
GREENWOOD REPORT

BEGINNING THE NEW YEAR

Investors are ready to close the books on 2011: a roller coaster, round-trip ride ending where we started. Until August of 2011, the United States economy and securities markets were inching forward toward a sustainable growth trajectory, then Standard & Poors downgraded US debt, Congress repeatedly failed to do its work, and sovereign debt issues in Europe reminded everyone that global economic problems persist.

The economic environment for 2012 may be slow to change. Globalization demonstrates that although the United States has experienced recovery from the 2008 financial crisis, the Eurozone is still very much in the soup and their inaction could push the world back towards recession. China and the emerging nations are struggling to avoid a “hard landing” as their economies grow at slower rates. Repeatedly, the anticipation of a successful solution is followed by the reality of intransigent disagreement. The volatility in the securities markets reflect this environment. Political problems will exacerbate economic solutions in 2012, but capital markets should move forward acknowledging that collapse is not an acceptable outcome.

Prospects for 2012 are bifurcated – short-term pessimism and long-term optimism. Both the United States and Eurozone *will* solve their problems, but timing is the issue, no one is prepared to say *when*. “Kicking the can down the road” is a popular phrase describing where we are in the process, but it really means hanging on until global growth returns. The *global* economy slowed to less than an estimated 4% growth this year from a 5% rate in 2010; prospects for 2012 indicate a bit slower than average growth, around 3.5%. It also means hoping that the Eurozone fiscal debt crisis does not become another Black Swan event like 2008, with a seizing-up of credit and liquidity paralyzing economic activity (apparently, Eurozone banks are willing to leave overnight deposits *only* with the European Central Bank, not with other sovereign banks.) Finally, and perhaps most importantly, it also means a return of *trust*.

The United States will be the bellwether – that is, when we get our house in order and return to growth, the global economy will follow. At present, the dollar is still the currency of last resort and the United States is still the banker of last resort. Europe, Asia, Latin America, emerging markets, and frontier markets may have singular countries with higher economic growth rates, but for sustainable growth they must be able to participate in the \$15 trillion United States economy. This is not arrogance or conceit, but a candid appraisal. Greenwood Gearhart discussed the desire for certainty, the issues of risk and volatility, and time bought by kicking the can down the road in our Greenwood Reports of 2011. We remain confirmed optimists because we have a long-term perspective.

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Our perspective *is* long-term and we believe our optimism *is* well founded. Growth will return as our appetite for risk returns. Low cost of capital (low interest rates), a global surplus of labor resources, reasonable availability of natural resources, but most importantly, ever-increasing technological innovation all assure this event. The United States will lead the way, but make no mistake, global economic growth and global integration have just begun. We are witnessing an explosive golden age filled with wonders we did not imagine and promises we dare not expect.

Our portfolio strategy for these interesting times includes searching for the “buys,” because they are always present. At the same time, we are ever aware of risk management requirements. Today, we think the equities of large companies with strong financial positions offer the best opportunities. They have sufficient market size to withstand demand/supply fluctuations and they have the financial flexibility to invest in new technologies while paying consistent dividends. Higher cash positions both mitigate and take advantage of market volatility. This is a conservative strategy, but not one of inertia; we are investors and the markets are exciting.

With apologies to all English majors and poets, we end this report with a bit of mirth. Some verses that parody a rhyme from the 1600s, with a tip of the hat to John le Carré’s *Tinker, Tailor, Soldier, Spy*.

THE WORLD IN VERSE, 2012

Tinker, Tailor, Soldier, Sailor
US, Britain, China, Neighbor

Rich man, Poor man, Beggar man, Thief
Germany, France, Italy, Greece

Unemployment, Housing, Sovereign Debt
Deficits, Downgrade, Default Threat

Economic problem, Political problem, Workable solution
Austerity, Dissolution, Eurozone Constitution

Black Swan, Bailout, Innovation, Technology
Competition, Contagion, Volatility, Psychology

Risk Management, Investment Strategy
“Kick the Can,” Avoid Tragedy

Greenwood Gearhart, Twenty-Two
Trusted Advisor, You Know Well

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