New Albany
Investment Management

MARKET INSIGHT…

- Performance
- Economic Update
- Charts* of Interest

February 21, 2012

PERFORMANCE: as of 2/21/12

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Sector	YTD	3Mo	1yr
S&P 500	8.6%	12.6%	3.7%
Russell 2000 (small/mid Cap)	12.0%	15.7%	0.7%
MSCI EAFE (Eurp.Asia, Far East)	10.9%	15.3%	-7.6%
MSCI Emerging Mkt	16.4%	14.2%	-4.9%
US Bonds (Barclay's agg. Index)	0.5%	1.2%	8.8%
High Yield Bonds (US)	4.0%	6.0%	5.0%
Gold (GLD: Net asset value)	9.4%	-1.3%	24.4%
Defensive Sector	2.9%	8.8%	13.6%
Cyclical Sector	12.4%	16.9%	-2.9%

Economic Update: Positive Momentum

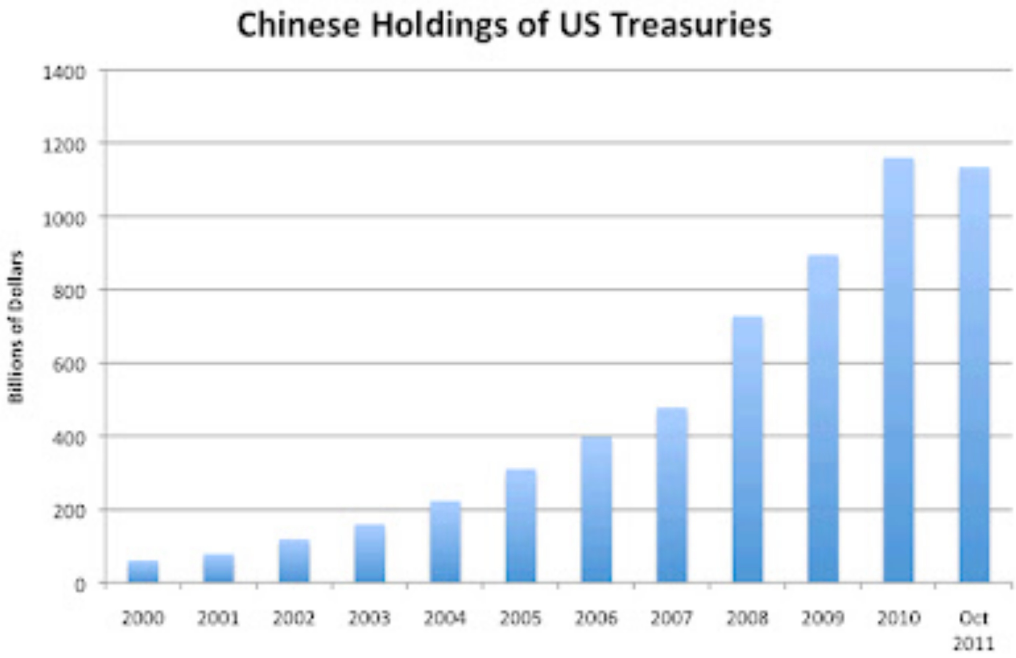
After a dull January, the U.S. economy showed good results in February when most of the sectors improved. Retail sales, remained strong. The manufacturing industry scored the best two-months performance in the past thirteen years. Housing starts recovered near three years high in January, supported by favorable weather conditions, and home builders are starting to hire again. Lastly, initial claims dropped to the lowest level since 2008.

Will it last? Housing prices are bottoming and this is a good start. Nonetheless, mortgage purchase applications are low, while the rate of mortgage delinquencies is still a few points above the average. Business investment could contract due to year-end expiration of tax incentives and consumers might start to re-fill their personal saving accounts, which were depleted during the holidays. Finally, job growth must continue for a few years to have a lasting impact on income and pull up economic growth to more stable level.

China: Good & Bad News

Since December 2011, China has been easing monetary policy in an effort to support (keep from plummeting) the local real estate market. This action has resulted in more reserves available for local Chinese banks, but less excess reserves available to buy US Treasuries. The good news: Chinese stocks (and emerging markets) have responded positively rising significantly this year (+8%, +16% respectively). The bad news: US Treasury rates have begun to rise (30yr Bond at 3.19%, up from 2.85% in Dec.) as there is less money available to buy the supply.   If Treasury rates rise significantly (to 4%), mortgage rates will also rise (back over 5%) and derail the US housing recovery.

