



MARKET OVERVIEW QIV 2011

The volatility experienced during 2011 was twice the prior fifty years' average. Headlines dominated fundamentals as fear mongering sell-offs and sharp rallies pushed many investors to capitulate. During the year, eighty-five companies fell twenty percent or more, compared with eleven in 2010, and fifteen in 2009. In the end, the S&P 500 Index returned 11.82% for the quarter, and 2.11% for the year, while the Russell 1000 Growth Index returned 10.61% for the quarter, and 2.64% for the year. For the full year, the conservative Utilities, Consumer Staples, and Healthcare sectors remained the top performers, while the worst performing sectors were the Financials, Materials, and Industrials, all of which were negative on the year. The bond market continued to climb in the fourth quarter amidst the stock market rally. The Barclays Intermediate Gov/Credit Index rose 0.84% on the quarter, to return 5.80% on the year, while the Barclays Muni 7-Year Index rose 2.75%, to return 10.15% for the year.

With various headlines commanding the attention of investors throughout the year, it was difficult to focus on the longer term underlying trends without succumbing to the volatility. In February, the leading news was out of the Middle East and North Africa, most notably an uprising in Egypt and a civil war in Libya. The result was a spike in the price of oil to \$115/barrel. For much of the spring, the globe was transfixed on events unfolding in the wake of the earthquake and subsequent tsunami in Japan and the potential short-term and long-term economic impacts. The summer was undoubtedly the most volatile period of 2011 as investors coped with headlines out of Europe which highlighted continued concerns over sovereign debt and S&P's downgrade of US debt. The Dow Jones Industrial Average alternated between gains and losses of more than 400 points over a four day period in August, marking the first occurrence of its kind in history.

Daily share swings in the S&P 500 averaged 2.2 percent that month, the most for any August since 1932. Closing in on year-end, the fourth quarter was no less volatile. October proved to be one of the best Octobers on record as investors implied the worst was over in Europe, and a major crisis was averted. The market made a strong upward move, but true to form, there were several abrupt dips in the process, as the march back to positive territory on the year never seemed a certainty.

The resiliency of the stock market during 2011 in the face of significant challenges gives hope for 2012. Given relatively attractive equity valuation levels, continued positive surprises in earnings growth, minimal threat of inflation, and improving economic data, the fundamentals are in place for a continuation of the US market recovery.

Global economies will certainly impact the performance of the US economy, not to mention the multinational corporations headquartered on U.S. soil. Europe is clearly an area of concern, though fear over slowing growth and a hard landing in China have subsided to a degree, as it appears a more gradual slowing has occurred, and China's monetary policy has resumed an accommodative stance. If moderate growth can be maintained in China and the emerging markets, it will help offset the drag of recession in Europe.

Potentially overzealous earnings estimate reductions by analysts provide a lower expectation hurdle for companies to achieve. As of this past October, analysts' fourth quarter estimates for the S&P 500 companies were at 14% growth, but are now down to only 7%. While revision of estimates was warranted, Wall Street consensus on most companies is now well below company issued guidance.

Meanwhile, the US economic indicators have also shown notable improvement recently. The manufacturing surveys indicate continued progress, while November housing starts rose 9.3%, and building permits rose 5.7%, marking their biggest gains since spring 2010. The recent four-week average of jobless claims has fallen to its lowest level since the financial crisis hit in 2008, and the US unemployment rate fell to 8.6% in November, the lowest rate since March 2009.



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While the jobs numbers appear positive on the surface, much of the employment gain may be due to stronger than expected temporary hiring due to the unseasonably warm weather experienced over much of the country. Both the construction and retail sectors increased hiring to benefit from this. Potentially, though, this stronger than expected seasonal hiring could lead to stronger than expected seasonal firing as we move into 2012. Furthermore, with hourly earnings and wage growth remaining flat and the savings rate down to 3.5%, if consumers choose to rebuild household wealth, they will do so at the expense of discretionary spending.

Further hampering the consumer's ability to spend could be the price of oil. After spiking in the early stages of 2011 due to geopolitical turmoil in the Middle East and Africa, oil prices pulled back throughout the summer as fears of a global recession weighed on traders.

However, given the latest developments in Iran, and with traders anticipating the global economy resuming a moderate pace of growth, oil has crept back over \$100/barrel. The potential increase of a risk premium due to escalation in Iran could lead to an even greater increase in price. Consumers and businesses alike must be cautious.

Lastly, we believe the largest overhang from 2011 is the lack of confidence in policymakers both here and abroad as budget concerns persist and an election looms. While much of the fourth quarter rally was attributable to Europe averting crisis, no long term solutions were achieved. With the actions of the ECB, the risk of a near-term collapse in the European banking system has certainly diminished, but the root of the issue has not been resolved. At home, the political stalemate in Washington, most recently apparent in the payroll tax debate, will most likely continue until the elections in November. This gridlock further erodes consumer confidence and also hurts business owners, who must scramble to adjust to the short term "fixes" enacted by our Congress. The numerous, pending tax increases on the docket for 2013 also loom, as it is unlikely politicians will agree on much prior to the election. Until greater stability is established in the European Union, and confidence is restored in our own domestic leadership and budget, investor sentiment will remain unstable.

Investors appear content to take the stock market higher for the time being, given the improved fundamentals. However, amidst the uncertainty still at hand, volatility is likely to flare up and prevent a steady advance. We will continue to use pullbacks in the equity market as opportunities to purchase high quality companies with promising long term growth potential. Likewise, as we see fit we will take the opportunity to trim or exit stocks when the valuation or outlook compels us. Our focus will remain on US Large Cap Growth stocks, which should continue to outpace other equity investment styles in this gradual recovery. The strong rally in bonds emphasized investor preference for high quality credits, and this is unlikely to change in the near-term. We will remain diligent from a credit perspective, and continue to look for opportunities to augment yield in the portfolios with attractive credits. Please let us know if you have any questions on the enclosures, or if there are any changes to your financial situation or investment objectives. Best wishes for a healthy and prosperous New Year.

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