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AND THAT'S THE WEEK THAT WAS...

For the Quarter (Year) Ended December 31, 2012

Market Matters...

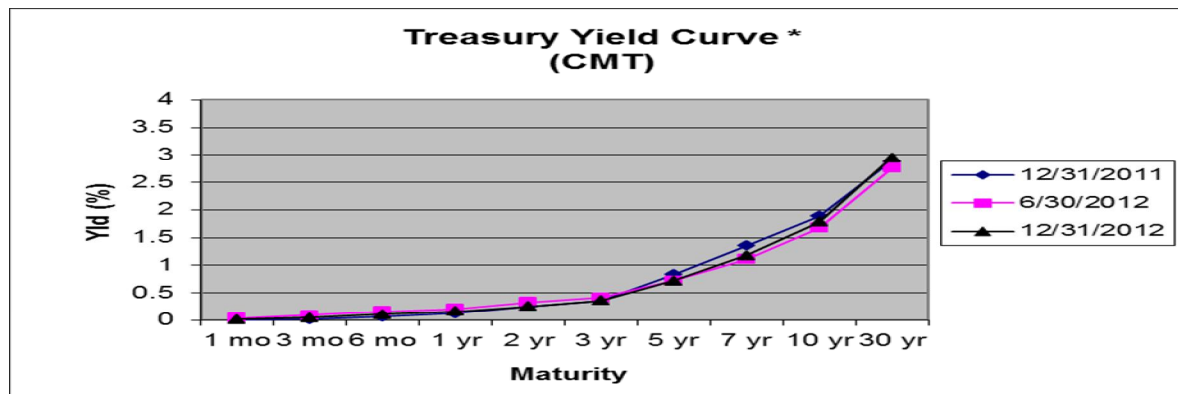
Market/Index	2011 Close	2012 Close	1 st Qtr Return	2 nd Qtr Return	3 rd Qtr Return	4 th Qtr Return	2012 Return
Dow Jones Industrial	12,217.56	13,104.14	8.14%	-2.51%	4.32%	-2.48%	7.26%
NASDAQ	2,605.15	3,019.51	18.67%	-5.06%	6.17%	-3.10%	15.91%
S&P 500	1,257.60	1,426.19	12.00%	-3.29%	5.76%	-1.01%	13.41%
Russell 2000	740.92	849.35	12.06%	-3.83%	4.88%	1.42%	14.63%
Global Dow	1,801.60	1,995.96	10.95%	-8.36%	4.91%	3.86%	10.79%
Fed Funds	0.25%	0.25%	0 bps	0 bps	0 bps	0 bps	0.00%
10 yr Treasury (Yld)	1.87%	1.76%	35 bps	-56 bps	-2 bps	12 bps	-0.11%

Politicos and investors surely make strange bedfellows. For much of 2012, politics dominated the domestic headlines and investors watched closely as they tried to predict the ultimate impact on the markets. A Prez election had folks speculating about how four more years of Obama would compare to a Romney regime. Each new ad, each Town Hall stump speech, each debate sent markets moving one way or another. By early November, öForwardö (Obama) defeated öBelieve in Americaö (Romney) and the American people knew who would be guiding the country for the next four years (for better or worse depending on party affiliations). Before the acceptance/concession speeches were complete, investors shifted focus to the öFiscal Cliffö and the potential disaster facing the country if Congress and the Administration could not agree on budget matters. After much bickering and badmouthing, they reached an 11th hour deal that raised income tax rates (on higher income folks) for the first time in about 20 years, but ökicked the canö down the road on key spending decisions. The deal also raised rates on dividends, capital gains, and large estates though the country will not see any real budgetary impact until Congress addresses much-needed spending cuts. Check back in two months for more political shenanigans and a larger crisis as the same budget challenges coincide with a new (old) debt ceiling dilemma.