Global Markets: China’s Holdings of US Treasuries has begun to decline, pushing Treasury prices lower, yields higher



Since December 2011, China has radically reversed course, easing monetary policy through decreased reserve requirements which intern has reduced the need to hold US Treasuries as foreign reserve currency.

Net impact is rising US Treasury yields could in turn derail US housing recovery.

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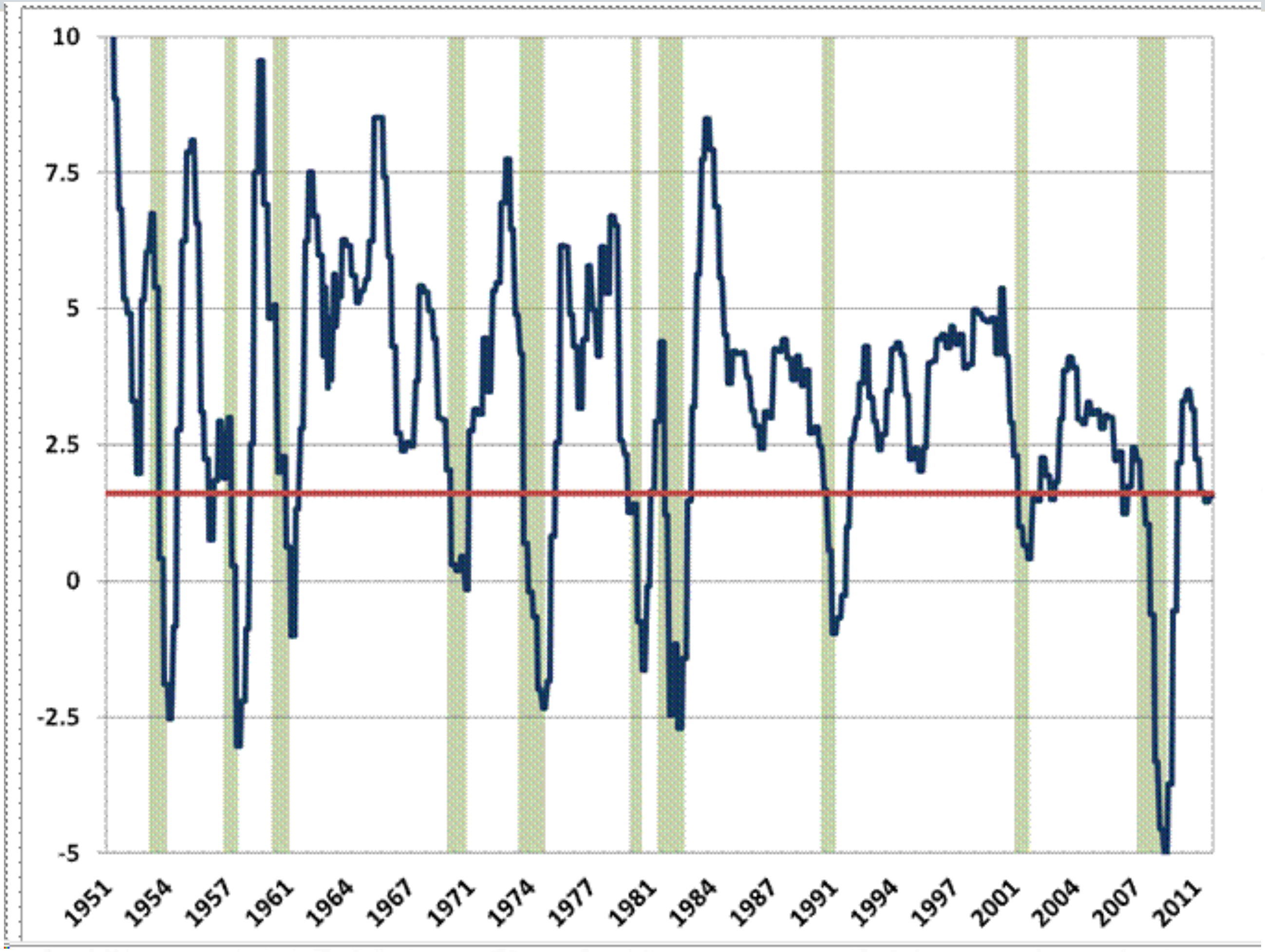
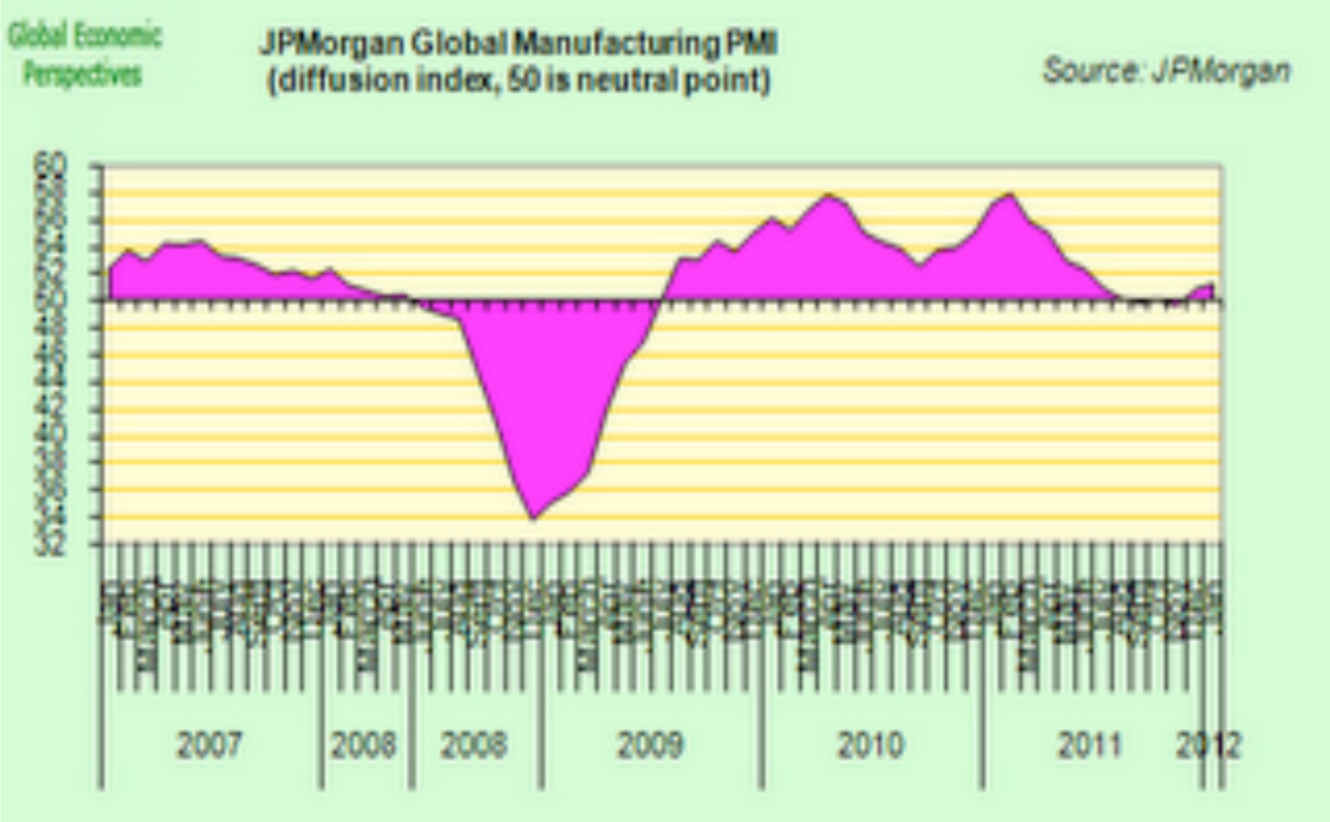
ECONOMY: With GDP Low, Recession Risk Remain High



