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QUARTERLY ECONOMIC NEWS

First Quarter 2012

As the American economy continues to rebound from the recession of recent memory, one can develop differing opinions on the current state of the economy by considering different economic indicators. According to the Bureau of Labor Statistics, the first quarter of 2012 saw substantial gains in the job market, as demonstrated by the 635,000 nonfarm payroll gains. This sum is not as high as some had hoped for. Federal Reserve Chairman Ben Bernanke predicted that the levels of job creation in January and February (275,000 and 240,000 in January and March, respectfully) were unsustainable, a prediction all too well supported by the relatively dismal 120,000 jobs created in March. For those more interested in unemployment rates than employment levels, it is equally difficult to clearly assess the state of the American economy. Many individuals who had previously fled the job market due to a lack of prospects returned to the job search in January and February, a trend that was then reversed in March. All in all, a large net gain in the labor force prevented the sizable job creation from making a significant impact on the unemployment rate. Consequently, unemployment remained relatively stable over the quarter as it dropped 0.1% down to 8.2%. The stock market, generally regarded as a leading indicator of economic change, has also shown signs of improvement during the first quarter of 2012. The Dow Jones opened 2012 at 12,221.19 and climbed to 13,212.04 through the end of March. With 2012 being an election year, historical trends would discourage reading too much into the strong start in the stock market. Election years typically include a period of hesitation among investors due to electoral anxiety and many economists are predicting that such an event could transpire between now and November. If only for the time being, it nevertheless appears that the relatively positive start to 2012 has led to increased consumer confidence and the prospect of further economic improvements.

Investment Scoreboard

Sustained investor optimism about the U.S. economy fueled stock market gains in the first quarter. Driven more by underlying fundamentals, stocks experienced a decline in volatility and investors demonstrated a willingness to take on greater risks moving from government debt into the equity markets. The Dow Jones Industrial Average (DJIA) gained 8.1 percent, its best first quarter gain since 1998. The S&P 500 posted returns of 12.0 percent and the Nasdaq Composite surged 18.7 percent. The following table highlights the average annual returns for various indices:

Index	1st Qtr	1 Year	5 Year	10 Year
S&P 500 (Composite Total Return)	12.58%	8.54%	2.01%	4.12%
Russell 2000	12.44%	-0.18%	2.13%	6.45%
MSCI EAFE (Price)	9.98%	-8.76%	-6.27%	3.00%
Barclays Aggregate Bond	-0.12%	7.25%	6.21%	5.62%

The S&P 500 is a commonly used measure of common stock total return performance, the Russell 2000 is a commonly used measure of small capitalization stocks, the MSCI EAFE is a commonly used measure of common stock total return performance of international markets, and the Barclay's Aggregate Bond Index is a commonly used measure of the bond market. All referenced indices are unmanaged and not available for direct investment. Past performance is not a guarantee of future results.

Greece Defaults

For over a year the world has been holding its breath, waiting to see how events would unfold in the Greek debt crisis. On March 9, after a protracted and contentious process, Greece reached a deal to restructure its national debt. The majority of private holders of sovereign Greek bonds agreed to exchange them for new ones—with less than half the face value. Those bond holders who did not agree to the exchange were forced to accept the deal after the government invoked a recently enacted law binding them to it. While not all creditors are pleased with the outcome, advocates of the restructuring are calling it a breakthrough, paving the way for Europe's central bank to loan Greece \$47 billion to help cover the budget deficit, and bring Greece's spending in line with its revenues. Despite the fact that the deal ranks as the biggest sovereign restructuring in world history—allowing Greece to wipe some \$130 billion from its debts—the much anticipated fallout has amounted to little more than a ripple in international markets. Concerns of spreading credit crunch-style contagion throughout the financial system were never realized. While a collective sigh of relief has followed the deal, economists are still keeping a close eye on the country. Austerity measures, political upheaval, double digit unemployment, and a deep recession expected to last at least five years lead some to question whether the restructuring will be enough.

2012: Technology Takes Over

Substantial buzz around technology companies grew at the end of 2011, and the trend appears to have continued through the first quarter of 2012. Tech startups Jive Software, Inc. and Zynga, Inc. launched IPOs in December 2011; their 2012 first quarter successes (Jive and Zynga increased 69.8 percent and 39.7 percent, respectively) may have paved the way for things to come. Social media giant Facebook filed a \$5B IPO on February 1, 2012, and the enthusiasm surrounding its impending trading in public markets is unmistakable. To add perspective, consider that Google's \$2.7B IPO in 2004 seemed unreasonably high to many at the time. It would be remiss to neglect also mentioning positive growth among more established technology companies, and perhaps none is a better example than Apple, Inc. Closing 2011 with its stock trading at \$405 per share, the California-based company climbed 48 percent in the first quarter of 2012 to reach \$599.55 per share. For those quick to point out that Apple has been riding a wave of increased popularity due to recent innovative product launches, it may be useful to consider a counter example in Microsoft Corporation. Despite lacking competitive product launches, Microsoft stock managed to improve 24.3 percent in the first quarter of 2012, closing with its shares trading just over \$32.25 per share. If the success of these companies is any indication of the technology sector's potential, it appears that 2012 may be a monumental year for technology equities.



Euro Zone Debt Crisis

With the risk of default on European sovereign debt still looming, European finance ministers took significant strides toward curtailing the Greek debt crisis in the first quarter of 2012. Despite her reservations against exposing taxpayers to excessive bailout obligations, German Chancellor Angela Merkel's persistent efforts to expand bailout funds available to struggling Euro zone economies won the quarter. The March 30 decision to allot up to €800B (including the €300B that had previously been committed) to the emergency fund known as the European Stability Mechanism (or "ESM") signified the lengths many are willing to go to ensure at least some stability in Euro-using nations. These efforts fall short of alleviating all concerns however and questions still remain about the economic sustainability of sovereign debt in other Euro zone countries, including Ireland, Italy, Portugal, and Spain. Such questions inhibit skepticism from subsiding even after the recent increase in bailout funds. Many fear that the ESM continues to

be underfunded if it is intended to protect against adverse economic developments in countries beyond Greece. This, combined with the fact that certain funds will not be made available to the ESM until 2014, only adds to the ongoing incredulity about the safety of Euro zone debts. There are of course other considerations to be made regarding the Euro zone debt crisis, including those from the affected nations' populous. Austerity measures originally introduced well before 2012 continue to catalyze unrest among those previously benefiting from the impacted services. Through March 2012, anti-austerity strikes have occurred in Greece, Ireland, Italy, Portugal, and Spain. All things considered, the prospect of reaching a resolution satisfactory to citizens and politicians alike appears improbable. Consequently it is unclear whether to perceive the recent increased funding for the ESM as a development worthy of celebration or simply a false sense of hope in a losing battle to prevent collapse of the Euro.

Economic Outlook

While the economic outlook has improved in recent months, uncertainty still exists about the year ahead. High unemployment and rising gas prices are likely to cut into consumers' already stretched finances and political gridlock coupled with anticipation leading to up to the November election make it difficult to embrace the notion of economic optimism.

Despite this, there exist reasons for hope. Economists expect levels of home construction and sales will increase this year marking an end to the most severe housing-price crash on record. While tight consumer credit standards are still the norm, it appears stabilization in home prices is materializing, with half of the Case-Shiller 20 Housing Markets Index showing flat or increasing prices early in the quarter.

While a number of Wall Street strategists are growing more conservative in their forecasting, diminished fears about Europe's sovereign-debt crisis and the Fed's continued support for the current accommodative policy bode well for the stock market and the broader economy.



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