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JUST LIKE BIG THUNDER MOUNTAIN -Murray Sawyer

If you take your family to the Magic Kingdom at Disney World, make sure your grandkids make you ride the [Big Thunder Mountain Railroad](#) roller coaster. It is a real life metaphor for the stock market's 2011 ride.

What does riding in a train car on Big Thunder have in common with the S&P 500 Index you ask? Well, for one they both start their journey and, at least last year, ended their journey in exactly the same place. In the case of the broad, large cap market index it closed on 12/31/2010 at 1257; it closed 12/31/2011 at 1257. What are the odds on that I wonder?

For another, the journey starts out in darkness. In the case of Big Thunder it's a blackened railroad tunnel. In the case of our broad equity index it did not know what the next 365 days would bring to our nation's investors.

Both ramped up before falling precipitously. The coaster slowly builds up steam until it's at its top, whereupon it banks sharply, making a 180-degree turn to the right, dropping all the while.

In the case of the S&P 500 it reached its high point in the spring at what would prove to be the intraday high for the year, 1370, on May 2nd. The day before, May 1st, our war on terror came to its own zenith when US Special Forces killed Osama bin Laden.

From that high point [Big Thunder](#) takes you on an adrenaline rush, but always in a downward plane. There are several minor drops and climbs, backing and filling if you will, before it drops into a cave where coyotes howl, and grandkids scream bloody murder.

Surely you remember the thrills of the past summer? Congress went out of its way to frighten everyone with its threat to cause the U.S. to default on our debt, taking us to the very brink. Our country's AAA, gold-plated credit rating was downgraded by Standard and Poor's, making America's debt less credit worthy than that of certain other sovereigns, to wit France, Liechtenstein and that world famous country, the Isle of Man.

As the S&P 500 Index first meandered south in June and July, then dropped as if dropped from the Golden Gate Bridge in August, our neighbors to the east, the Europeans, dithered while their siblings Greece, then Italy burned and bled. On October 4th, the index hit its intra-day low for the year at 1074, having fallen a full 22 percent from its high in five short months. Yours truly penned my 2011 Q4 newsletter at that precise moment entitled "Is It Time to Throw in the Towel?"

Memories of Jean Van de Velde's 1999 British Open collapse were brought to mind. Needing only a double bogey 6, the Frenchman posted 7 strokes on the last hole at Carnoustie to force a playoff which he eventually lost.

Unlike poor Jean, our market began to turn upward at that low point, just as Big Thunder does once it emerges from the depths of the Dave V Jones mine. Crossing an earthquake in progress, the train narrowly avoids falling rocks. Cresting the last hill, the coaster train slows down and exits in sunlight before finally returning to the station. The riders are more than happy to have ended up where they began.

From that early October low point the broad market index climbed 183 points, or 17 percent, to get back to square one. Our investors figuratively jumped from the train, happy to still be in on piece.

This fall and into the winter, the leaders of Germany and France, the EU and IMF heads, European bankers and related stakeholders continued to look for solutions, admittedly in fits and starts, to the problems wrought by fifty years of enjoying an overly generous governmental social welfare model.

Increased taxation, reduced pensions and vacations, coupled with an emphasis on the Germanic model as the ideal put real pressure on the Southern and Eastern European countries as they tried to bring their debt to GDP ratios under control.

Strikes were common. One that tickled my fancy because it serves as a telling anecdote for all the turmoil is this: In a sign of just how harsh this new world order has become, thousands of over-worked Romanian mothers took to the streets of Bucharest protesting the news that their maternity leave was being cut in half . . . from two years to one. Be that as it may, progress was nonetheless moving forward, onwards and upwards, not backwards.

And in the good old U.S. of A. in December after much gnashing of teeth and freshmen tea party hesitancy, the president and Senate Republicans were able to shame House Republicans into kicking the can down the road for two months more of the 2% social security tax holiday and extended unemployment insurance. I guess that's progress of a sort too. At least the market didn't turn tail and run once more.

HOW DID MONEY MANAGERS PERFORM IN 2011?

The smartest guys in the room struggled as well. Chalk it up to three things: record volatility, the unanticipated congruence and correlation of various asset classes and markets, and finally the unprecedented influence on all markets of world macro events.

Lipper, a nationally regarded company, supplies mutual fund information and ratings. It reported that the professional money managers of the average U.S. stock mutual fund lost 2.9% in 2011. Large-company diversified international funds were down 12.6% on average, while the average emerging markets fund plummeted 20.3%.

The generally accepted wisdom of professional advisors is to recommend that clients hold a diversified stock portfolio consisting of large and small cap U.S. stocks, and international stocks, both from developed as well as emerging market countries. If we assume our hypothetical investor followed that prescription for 2011 and held a portfolio consisting of 70% U.S. stocks, 20% developed international equities and 10% emerging market ones, their return for the year would have been negative 6.6%.

At least that would have outstripped the really smartest guys in the room, the hedge fund managers. You will remember that they are only open to the truly sophisticated investors - very high net worth individuals, pension plan administrators, college endowments, etc. And you'll also recall that those lucky enough to qualify to have their dollars so managed pay a pretty penny, typically 2% of assets managed plus 20% of the profits generated. That's considerably above the retail investor who pays around 1.5% for their mutual fund managers, as well as a commission of 4-5% to buy the fund in some instances too.