GDP remains below 1.6% (red line). A decline to this level has always been associated with recession.

ECONOMY: Global Manufacturing Steadies


Global Economic Perspectives

JPMorgan Global Manufacturing PMI (diffusion index, 50 is neutral point)

Source: JPMorgan

Global Manufacturing at a seven month high but still below its long run average. Growth of new export orders was led by India, the US and Turkey. China, Japan and the UK all reported modest increases, in contrast to the declines seen in the Eurozone, Russia, Canada, South Korea, Taiwan and Brazil.`

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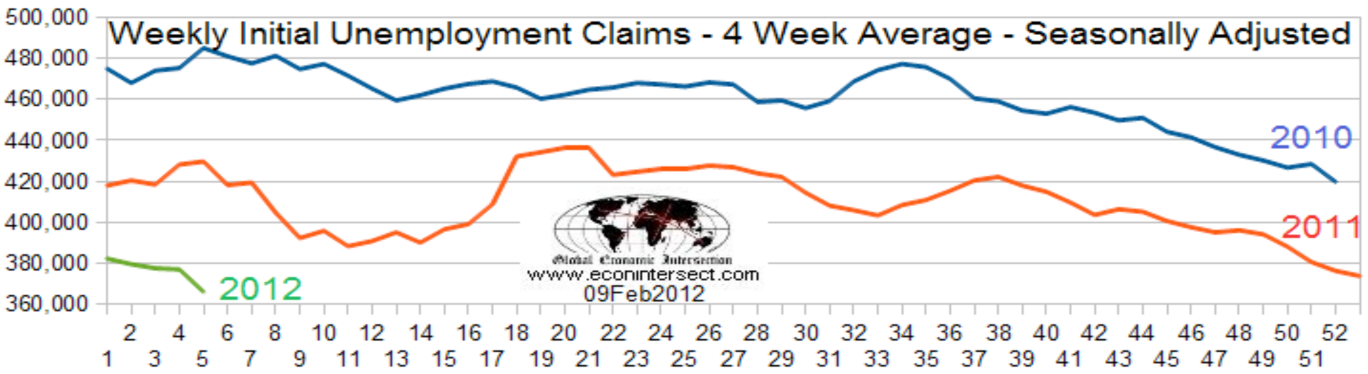
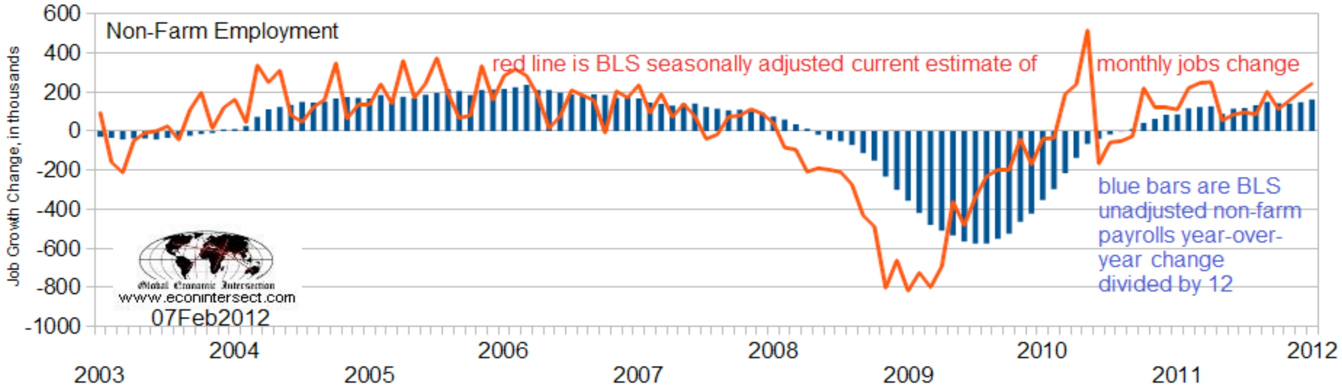
US EMPLOYMENT PERSPECTIVE:

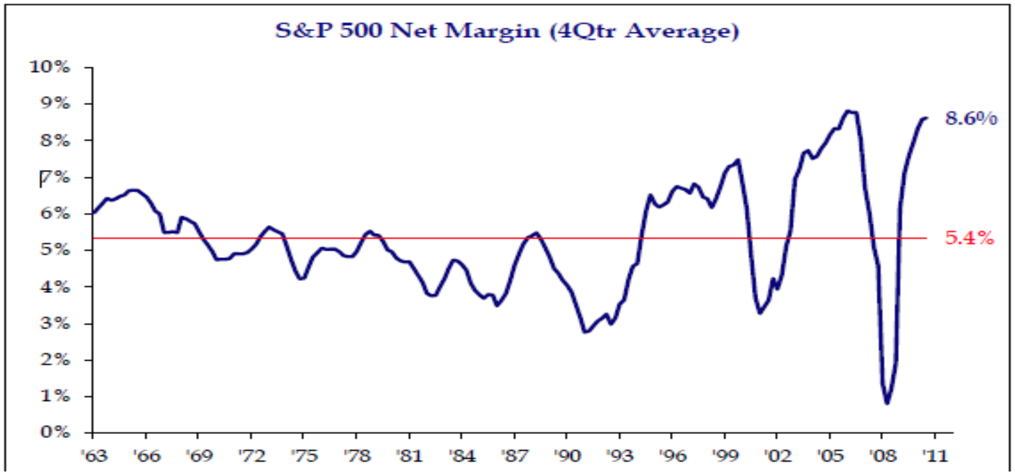
Still Fragile at best….

