



TRENDS NEWSLETTER

QUARTERLY MARKET REVIEW & OUTLOOK

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"The four most dangerous words in investing are, 'this time it's different'". — John Templeton

Fourth Quarter 2011

As we begin a new year I look into my crystal ball and try to gain perspective on what will be the market trends for 2012. Okay, the cat is out of the bag - I have no crystal ball. So instead I study a whole bunch of charts and forecasts to gain some perspective on key sectors in the market and ultimately what effect their performances will have on portfolios. Here are a few key areas to review:

1) Stocks: There is no doubt the stock markets were volatile in 2011 as measured by the Volatility Index (VIX) and I think that trend will be the new "norm" in 2012. What I do expect in 2012 is a bit more strength to the upside for some stocks. What I mean by "some stocks" is that some industries like retail may continue to struggle given unemployment and higher energy prices. Industries like energy, agriculture, metals, and even defense may outperform the broader market.

2) Bonds: The bond market, namely treasuries, enjoyed a 9% return in 2011. I would expect the yield on the 10 year treasury to drop further - maybe to 1.60% before recovering. Any strong rally in stocks will push bond yields higher as money moves away from the more "conservative" bonds and into stocks (a.k.a. "risk trade"). Of course the opposite is true if stocks correct - bonds' "save haven" status will stay intact pushing yields lower.

3) Gold: I took a little ribbing during the recent gold price correction after the metal fell roughly 18%. Gold hit a high of \$1,888 an ounce on August 22nd then slowly corrected to \$1,540 an ounce on December 29th. I think gold could move past the August high of \$1,888 toward \$1,900. Based on this gold positions will continue to be held in our portfolios in 2012.

4) Silver: This poster child of volatility is not for the faint of heart. After hitting a high of \$49.79 silver hit a low on September 26th of \$26.07. We sold out of our silver positions on May 5th at around \$38 an ounce. Since then the metal has settled to its current price of \$29. I see some opportunity at silver's current level with a potential retracement to the \$34 - \$35 range (+20% upside).

5) Oil: In the September issue of Trends I subjected readers to more gloom when I placed a near-term price target of \$90 a barrel on oil. This after the price broke its technical downtrend moving over \$85. From there oil hit a high of \$103.22 and since has settled at the \$98/\$100 level. I believe under the right conditions, such as Iran attempting to close off the Strait of Hormuz, oil could move higher breaking the \$103/\$105 level.

Strategies: The Bond Alternative

One of the strategies we continued to utilize in 2011 was boosting income through positions in dividend paying stocks. Companies like those listed in the table to the right are an example of some of the stocks we placed in portfolios. With the 10 year treasury yielding under 2% and dividend stocks yielding upwards of 3%—in many cases yielding more than the same company's own corporate bonds—the strategy has worked well over the past 12 months.

In most cases a stock yielding close to 4% may not be a "growth stock" but that's not to say a stock like Sysco shouldn't be used as an alternative for income. As with any equity position, risk must be a factor in determining its appropriateness for the client.

Stock	Dividend\$	Yield%	S&P Rating
AT&T (T)	\$1.76	5.90%	A-
Verizon (VZ)	\$2.00	5.20%	A-
Southern Co (SO)	\$1.89	4.20%	A
Paychex (PAYX)	\$1.28	4.10%	—
Kimberly Clark (KMB)	\$2.80	3.90%	A
Sysco (SYO)	\$1.08	3.70%	A+
ConocoPhillips (COP)	\$2.64	3.60%	A

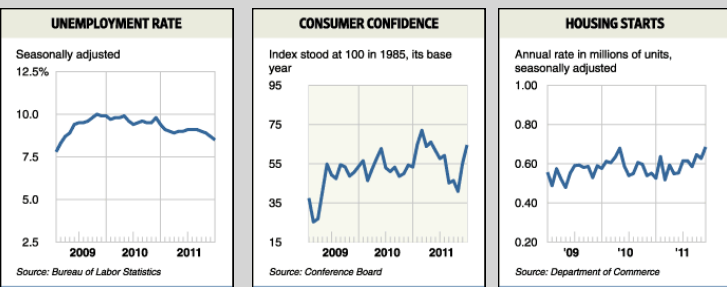
2012 Outlook: The S&P 500

One of my routines at the end of every year is to look back at all the investment strategies I came up with and take a hard look at what worked, what didn't, and why. Then ask myself what events—politically, economically, and globally—will define the new year.

