We would therefore be wary of investing in Treasury bonds at current interest rates. Making adjustments for credit risk, we would prefer high quality corporate and municipal bonds over Treasury securities.

Uncertainty still prevails regarding the outlook for the U.S. economy and the financial markets. Business cyclical worries, along with the Federal Reserve implementation of a third program of quantitative easing, and a very close election between two opposite views on government's role in the economy, all contribute to investor anxiety. The future economic outlook is also clouded by the upcoming fiscal cliff. We believe that it is likely that Congress will pass enabling legislature to postpone the fiscal cliff until perhaps the end of March, at which point the new Administration will introduce new tax and spending plans to develop a budget according to its political philosophy.

Investor anxiety will persist until after the elections. We can't be certain that a lame duck legislature will be able to agree on anything, given its performance in 2012. However in the context of election year cycles, on average, stock market returns are positive regardless of whether a Republican or Democrat is in the White House, as well as whether they have full or split control of Congress (see NDR Research Exhibit I). The two most likely outcomes for the November election are either full Republican control or a Democratic president with a split Congress; both results have historically produced the strongest equity market returns since 1937, according to JPM Securities.

EXHIBIT I



Source: Ned Davis Research

Finally, the U.S. economy is more closely tied to global events than it has been in the post-war period, and global economies have been slowing. In addition, the major upheavals in the Islamic world, particularly the Middle East, contribute to an unpredictable outlook. Given the above uncertainties, it would not be unreasonable to expect a correction in the context of a bull market. We are maintaining our forecast of real GDP growth of 2.3% for 2012, with a gain in corporate profits of 7% and a gain in CPI inflation of 2.3%. Until the political outlook clears, we are maintaining a similar forecast for 2013.

Hurricane Sandy's Economic Impact

Early damage estimates from Hurricane Sandy are in the range of $30-$50bn. These losses, which have gradually been trending higher as the full extent of the storm's impact is revealed, put the costs from Hurricane Sandy above many of the hurricanes that have struck the U.S. in recent years - on par with Hurricane Andrew in 1992 and the cumulative costs from the four large hurricanes of 2004. However, damage estimates from Sandy are well below those of Hurricane Katrina in 2005 at this time. Our view is that Hurricane Sandy may pose a modest drag on Q4 GDP on the order of about 0.2-0.3 percentage points, with any negative effect in October and early November partially offset by a rebound later in the quarter and next year. We have not changed our forecast that real GDP will expand at a rate of 2.5% in Q4, but see the economic impact of Hurricane Sandy as posing modest downside risk to our outlook. The sheer size and diversity of the U.S. capital stock (the business enterprise) makes it very unlikely that any one natural disaster will cause significant destruction to the capital stock and the flow of income derived from that stock.