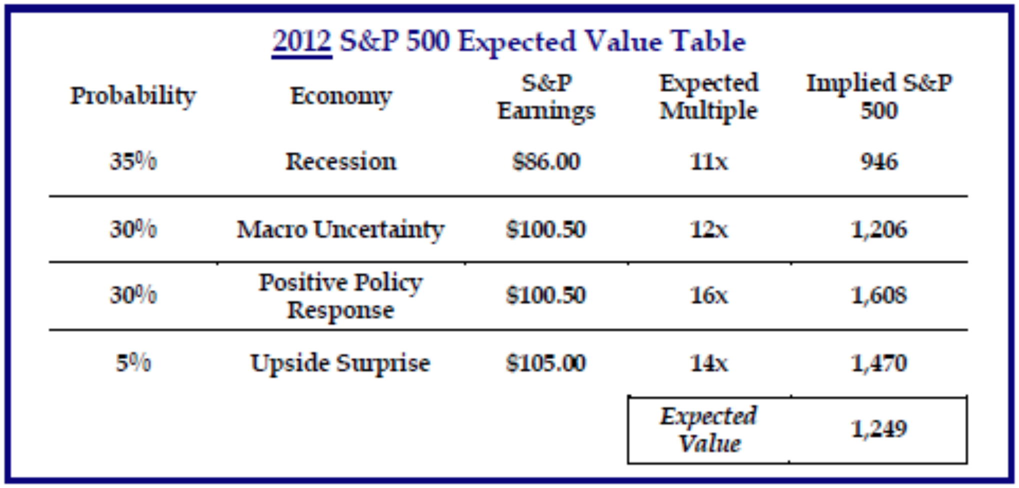
. •Employment at January 2005 levels yet population has grown by 18mm.
•Job growth rate at January 2008 levels
•Historically, recessions do not start when payroll is expanding





EARNINGS & MULTIPLES: Profit Margins near all time high but can they remain given flat economic growth forecast?


S&P 500 Net Margin (4Qtr Average)



2012 S&P 500 Expected Value Table

Probability	Economy	S&P Earnings	Expected Multiple	Implied S&P 500
35%	Recession	$86.00	11x	946
30%	Macro Uncertainty	$100.50	12x	1,206
30%	Positive Policy Response	$100.50	16x	1,608
5%	Upside Surprise	$105.00	14x	1,470
			Expected Value	1,249

Changes in P/E multiple, driven by investor confidence (or lack there of) likely biggest factor in driving stock prices in 2012.