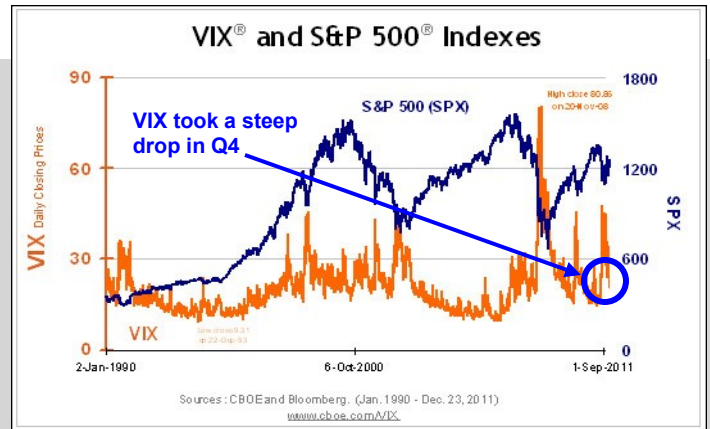
Let me start by saying I am not a “perma-bull” when it comes to the stock market. I believe there is a time to go long stocks and a time to back away and be more defensive. With that said I think that in 2012 the S&P 500 could break out of its narrow trading range and move higher. Let me make a few points in support of my theory but also review some of the risks.

As everyone knows 2012 is a presidential election year and historically election years have been quite good for the stock market (known as the “Election Cycle Theory” developed by Yale Hirsch). There seems to be a boost in consumer morale as candidates promise the world to voters. I would expect this election year would be no different which could help the S&P 500 move toward 1,400 or 10% from the Index’s current level of 1,263.

There has also been some positive economic news. Consumer confidence has been on the rise after a slow steady decline and ADP reported 300,000 new private sector jobs were added in December bringing the headline unemployment rate to 8.5%. Now I’m not saying we don’t have real issues with job creation, housing, or our national debt. What may be the case after examining economic trends is a steady improvement as the down cycle “bottoms out” leading to a protracted but sustained recovery.



Aside from economic indicators the S&P 500’s price-to-earnings multiple or P/E of 13x is at an historically low level. Typically the S&P 500 trades upwards of 20x to 21x earnings. As corporate profits rise and stock prices stay rather depressed I view this as an opportunity. Again, one must be vigilant in his/her analysis of sectors and individual stocks but this S&P 500 valuation is attractive.



Though I believe volatility in the stock market is the new “norm” I also look toward the CBOE’s Volatility Index (VIX). A falling VIX indicates a reduced sense of “fear” in the S&P 500 or stocks in general (this is why the VIX is also known as the “fear index”). The VIX has fallen to the 22-23 level and is almost 50% below its October (fourth quarter) high of 46.88. I see this fall in the VIX as a bullish signal. Remember, the VIX moves in the opposite direction as the S&P 500 Index as noted by the above chart.

Risks to my somewhat bullish sentiment can come in many forms or what I like to call “unknown variables”. For 2012 one of my main concerns is the ever growing tension between Washington and Iran. Recent Iranian war games in the Strait of Hormuz along with U.S. sanctions and battle group movement (USS John Stennis) in the Strait have me watching this situation closely. Any spark would ignite a huge rise in oil prices and be the catalyst for a stock market correction.

Europe never leaves the daily headlines and has been one of the ongoing sagas adding to global market volatility. The risk for Europe and the Euro currency would be the separation of a country like Greece from the Eurozone. Initially this could be seen as loss of confidence in the Euro Model and equity markets would come under pressure. On the other hand some investors may float the idea the Euro currency and Euro Model is stronger without the added cost of a debt burdened country allowing the Euro currency to actually strengthen against the U.S. dollar.

At this point I feel that 2012 offers an opportunity for stock investors and some caution for bond investors. Of course all that can change in an instant but at this point I would weight stocks within the high range of our portfolio allocations (i.e. 65% for balanced, 80% for growth, and 98% for aggressive growth portfolios). I will review results with you in the first 2012 issue of Trends in March.

Here are Four Stocks from the Investment Management Division's Buy List I like for 2012



Accenture (ACN) Div/Yld: \$1.35/2.60% *IVM: \$65 S&P Rating: A+
A global leader in the areas of consulting and technology services with more than 200 offices in 53 countries.

Based in Dublin, Ireland, Accenture has been a stellar performer in our portfolios over the past several years. I believe shares still have room to move higher. Yielding 2.60% and trading at only 10x cash flow Accenture has positioned itself as the “go to” consulting company. This is reflected in the fact that 91 of Accenture’s top 100 clients have been with the company for over 10 years.

I believe 2012 will be another good year for Accenture as more companies seek consulting solutions and outsourcing, which allows Accenture to have a predictable long-term revenue stream.



Schlumberger (SLB) Div/Yld: \$0.25/1.46% IVM: \$96 S&P Rating: A+
SLB is one of the largest companies in the oil services and equipment industry.

As the price of oil continues to rise oil service companies like SLB should benefit as production becomes more cost effective to oil producers. Research and Development has been a key area for SLB as the company adopts new techniques for oil and gas extraction like the company’s HiWAY fracturing technique which allows drilling while using less water and fracturing fluid.

Shares are trading at roughly 14x forward earnings and 14.35x cash flow. I think shares could move back toward the \$90 range over the next several months.



Parker Hannifin (PH) Div/Yld: \$1.48/1.90% IVM: \$94 S&P Rating: A
PH is a global leader in the production of systems and components that control the flow of industrial fluids such as pumps, filters, and seals. The company also produces components for fluid purification, fluid and fuel control, air conditioning, refrigeration, and electro-magnetic shielding.

