



Forza Investment Advisory, LLC

Strengthening Our Clients' Financial Lives

Forza Investment Advisory Annual Market Summary

Jan 11, 2012

The market closed out the 4th quarter with a whimper and we head into 2012 with more of what we left 2011 with – uncertainty. As I write this letter, the market has staged a small rally during the first 5 trading days of 2012. We can only hope for more of the same as the year moves ahead but I think I can state with almost 100% certainty that we will continue to face a tough environment and stock prices will ebb and flow. One thing we learned in 2011 was how volatile and unpredictable the markets could be as the world's major economies piled on debt. To quickly recap some of the highlights of last year:

- Revolts in the Middle East drove oil prices higher
- Japan was hit by an earthquake in March that triggered a tsunami and a nuclear disaster
- The US economy went soft in the summer and the US Congress took the country to near default on its debt payments in August – triggering the first-ever downgrade of the US's credit rating
- Meanwhile, Europe's sovereign debt problems escalated and Greece came within a hair of default. The debt contagion spread to Italy and France was hit with a credit downgrade due to debt of its largest banks
- Europe spent the remaining 3 months of the year trying to come up with a plan to stem the debt crisis
- And how about this whacky fact -- The sovereign debt of the US, Italy, Spain, Portugal, Ireland and Japan were downgraded while countries such as Angola, Brazil, Bulgaria and Estonia and Peru experienced upgrades

As we head into 2012 there are some glimmers of hope that the US economy is “sort of” heading in the right direction and the ECB is moving to contain the growing credit crunch. However, a lot of work needs to be done. A major question is how much is smoke and mirrors? Are the Fed and ECB “all in” at this point; can they continue to walk a tightrope and bring the world economies back to life while not further strangling us by mortgaging our futures with debt? How long can central banks continue to pump cash into the financial system? Can politicians stop acting like politicians and start acting for the good of their constituencies? Well, let's not go crazy here. That is not going to happen; especially in an election year both here and in France.

Europe must get out of the headlines. Last year was characterized by crazy turns in asset prices driven by the news of the minute from that European soap opera called “One Life to Ruin”. And many financial lives were practically ruined depending on the news that came each day. How volatile was it? From August until the end of the year, the Dow Jones Industrial Average fell by at least 200 points a staggering 19 times while rising by the same 15 times. For the whole first half of the year, the market only breached that number 3 times. The terms “risk-on” and “risk-off” became part of everyday lingo. The S&P 500 closed up or down 2% on 35 days in 2011.



Forza Investment Advisory, LLC

Strengthening Our Clients' Financial Lives

So, as your money manager, where do I stand on all this? I hate to use this cliché, but I am cautiously optimistic about 2012. I do think that US Corporate earnings can help move the market higher – if Europe doesn't go into a deep recession. The US economy really is showing some signs of life; especially in manufacturing. Stock prices are not expensive and the major indexes are trading at very reasonable levels based on trailing and forward PE ratios. The S&P trades at about 12.8x trailing earnings and about 11.8x forward EPS compared to historical averages of 14x-16x. Cyclical stocks underperformed in 2011 (energy, basic materials and industrials) but if the economy gets a bit stronger, these stocks can help lead the market higher. There are a lot of negatives that we need to overcome. This much we know already. Also on the negative side, changes are coming on the regulatory front with the Volker Rule and implications of Dodd-Frank. This uncertainty will not help financial stocks. And we need financial stocks to act better for the market to move meaningfully higher.

So, in sum it may be another tug-of-war between fundamental strength among companies and macroeconomic worries. The coming presidential election also may put a damper on stocks while Europe's debt crisis will continue to stay in the news. As long as companies show good earnings results and continue to meet or beat earnings and sales estimates, the fundamental outlook could help overcome macro worries. But the macro news must stay within expectations and not surprise to the downside. 2011 was certainly a year to be defensive but 2012 might be time to play some more offense.

Looking ahead, we enter 2012 about fully invested. The portfolio is well diversified and finally about where I want it to be after making changes through last year. A good earnings season should help us regain momentum and put us on the right path given all the uncertainties.

Bob Centrella

Managing Partner

Forza Investment Advisory, LLC