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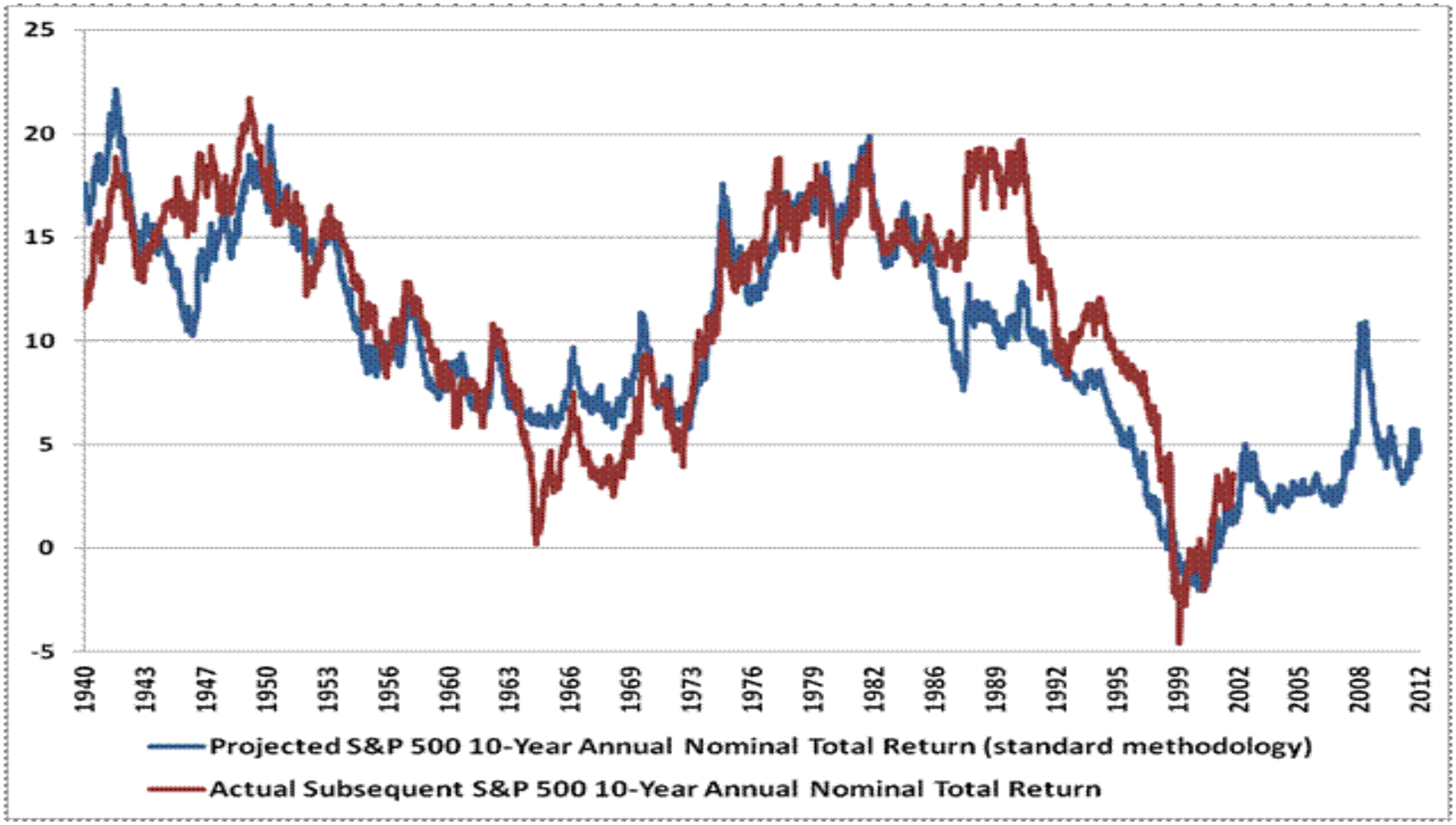
VALUATION: Stocks projected 10yr nominal return at 4.7% (John Hussman's Valuation Model)



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MARKET Performance & Volatility:

The chart on the next page shows performance of the Dow and S&P 500 over the last 5yrs. Depending on which time frame you select, the performance can look very good (+ 16% ~ 3yr return), very bad (-36% ~ 2008), or very unremarkable (-0.1% ~ 4 & 5yr return- before inflation). The wide spread of returns reveals the damage from volatility and the need to managed risk. One performance criteria to look at is the return relative to the amount of risk. In other words, was an investor paid to ride out the volatility over the last 5yrs? The answer is most assuredly no.

An investment strategy that '**floats**' along with the broad market indices is best described as a '**passive aggressive**' strategy. This strategy would provide positive returns over the long term as long as economic cycles are long, contractions are mild, and the investor is continually adding new money. However, the current economic environment is quite different. With chronically low level of US GDP (currently 1.6%) expected, economic cycles will likely be shorter, with deeper contractions. This translates into higher market volatility and hence a strategy of 'floating along with market' is not appropriate for most investors. In fact, a better strategy for this type of economic environment is one that is dynamic (flexible), well diversified, and generally lower over all risk.

