CITRINCOOPERMAN
WEALTH MANAGEMENT, LP
Registered Investment Advisors

A look back, 2012:

Between the ancient Mayans' prediction that the world would end in 2012, still-sluggish growth in U.S. and European economies, the prospect of a hard economic landing in China, and heaps of political bickering, can-kicking, and near fiscal-cliff diving, it's a wonder that stocks made any upward progress at all during the year. But despite all that, the world kept on spinning – and the market, as represented by the S&P 500 Index, kept climbing for the fourth consecutive year. The results for the full year were impressive: the S&P 500 generated a total return, including reinvested dividends, of 16%.

2013 Outlook:

The economic and market environment remains uncertain as we move into 2013. An investor need not look far to find risks that could propel us sharply downward. Given the vast complexities, examining investment markets as a whole can lead to conflicting signals. CCWM seeks to simplify the markets by focusing on what we know. Consequently, we leave the game of predictions of the unknown to the many market pundits.

What we know:

Extremely Aggressive Monetary Policy - One fact we know is that the U.S. Federal Reserve (the "Fed") continues to print money at an incredible rate. Overall, the Fed will inject more than $1 trillion into the financial markets in 2013, as part of its QE3 program, at a rate of roughly $85 billion per month. The Fed's printing press will be joined along the way by major programs from the European Central Bank, the People's Bank of China, and other major global central banks. In recent years, such aggressive monetary stimulus programs have driven investment markets higher regardless of economic fundamentals. Given the scale of monetary stimulus in the coming year, it is likely that we may see more of the same in 2013. In terms of investment impact, this should benefit stocks, high yield bonds and precious metals, including gold and silver. These gains are likely to come at the expense of U.S. Treasuries, particularly Long-Term Treasuries, as capital flows out of the safety of U.S. government bonds and into riskier assets.

Taxes Are Going Up - Mostly everyone in the U.S. will be paying more in taxes than they have in previous years, even if it's only 2% or so of their paychecks. If consumers and businesses are sending more of their money to the government, they have less money left over to spend on consumer and capital goods. This logically would place a drag on economic growth and weigh on stocks and high yield bonds in favor of precious metals and U.S. Treasuries. The heavy flow of liquidity from the Fed, however, may help investors to ignore such fundamental truths for another year or so.

Fiscal Policy Paralysis - A fact repeatedly reinforced by Congress is that until politicians fear the threat of non-reelection, nothing of substance will be accomplished to address the critical issues facing the U.S. The recent fiscal cliff debacle highlighted this point. The media is captivated by a debate over policy solutions that do not even begin to scratch the surface of the underlying problem. For example, the Federal debt has increased by $6 trillion over the last five years, yet in the latter part of 2012 Congress and the President fiercely debated implementing just $100 billion in spending cuts.

The European Crisis Remains Unresolved - The seeds of the European crisis were sown years ago and began manifesting themselves during the outbreak of the financial crisis back in 2008. The problem has gotten worse with each year. In 2010, the main focus was on Greece, but by 2011 the crisis had spread to Ireland and Portugal. In 2012, it fully infected Spain and Italy. As debt problems continue to mount, economic growth remains insufficient to reverse the trend, particularly as the global economy only muddles along. While coordinated global monetary stimulus may help markets and permit investors to ignore the festering problem across Europe for another year, the problems facing the region and subsequently the world continue to mount. Like the Fed in the U.S., the ECB appears ready to throw more and more money at the problem. While one cannot solve a debt problem with more debt, the Europeans appear determined to continue trying.

The Unknowns:

The Global Economy - Many signs point to stagnation or minimal growth in many parts of the world in the coming year. It remains possible, however, that growth could surprise to the upside considering the magnitude of monetary stimulus being injected into the global economy. Any such growth may prove fleeting, and could have negative ramifications. It could, for example, raise inflation concerns and cause monetary policy makers to withdraw stimulus sooner rather than later.

Corporate Profits - Many analysts feel that corporate profits are unlikely to increase with any significance. Profit margins will likely compress as companies have less room for further cost cutting.

Inflation - When central banks inject as much money as they have over the last several years into the global economy, inflation will remain a concern. While policy makers cite that current inflation pressures remain largely contained, one could argue that current inflation measures do not accurately capture actual price increases. Once inflationary pressures take hold, they can be difficult to contain, even with a hard press on the monetary brakes. Such a response has the potential to sharply rattle investment markets, both stocks and bonds.

What this means to you:

It is the unknowns, including potential problems of which we are not even aware, that have the greatest likelihood of resulting in a sudden and dramatic shift in the investment markets.

When considering all of these factors, both in isolation and collectively, we draw the following conclusions:

1) The Fed plans to continue aggressive stimulation of the economy in the coming year by printing over a trillion dollars, and other global central banks will contribute with their own major stimulus programs. History has shown that during periods when monetary stimulus is applied so aggressively and at such a massive scale, risk assets; including stocks, high yield bonds and commodities, have risen regardless of how fundamentally weak the economy and corporate profits may be. Thus, until this trend is definitively broken, we expect it to likely continue.
2) What exactly could definitively break the trend of aggressive monetary stimulus? There are several possibilities that hang over the investment markets, and they all require close monitoring. These forces include the ongoing crisis in Europe, the outbreak of inflationary pressures, or some other event that cannot be presently anticipated.
3) Based on the forgoing, a hedged investment strategy remains prudent in the 2013. The coming year promises to provide interesting times for the investment markets and its participants. A broadly diversified strategy with components designed to participate in further Fed-induced upside, but that can also withstand sharp and dramatic turns along the way, is our recommended approach in the current environment.

Investing in International and Emerging Markets

Emerging markets are nations that are in the process of rapid growth, industrialization, urbanization and increased global trade. The current market capitalization of emerging countries today is over $9.9 trillion, which is approximately 20% of the world's capitalization. According to the International Monetary Fund (IMF), emerging markets only represented 12.5% of the world capitalization in 2010. In recent years, new terms have emerged to describe the largest developing countries, such as *BRIC,* for Brazil, Russia, India and China and CIVITS, for Columbia, Indonesia, Vietnam, Egypt, Turkey and South Africa. Some emerging market securities may be more highly rated than those of developed countries, but often have less stringent accounting and financial reporting requirements. An investment in emerging markets often has inherent risk. A modest exposure to emerging markets in a diversified portfolio, however, can lower overall volatility and increase annual return. Emerging markets securities are typically more volatile and less liquid than those of developed markets and can experience dramatic swings from sudden political and economic events. Emerging market fixed income is also subject to credit risk (possibility of country default on its debt), interest rate risk (rise in rates can devalue the bonds held), and currency risk (unstable monetary and fiscal policy). Data from the IMF's World Economic Outlook, International Financial Statistics, and the World Bank's World Development Indicators confirm that emerging markets and developing economies are now more resilient than they were in previous decades. Americans tend to be ethnocentric and our investments often reflect this, to a fault. While we believe that the bulk of our exposure should be in the United States, an investor who completely ignores other countries does so at his or her peril. When we review existing portfolios of prospective investment clients, it is not uncommon to see 90-100% of their investments, both stocks and bonds, in US companies and US government debt. In those instances when an investor has international exposure, it is generally limited to only foreign equities. International fixed income is usually completely absent. Furthermore, when we do see international equity exposure, it is usually limited to large cap funds, which are very highly correlated with the S&P 500 index. Emerging and developed international market investments offer attractive potential returns to long-term investors, but also carry higher potential risk. A portfolio with modest exposure to international debt and equity is a reasonable way to help optimize diversification.