Capstone Comments

A forum for communicating information about the management of assets

Q:

What will we remember about 2011?

A:

The past year reminded investors that they should hope for the best, prepare for the worst, and be thankful when reality does not match their fears. Investors entered 2011 with hopes that the world economy would continue recovering from a long and painful deleveraging process. Equity markets had posted two straight years of positive performance, central banks remained committed to pro-growth monetary policy, and major developed nations were focused on reducing debt.

By mid-year, however, optimism faded as troubling events around the world dominated headlines. The devastating earthquake and tsunami in Japan, political unrest in the Middle East, rising oil prices, a US credit downgrade, the threat of another global recession, and an escalating debt crisis in Europe weighed heavily on markets. As stock market volatility returned to global financial crisis levels, investors faced a major test to their discipline and staying power (Dimensional Fund Advisors, "2011 Review: Economy & Markets").

Although US stocks experienced some of the highest volatility in years, the broad US market delivered flat performance in 2011. The total return for the S&P 500 index including reinvested dividends was 2.11% (By The Numbers, 01/02/12). Developed markets logged negative returns, and emerging markets had mixed performance with most countries also underperforming the US. The bright spots were in the fixed income arena, where a flight to quality triggered by the euro debt crisis and US credit downgrade boosted returns on US government securities, inflation-protected securities, and municipal bonds.

Looking forward to 2012, it seems likely that we will see a continuation of slow, but positive growth. The US economy remains focused on the crisis in Europe and the upcoming presidential election. Historically, there has been a clear visible link between the Presidential Election Cycle and Wall Street. Presidential Election years tend to be more moderate, but historically are still the second most profitable in the four year cycle. Due to the many political issues that are still on the table, we would expect continued volatility in the market. It is highly unlikely that either party would implement any significant changes, but rather continue to "kick the can" down the road (InvesTech Research, January 20, 2012).

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