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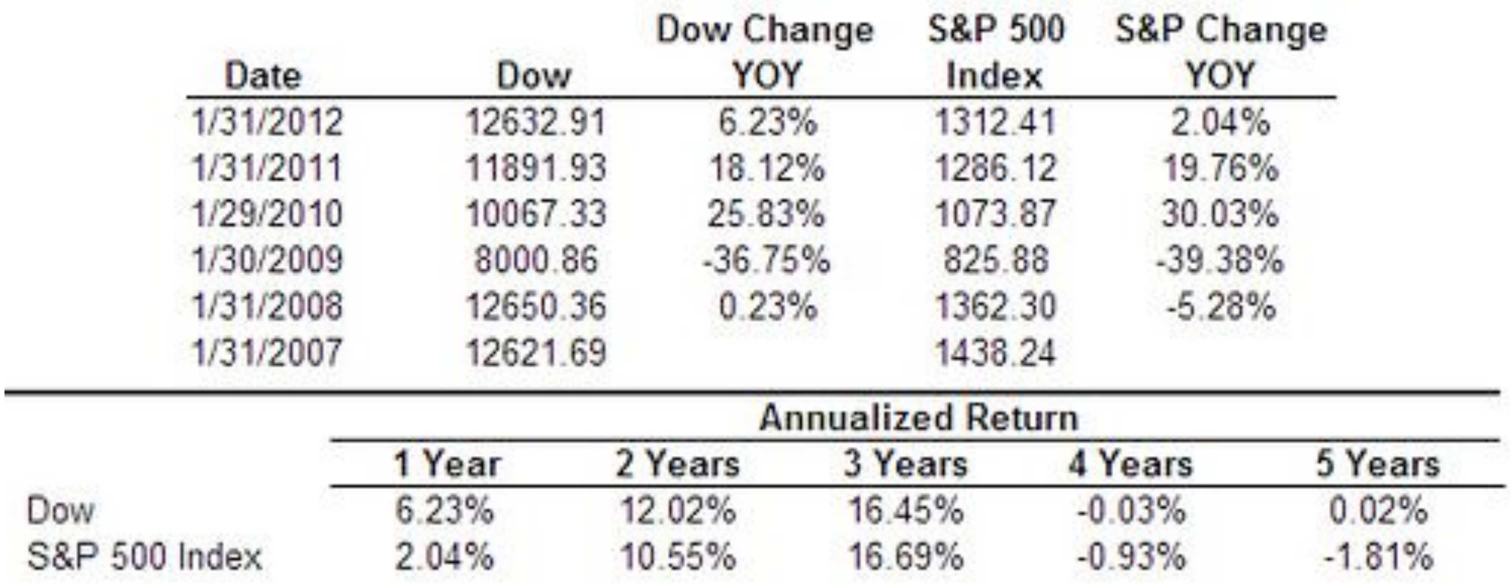
MARKET PERFORMANCE & VOLATILITY:



Date	Dow	Dow Change YOY	S&P 500 Index	S&P Change YOY
1/31/2012	12632.91	6.23%	1312.41	2.04%
1/31/2011	11891.93	18.12%	1286.12	19.76%
1/29/2010	10067.33	25.83%	1073.87	30.03%
1/30/2009	8000.86	-36.75%	825.88	-39.38%
1/31/2008	12650.36	0.23%	1362.30	-5.28%
1/31/2007	12621.69		1438.24	

	Annualized Return				
	1 Year	2 Years	3 Years	4 Years	5 Years
Dow	6.23%	12.02%	16.45%	-0.03%	0.02%
S&P 500 Index	2.04%	10.55%	16.69%	-0.93%	-1.81%

MARKET STRATEGY:
Flexible, Diversified, Durable, Efficient….

Portfolio Strategy is positioned across 5 asset sectors and managed according to each Client's investment objectives and risk tolerance.

1**)** **High Quality Bonds**: Interest rates are expected to remain subdued. Exposure to Intermediate Corporate bonds (3-4% yield), provide income to portfolio.

2) **High Yield Bonds**: Sector was hit hard in 2011 pricing in a potential recession and high default rates. A disconnect between expectations and reality pushed prices down hard. But with yields over 7%, and improved confidence of a slow albeit growing US economy, HY bonds offer both income and price appreciation opportunities.

3) **Stocks:** Sticking with High Quality, Growth and Dividend Paying sectors as core position. Increased exposure to risk assets such as Mid Cap and Cyclical stocks in more aggressive portfolios. Moved out of Defensive sectors.

4) **Dynamic Fund Stock Strategies**: Exposure to funds which can rapidly adjust positions across the global markets as market conditions change. Also exposure to funds which employ long/short strategies- where they hold long positions in assets expected to rise in price against selling short positions of assets expected to fall in price.

5) **Commodities**: Exposure in two ways: Long Gold; Long/Short position in commodities through funds.