

Weekly Investment Commentary

A Look at Our 10 Predictions for 2011

July 11, 2011

At the halfway point of the year, we thought it would be appropriate to take a look at the predictions we made at the beginning of 2011 to see where we stand.

1. US growth accelerates as US real GDP reaches a new all-time high.

US real gross domestic product growth reached a new all-time high in the first quarter of 2011, so we have already gotten the second half of this prediction correct. The first half will be dependent on the degree to which the US economy is able to accelerate in the second half of this year.

2. The US economy creates 2 million to 3 million jobs in 2011 as unemployment falls to 9%.

Employment trends have been uneven so far in 2011, but as of the halfway point of the year, the pace of new jobs growth is above the midpoint of our 2 to 3 million mark. By the end of the year, we are expecting unemployment to be somewhere between 8% and 9%.

3. US stocks experience a third year of double-digit percentage returns for the first time in over a decade as corporate earnings reach a new all-time high.

In the first half of the year, US stocks appreciated by 6%, so if we are fortunate enough to see that pace continue, US equities would experience double-digit gains for the year. Regarding the second half of this prediction, earnings should reach a new all-time high in the third quarter.

4. Stocks outperform bonds and cash.

Again, if the first half of the year is any guide, we are on track to get this prediction correct since stocks have outperformed bonds and cash over the first six months of 2011.

5. The US stock market outperforms the MSCI World Index.

It is close, but as of the midpoint of the year, US stocks have outperformed the MSCI World Index (which was up 5.3%). Although there are a number of risks facing US markets, the same can be said for international markets as well, and we think US stocks remain better positioned than their developed market counterparts.

6. The United States, Germany and Brazil outperform Japan, Spain and China.

As of now, a basket of our “outperform” countries has outperformed a basket of our “underperform” countries on a year-to-date basis.

7. Commodities and emerging market currencies outperform the dollar, euro and yen.

Commodities are in positive territory for the year and have outperformed developed market currencies. Additionally, emerging market currencies have been stronger than developed market currencies to date.



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8. Strong balance sheets and free cash flow lead to significant increases in dividends, share buybacks, mergers and acquisitions (M&A) and business reinvestment.

Business reinvestment levels may have been slow so far this year, but corporate dividends, buybacks and M&A activity are all up nicely for the year. Interestingly, M&A activity has been particularly shareholder-friendly in 2011, given that in many cases, when deal activity has been announced, not only has the to-be-acquired company seen a stock price boost, but so has the acquiring company.

9. Investor flows move from bond funds to equity funds.

Investor flows moved into stocks during the first quarter of the year, but the second quarter saw a sharp outflow of money from stocks back to bonds. We would need a significant reversal of this trend to get this prediction correct.

10. The 2012 presidential campaign sees a plethora of Republican candidates while President Obama continues to move to the center.

President Obama has certainly continued to maintain a relatively centrist position as he attempts to work out various compromises with Congress. On the Republican side, the presidential race was slow to get started, but at last count there were eight declared candidates with a few more waiting in the wings.

Economic and market conditions have been uneven so far this year, but, on balance, have been positive. The US and global economies remain in a subpar growth cycle and currently appear to be in a slowdown phase within that cycle. Some of the reasons for the economic soft patch are temporary (the disruptions caused by the disasters in Japan, a spike in oil prices, bad weather) and we are expecting better economic conditions in the second half of 2011.

Markets have faced and continue to face a number of risks. The European sovereign debt crisis continues to cause concern, but as of now a temporary fix has been enacted. The debate over the US debt ceiling is also a source of consternation, but we are expecting a resolution to that issue as well. In any case, market fundamentals continue to remain sound, with revenues, earnings and free cash flow growth all showing signs of strength. For some time now, we have been arguing that the economy would “muddle through” while markets “grind higher.” That has been the case for the first half of the year, and we expect the second half to be just as good, if not better.

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