SELECTOR® Money Management
2012 First Quarter Review

While the fourth quarter of 2011 left like a lion, the first quarter of 2012 opened like a lamb. The intense volatility that had gripped equity markets the last five months of 2011 suddenly disappeared. In fact, the S&P 500 and the Dow Jones Industrial Average did not experience a 1% day, up or down, until the first week in March. It was the longest running 'quiet opening' of those markets in 14 years. How it could follow such a violent fourth quarter remains a mystery. Even more curiously, equity markets quietly made their way higher over that same period. They seemed oblivious to the 18%, two-week market drop that occurred just four months earlier and the multiple 5% and 10% drops in September, November, and December.

No one anticipated such a quiet, positive opening for the new year and the more experienced the investor the more suspicious they remained. But by March, there was no denying the legitimacy of this new market trend. Encouraged by a brief correction the first week in March, investors accepted the higher prices as the equity markets' reality and continued to embrace equities, buying the dips quicker and with more conviction. By the end of the first quarter the S&P 500 had experienced its biggest first-quarter advance in fourteen years. The equity market advance also broadened its scope as it rose higher, including not only large cap, but also midcap and small cap domestic equities. On the international front, as European financial markets worked to resolve their debt issues, their equity markets became stronger, which especially buoyed emerging markets equities.

At the first quarter's end, the S&P 500 stood a remarkable +12.59% higher, the strongest opening since 1998. The S&P MidCap 400 Index was up +13.50%, and the Russell 2000 Small Cap Index was up +12.44%. The international equities EAFE Index finished the first quarter of 2012 up +10.86%, and the MSCI Emerging Markets Index was +14.08% higher. The strongest performing domestic equity sectors were financials and home construction, two sectors which had been under considerable selling pressure in the weak economy. The Dow Jones U.S. Financial Services Index shot up by +26.86% in the first quarter, the Dow Jones U.S. Select Home Construction Index was up 24.04%. The laggard was the Dow Jones U.S. Utilities Index, which had been a stalwart performer previously. Obviously, there was a shift of capital from conservative to more aggressive equity sectors.

Bond markets were mixed in the first quarter of 2012 and experienced their first significant correction in over a year. The Barclays Capital U.S. Aggregate Bond Index closed the first quarter of 2012 up just +0.3%. Meanwhile, the Barclays Capital U.S. 20+ Year Treasury Bond Index declined by -6.73%, the Barclays Capital U.S. 7-10 Year Treasury Bond Index fell -1.63%, and the Barclays Capital U.S. TIPS Index gained +0.86%. High yield bonds benefited from the equity market action and were the best performers of the first quarter, as the iBoxx $ Liquid High Yield Index gained 4.55%. Municipal bonds also experienced a positive opening quarter, with the S&P National Municipal Bond Index ending up +1.77%.

SELECTOR® Money Management entered the first quarter of 2012 with very conservative portfolio allocations. The relative comfort of being defensive in January was displaced with a desire to reallocate more into equities, hopefully during a market correction, in the month of February. The absence of any correction prompted us to gradually move into equity positions the end of February and early March. SELECTOR® models are now fully invested in equities in most all portfolios, within the constraints of the particular management style. Those allocations may include small cap, mid cap, energy, as well as developed international and emerging markets equities. We have also included health care, utilities, and real estate equities.

The strong start for equity markets thus far in 2012 is just one of the reasons why we are now fully invested. The U.S. economy is improving, albeit very slowly. Housing numbers and unemployment numbers, always the last to step back into the ring after a recession, are stabilizing. In general, election years are generally favorable for equity markets. In particular, regardless of which Party is victorious, the last seven months have seen gains in the S&P 500 in thirteen of the fifteen presidential elections since 1950. Interest rates are still very low. Consumer sentiment is showing signs of improvement. European debt fears are abating. All of the equity market's problems are not resolved, which is just fine. They tend to perform better while there are still question marks in the air.

Edward D. Foy
Manager, SELECTOR® Money Management

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Foy Financial Services, Inc.
12501 Holdrege Street
Lincoln, Nebraska 68527

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