



Summary

The U.S. economy continues to show signs of growth and recovery, though figures don't indicate that economic growth is picking up substantially. Both the Institute for Supply Management (ISM) manufacturing and non-manufacturing indexes have risen slightly in recent months and are above the milestone 50 level that separates growth from contraction. However, at 53.9 and 52.6 respectively, their levels indicate that the economy should be showing only moderate growth. While true for much of last year, it appears as though the fourth quarter may show better growth due to pent-up consumer demand going into the holiday selling season.

The question going forward is whether this momentum will carry into the new year. Some of the key areas impacting the economy are providing some bright spots. In recent months, the important housing sector has shown signs of further stabilization: rising builder confidence, a pickup in construction activity, fewer unsold new properties for sale and housing starts at the highest level since April 2010. The labor market is also showing some life. The unemployment rate has declined to 8.5%. While still relatively high by historical standards, nonfarm payrolls have shown steady improvement. All of these factors have led to an improvement in consumer confidence, which, in the end, is a big determinant of growth in the economy.

With the consumer feeling better about the economy and the manufacturing sector showing growth and rebuilding inventories, the economy should continue on its upward path. The financial situation in Europe remains a concern, but gradually the positives of our economy should be noticed and outweigh many of those concerns.

POSITIVES

- ❑ Conference Board's Consumer Confidence Index rose sharply in December
- ❑ ISM manufacturing and non-manufacturing indexes rose in December
- ❑ Nonfarm payrolls rose by 200,000 jobs in December
- ❑ Additional stability seen in housing sector

NEGATIVES

- ❑ Strength in U.S. dollar a potential negative for net exports
- ❑ Continued financial problems in Europe

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- ❑ Impact of presidential campaign rhetoric on consumer attitudes



THE SOURCE

FCI

FINANCIAL COUNSELORS INC.
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EQUITY OUTLOOK

Summary

Finally, 2011 is over. In a year punctuated by unprecedented volatility, investors, seeking refuge from the daily onslaught of apocalyptic headlines from Europe, flocked to defensive sectors of the market. In an environment where interest rates collapsed to nearly zero, it's not surprising that the dividend-paying utilities, staples and health care sectors led the market with gains of 14.8%, 10.5% and 10.2%, respectively.

The U.S. market, while sporting a meager 2.1% return as measured by the S&P 500 Index, trounced the rest of the world as the MCSI EAFE index slipped 14.8% and the MSCI Emerging Market Index plunged 20.4%.

After a touch and go spell last summer, it appears economic activity in the U.S. improved measurably in the last several weeks of the year. Announced layoffs declined sharply, the engine of job growth appears to have turned over, auto sales revved up, and consumer confidence rebounded from the drubbing inflicted by last summer's congressional debate over increasing the federal debt ceiling.

Our outlook is for positive returns in the U.S. equity markets in 2012, due in part to better-than-expected economic reports in the first half of the year. Increased job creation has a way of inspiring better overall economic activity, and therefore market activity.

Emerging markets appear to be better positioned for a positive 2012 as many central bankers around the globe have recently adopted pro-growth monetary policies after a year of fighting inflationary brush fires.

POSITIVES

- ❑ U.S. job creation picking up
- ❑ Valuations attractive
- ❑ Global monetary policies pro-growth

NEGATIVES

- ❑ Europe still mired in debt crisis
- ❑ Iran nuclear development moves to front stage
- ❑ U.S. election rhetoric to escalate

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- ❑ Europe resolves debt sharing issues



Summary

There were many uncertainties that contributed to a significant decline in Treasury yields over the course of 2011: a near-nuclear disaster following an earthquake and tsunami in Japan; the Arab uprising and disposal of three entrenched governments; the inability of European leaders to craft a workable solution to ease the debt burden on numerous member countries without wrecking their entire financial system; and finally in the U.S., a debt ceiling stalemate that presented the possibility of a default, prompting the first downgrade in history of U.S. Treasury debt. Many of these uncertainties remain.

Offsetting these uncertainties is the realization that domestic economic activity appears to be on firmer footing. Almost all indications are that the economy will continue to grow, albeit modestly, and the threat of sliding into another recession is diminished. The fly in the ointment remains Europe, where a recession is almost certain due to the significant austerity measures that are to be enacted. But, if Europe remains unable to reach a realistic plan to address its structural budget deficits and overwhelming debt loads, then its weaker countries may be unable to fund themselves in the public capital markets and a historic crisis could emerge. Based on the global linkages between finance and trade, our nascent recovery could be in jeopardy.

The Federal Reserve has already committed to holding the fed funds rate at 0.25% until mid-2013. The Fed has also announced that that rate is likely to be extended into 2014 given the risks to the global economy. With short rates anchored, longer-term rates are unlikely to increase much over the coming year. Corporate credit remains attractive on a spread basis, and, given the nature of the European crisis, is likely to remain so until there is some resolution.

POSITIVES

- ❑ Uncertainty due to European debt crisis
- ❑ Non-traditional recovery in the U.S.
- ❑ Inflationary outlook is benign

NEGATIVES

- ❑ Rates already reflect slow growth and uncertainty and are at historic lows
- ❑ Most Treasury yields lower than the 12-month trailing rate of inflation

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- ❑ Investors continued flight from riskier asset classes
- ❑ Further Fed actions to stimulate the economy: QE3?