

## 2012: Another Typical Year

This past year a number of difficult headwinds caused waterspouts in the financial markets.

First and foremost was the self-inflicted economic drag out of Washington that waited until the final day to enact policy to avoid the ‘fiscal cliff’. While the band-aid agreement only delayed some tough decisions, waiting until the final deadline pushed the country through an economic dead-zone that was unnecessary. For most of the year, we were subject to a cavalcade of political pundits promoting their candidates. After spending a record amount on political ads, we ended the year with the same government leaders that brought us to the precipice.

The Federal Reserve spent the year showering the economy with money. After QE II didn’t work, we received QE III and then a plan to spend \$40 billion a month buying up mortgages. While this did drive the yields for government agency paper down to treasury yields, it did little to stimulate the economy. Corporate earnings slowed, bond yields fell, hiring was weak and growth in consumer spending has waned. Other news events included the devastation

of Superstorm Sandy, the tragedy at Sandy Hook Elementary, the largest tech IPO ever in Facebook, the trader known as the ‘London Whale’ who lost \$3 billion for JP Morgan, the Supreme Court upheld the Affordable Care Act, the Olympics and the possible end of civilization according to the Mayan Calendar. Furthermore, overseas growth slowed in China, the U.S. Ambassador was killed in Libya, Europe remained mired in a recession where Spain and Greece both had unemployment rates above 20% and the Middle East continued to reset the bar upwards on the term “instability”. It was a particularly tough year managing stocks and bonds. Or was it?

While each turn of the calendar has its particular quirks, every year is challenging due to the various economic calamities that inevitably arise. Every quarter brings different obstacles that force us to weigh the risks and potential impact on portfolios. Macroeconomic dynamics may change to the weightings of asset classes and industry sectors.

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We attempt to make calculated bets to minimize risk based upon the income needs or growth objectives of a client. When the best laid plans are altered by outside forces, we challenge our current position and, if necessary, adjust to the new environment. When a credit rating changes for a bond or earnings are reported for a stock, it stimulates a series of decisions as to the impact on client values now and for the future.

We know through behavioral finance that investors have short memories. It is easy to look back at the late 1990's and suggest those were easy years when everyone made lots of money. Realistically, they were as difficult as any other time period. There were negative quarters, scandals, IPO frenzy and high valuations to contend with. And of course, performance is always relative; if the market was up 38% and we only delivered 35%, the pressure to perform was amplified. These short memories can work to an investor's favor by quickly forgetting the pain of the 2008-2009 periods. It is always important, though, to remember the lessons learned while navigating through tough economic periods and that the cycle will eventually return.

Considering the stock market was up 9-16% (depending upon the index) and bonds delivered 4-6%, in a few years you might look back at 2012 and consider it an easy year. However, we know differently since every year presents specific obstacles. Similar to waterspouts on Lake Erie, the events of last year appeared ominous and downright scary but they blew over with little effect. We do believe in five years when we look back at 2012, we'll be amazed at the low rates of interest.

We are positioning bonds to maintain values by keeping maturities low and maintaining quality. The year-end deal out of Washington solidifies income, capital gain, dividend and estate taxes, which are much needed certainty for investors, accountants and attorneys. We can now put cash to work in the market knowing the rate of taxes on profits. This year the U.S. economy is expected to continue its slow recovery, hiring is steady and housing is improving. A tremendous amount of cash around the world is looking for a productive home, and the U.S. stock market might continue to be the safest haven. We look forward to another year helping you meet your financial objectives, knowing 2013 will have its share of challenges.



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