The Fiscal Cliff was not the only önaturalö disaster to hit during the prior three months as Superstorm Sandy proved an unwelcome visitor to the East Coast, severely disrupting business (and everyday life), and even forcing the stock market to close on consecutive days for the first time since 1888. While some analysts predicted the overall economic impact to be temporary, the losses to the insurance industry brought back memories of Hurricane Katrina and the storm's timing may have forced some consumers to rethink their holiday shopping patterns. In corporate news, boardroom discussions revolved around buybacks and enhanced dividends as management teams remained hesitant to spend on tech and/or infrastructure ahead of a potential cliff hanging disaster and instead rewarded shareholders with any excess cash. Earnings remained solid again in the third quarter, though many companies warned about a year-end slowdown amid the uncertainties out of DC and the sluggish economies abroad. Energy prices traded range bound (\$85-\$90/barrel) throughout much of the quarter before busting the \$90 level at year-end on Middle East unrest and the last-minute, deal-making optimism.

Stocks entered the home stretch safely in positive territory, though fiscal concerns renewed pessimism in the quarter and most major indexes gave back ground. Investors still enjoyed nice annual returns with the Nasdaq, S&P 500, and small cap Russell 2000 posting double-digit gains. Fed moves were aided by a surging housing market to guide equities higher with financials leading the charge. The only major sector to give up ground was utilities. Much maligned Europe even performed well with Germany's DAX jumping 29%, while Spain's index was among the biggest losers. Japan's Nikkei closed at 2012 highs as a weak yen offered promise for export growth. Corporations issued debt in droves to take advantage of the low rates. How long until öfiscal cliffö tops the headlines again? Happy New Year (for now).

Economically Speaking...



With the domestic economy slowly but surely working its way into solid growth mode, the negative ramifications of the budget crisis during the past three months put a damper on the progress. GDP in the third quarter jumped 3.1%, though Sandy and *Cliff* threatened to diminish the growth in the fourth. **(Labor)** The jobless rate dropped to its lowest level in almost four years and more nonfarm jobs than expected were added to the economy in November. **(Manufacturing)** Industrial production bounced back from a temp slowdown from Sandy, though the ISM index moved into contraction mode (hopefully temporarily) for the first time in three months. **(Retail)** While Black Friday initially depicted a decent start to the holiday season, **MasterCard's** SpendingPulse unit reported that overall sales were lackluster at best from late October through Christmas Eve. Additionally, consumer confidence fell to the lowest level since August on the ongoing political bickering over taxes and spending. Surprisingly, the **housing** sector has led the resurgence in the economy as new construction was robust, sales jumped to levels not seen in three years, and home prices produced an annual gain for the first time since 2006. **Inflation** remained a non-factor (for now) as energy prices tumbled during much of the quarter.

Fed Chair Bernanke could top the list of investors' *Man of the Year* (if such an award existed) as his policies helped set the tone for the positive vibe in the equity market. The treasury bond buying programs (\$40 billion/month ongoing and an additional \$45 billion to compensate for the end of Operations Twist) were well-received by investors and served to keep rates low and moneys pouring into *risk* assets like stocks. Policymakers seemed intent on doing everything in their powers to maintain the low rates for the foreseeable future as improvements in labor remain *too gradual* for their liking. Bernanke also hasn't been shy about urging Congress to put the budget back *on a sustainable path*, another act that may have earned him additional brownie points from investors who are frustrated with the fearless leaders in DC.

The global story has changed little over the past 12 months and most forecasters (Organization for Economic Cooperation and Development and the European Central Bank) see further contraction for the combined euro-zone economies. Consecutive quarters of faltering GDP has translated into another recession for the region. Greece remained in the common currency bloc and even successfully initiated a debt buyback program, though its unemployment rate stands upwards of 25 percent. Likewise, Spain suffered another quarter of economy contraction and a surging jobless rate. Still, the ECB all but promised to get the joint economy rolling again and the bond buying program is a step in that direction. Meanwhile, China looks to be back on track as its manufacturing index soared to a 14-month high.

On the Horizon... While politicians may be patting themselves on the back for *averting* the fiscal crisis (for now), the reality is that they merely pushed the inevitable back a few months and soon will have to come to grips with necessary spending cuts. Any equity market rally may, in fact, be short-lived as Congress and Prez O have given zero indication that true compromise is coming. And thus the eyes of the global investor remain firmly on DC and until a true deal can be reached (if ever), all else will remain in limbo. (Time for another harsh reprimand, Dr. Bernanke.)