For some investors PH may not be as rousing of company as say Apple or Google but from a fundamental perspective it surely is a profitable one. Trading at only 12x earning and 9x cash flow shares offer a solid value play in today’s volatile markets. PH has clients ranging from machinery producer Caterpillar to fast food giant McDonalds and aerospace manufacturer Boeing. The company has 12,000 Parker Hannifin stores as its supply chain network.



CSX Corp (CSX) Div/Yld: \$0.48/2.00% IVM: \$32 S&P Rating: BBB
CSX operates a 21,000 mile rail network which serves 23 states and operates 4,000 locomotives. CSX rails are east of the Mississippi River, the District of Columbia, and the Canadian provinces of Ontario and Quebec.

I like the rails simply for the fact rail traffic has been steadily increasing as companies look for cheaper shipping alternatives (3x more fuel efficient per ton shipped). As economic conditions improve I believe CSX—given its Eastern U.S. demographic—will be a direct beneficiary. CSX trades at 14x earnings and only 7x cash flow with earnings expected to growth 10% year-over-year. Given the stocks valuation I believe its an attractive play in the transportation sector.

*IVM or Intrinsic Value Model is the metric I use to place a “fair value” on shares of a company’s stock.

S&P 500 Review: Fourth Quarter 2011

Here is a review of the S&P 500 and the headlines that moved the markets. Note the volatility in the S&P 500's percentage gains and losses.

The fourth quarter started with a bang on **October 4th** with the S&P 500 surging 4.1% out of the red and ending the day up 2.3%. This after news European Union officials were examining how to recapitalize the region's banks. On the domestic front an economic report showed orders for capital equipment rose 0.9%. The S&P 500 closed at 1,123.95, up 24.72 points.

On **October 10th** markets were again in rally mode as the S&P 500 rose 3.8% representing the biggest gain since August 23rd. News of Germany and France pledging to create a solid plan to address the Euro debt crises and assist European banks helped to propel stocks higher. The S&P 500 rose 39.43 points to 1,194.89. The Dow ended closed higher by 2.97% while the NASDAQ gained 3.50% on the day.

Stocks continued their rally on **October 27th**. Indices rose to near three-month highs lifting the S&P 500 back to positive territory for 2011. The S&P 500 gained 42.59 points, or 3.4%, to 1,284.59. The S&P was now up 2.1% for the year and was up a whopping 14% the month of October. It was the highest close for the S&P 500 since August 1st. The rally came as investors in Greek debt accepted a voluntary write-down of 50% and European leaders increased the rescue fund to \$1.4 trillion.

Four days later on **October 31st** the S&P 500 fell 31.79 points, or 2.5%, to close at 1,253.30 as the failure of MF Global Holdings and new worries about Europe's debt weighed on financial markets, namely the stocks of major banks. As a result of the selloff the S&P 500 ended down 0.35% year-to-date.

On **November 3rd** stocks rose after the European Central Bank (ECB) unexpectedly cut rates. Greece also backed away from a planned referendum on its bailout package, which placed some needed confidence in the market. The S&P 500 advanced 23.25 point, or 1.9%, to 1,261.15. A report that claims for unemployment insurance fell to their lowest level in five weeks also helped to spur stocks higher.

On **November 9th** stocks fell in heavy selling after a spike in Italian bond yields to 7.502% signaled the European debt crises had worsened. The S&P 500 fell 46.82 points, or 3.67%, to 1,229.10. All S&P sectors were down for the day but hardest hit was the S&P financial sector which fell 5.9%. The 7% yield level was the same level debt from European nations like Ireland and Portugal hit as both nations requested bailouts as financing costs ballooned.

November 16th ended with stocks lower, again over concerns about the European debt crises. The S&P 500 fell 20.90 points, or 1.66%, to 1,236.91. Moody's cut the credit ratings on several German public sector banks while credit rating company Fitch stated though the outlook for the U.S. banking industry is stable, it could worsen of the European debt crises is not resolve quickly.

On **November 30th** stocks rose after major central banks agreed to make cheaper dollar loans for struggling European banks in an effort to prevent a full-blown credit crisis. The S&P 500 surged 51.77 points, or 4.33%, to close at 1,246.96.

On **December 8th** stocks lost ground as the Euro crises once again invaded headlines. The S&P 500 lost 26.66 points, or 2.1%, to close at 1,234.35. European leaders found themselves unable to devise a plan that would rein in sovereign debt.

On **December 13th** stocks again lost ground as the Federal Reserve held off making any announcement on new initiatives for the ailing economy. The S&P 500 fell 10.74 point, or 0.9%, to close at 1,225.73. The Fed also stated the European debt crises posed a risk to the U.S. economy.

On **December 20th** stocks rallied after a report showed permits for housing starts rose to a 1-1/2 year high. The S&P 500 closed up 35.95 points, or 2.98%, at 1,241.30.

On **December 30th** the S&P 500 closed the year basically flat at 1,257.60, or 0.04 points from where it opened at the beginning of 2011. Adding in dividends the S&P returned 2.11% for the year. 2011 proved to be volatile with stocks swaying large percentage moves on a day-to-day basis.

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