So how did the hedgies do you ask? According to data from [Hedge Fund Research](#), through 12/27/2011 the Global Hedge Fund Index was down a shocking 9% while the Equity Hedge Fund Index was down a mind numbing 19%. The Dow Jones Credit Suisse Hedge Fund Index reported that the eight hedge fund strategies -- long/short, global macro, event driven, core, convertible arbitrage, emerging market, fixed income arbitrage and managed futures -- all lost money. Every single one.

So, if your investment advisor did better than these hedge fund manager norms, give him a hug, and be thankful you're not a player in the 2 and 20 game.

Sometimes Mr. Market has the last laugh on everybody.

WHAT'S IN STORE FOR 2012?

I'm not sure you want to ask me that question. At least don't take my prognostication acumen to the bank. Last year at this time I made three predictions. One proved out, one was halfway right and the last, . . . not so much. The Westover crystal ball predicted:

1. The U.S. equity market would be positive

You know how that turned out. Cup half full, half empty. Comme Ci, Comme Ça.

2. The large caps would shine

They did. The Dow Jones Industrial average was up 5.5% for the year. Beat every other broad U.S. based index.

3. US Treasuries would disappoint

Oops. Not quite. Boy, this was one even Bill Gross, the famed Pimco bond guru, missed too. I guess you could say I was in good company. "Disappoint"? Hardly. Long-term treasuries were up over 20% for the year and the overall bond index was up about 7.5%.

My observation is that sometimes the things you are most certain about are the things you should be most skeptical of. If you're interested, a fascinating book on this subject is [How we Know What Isn't So](#), by Thomas Gilovich.

Ever the glutton for punishment let me offer some predictions for this year:

1. **The market will surprise to the upside**, notwithstanding the slow, almost tepid economic growth and GDP we will experience. Housing will show a bottoming. Unemployment will marginally improve. The consumer will keep on keeping on modestly while manufacturing, particularly the export side, will lead us forward. One recent green shoot: private sector jobs have increased by over 100,000 each of the last 6 months. That last happened in 2006.

The fourth year of a Presidential election is historically a positive one for the market, as whoever is in the White House does everything in their power to improve our economic life. Of the 21 election years since 1928, there have only been three where the S&P 500 index had a negative return. Of course 2008 was a real stinker at minus 38%, so no rule is absolute. The average return for these 21 election years is 11.8%. Since WW II President Jimmy Carter has the distinction of having the two highest stock market return years, 23.8% when he beat Gerald Ford and 32.4% when he lost to Ronald Reagan.

James Carville's famous dictum, "It's the Economy, Stupid", still rings true twenty years later! Regardless of your political persuasion, for the sake of our respective investment portfolios, let's hope Barack Obama doesn't become the first president ever to have been elected and four years later to have been in office when the markets turned south both times!

Put all that in the blender, shake it up and you'll see a **high, single digit improvement** in the S&P 500 index by year's end. If I'm wrong, it will be because I underestimated where we'd end up, not the other way around.

2. **Bonds are done.** Stick a fork in them. Quick now, answer me this: Bonds have outperformed stocks for:

- A. 1 year
- B. 5 years
- C. 10
- D. 20
- E. 30
- F. All of the above

That's right, it's F. Not since the Civil War have we seen bonds outstrip stocks for thirty years. Still the difference is miniscule. The Ibbotson SBBI Index for bonds returned 11.03% a year on average for the last 30 years, barely beating the 10.98% return for equities. Still both those numbers are nothing to sneeze at are they?

And even though the S&P 500 index, ex-dividends impersonated Big Thunder Mountain in 2011, its average over the last three years was still a healthy 10.82%. See? Patience is a virtue.

Last year we saw the European meltdown send investors scurrying to the best house in the world's bad neighborhood -- the U.S. Treasury market. Barring another Black Swan macro event (e.g., Iran goes nuclear or gets nuked by Israel), I just don't see how interest rates can go lower or U.S. Treasuries higher. I expect a **negative return for U.S. treasury debt in 2012.**

LISTEN TO THE MUSIC

No one knew that the commonality of ten artists I mentioned -- Bryan Adams, Paul Anka, Justin Bieber, Celine Dion, Diana Krall, Alanis Morissette, Anne Murray, Oscar Peterson, Shania Twain and Neil Young - was that they were all Canadians.

Neither did anyone know the answer to the other part of that first question matching songs with artists or to the two parts to the NCAA football quiz.

I think that either Listen to The Music may have run its course over these ten years, or maybe the questions last time were too convoluted. I'll give it one more college try.

Here's one everyone can play. \$50 goes to the winner: Name the 2012 Super Bowl champ. Now you may think it's smart to wait until February 6th, the day after the game, to submit your guess. That won't work. Here's why. The first person to submit the name of the winning team will win Westover's pool. Everyone is entitled to two guesses. Good luck!

MARK THE DATE

If you have read this far, you're in for a real treat. Westover is putting on its second annual Investment Seminar this spring. And for the first time we've opened it up to more than just our clients. We've lined up a nationally regarded investment counselor and author as your speaker. He's been on all the business channels, is quoted in the Wall Street Journal on a regular basis and knows how to deal with the intersection of politics and investing.

On April 10th at the Wilmington Country Club he will enlighten you, and maybe his ideas will make your wallet fatter too. In February we'll give you greater details about this invitation-only meeting.

Instead of handing out bracelets as proof of admittance, you've got to be a Westover reader to get in the front door. I'm sure it will be oversubscribed so be on the lookout for your invitation.

This is a Westover wish from yours truly and Chip. Here's hoping that this year when it comes to your investment portfolio, the skies are Carolina Blue.

January 6, 2012