Market Commentary
Yearend 2012
Prepared January 1, 2013

Dear Clients and Friends,

The Stock Market. For the full year of 2012, the market, as measured by the S&P 500 index rallied by 13.4%, and as measured by the Dow Jones Industrial Average rallied by 7.3%. A bull market peak was registered on September 14th as the S&P 500 index closed at 1,466 on that day, before closing the year at 1,426. It was nerve-wracking year for investor's and this advisor, that's for sure. Anxiety over potential outlier events such as possible blow-ups in Europe, and the fiscal mess in the United States served to keep investor sentiment in a risk-adverse mood. But in the end, perceived risks proved to be "unrealized".

Bull/Bear Market Scorecard. While late-bull market behavior is becoming increasingly visible, the weight of the evidence indicates that the bull market that began on March 9, 2009, is still in force. See my discussion and summary below.

TECHNICAL, SENTIMENT AND TIMING CHARACTERISTICS OF TYPICAL BULL OR BEAR MARKETS/ CURRENT STATUS

Bull or Bear. A bull market has been in progress since March 9, 2009. As of December 31, 2012, the bull market is 46 months old, challenging the outer limits of an extended cyclical bull market advance. The 2003-2007 bull cycle ran for 52 months and the super-bull market of the 1990s ran for most of that decade, illustrating the potential for bull cycles to extend past "outer limits".

Initial Public Offerings (IPOs)/ Secondary Offerings. Investor excitement regarding IPOs has become more evident in 2012 than any prior point of the entire bull market. Facebook and numerous other social media IPOs immediately come to mind. Through December 2012, the number of IPOs is up 51% over IPOs of the prior year time frame. Additionally, secondary offerings (stock offerings of insiders) have increased by 40% over the prior year period. **CONCLUSION: LATE BULL MARKET BEHAVIOR.**

Technical Indicators. The advance-decline line of publicly-traded operating companies made a fresh bull market high in December 2012. Bull markets rarely top out concurrent with an A-D line peak. A bull market top should be expected within six months after the peak, so the December A-D line peak is a signal of an extension of the bull trend into early 2013, at a minimum. **CONCLUSION: BULLISH**

Participation as measured by the behavior of the "SPX Stocks Relative to 52-Wk. Hi/Lo Range" indicator has steadily declined as the bull market has progressed (call the office for a more detailed discussion). This is a normal bull cycle progression, but I think it is noteworthy that the indicator has fallen below the level found at the prior bull market top (2007). **CONCLUSION: LATE BULL MARKET BEHAVIOR**

Non-Divergences. Non-divergences occur when a high in particular stock average/index is not confirmed by a high in another. For instance, the failure of the Dow Jones Transportation Average to confirm a high in the Dow Jones Industrial Average would be regarded by technicians and proponents of the Dow Theory to be an example of a negative non-divergence. While it is correct that the transportation average has failed to confirm the Dow high, I would also note that the Transports are only a couple of percent below their bull-market high, a hurdle that could be easily overcome in a couple of trading sessions. Additionally, I find most other US stock sector indices to be in general confirmation of highs in the S&P 500. **CONCLUSION: BULLISH**

Volatility/ Investor Complacency. The unknowledgeable media often talks of the "highly volatile" stock market. They couldn't be further from the truth on this point. Volatility has generally remained at extraordinarily low levels throughout 2012, an illustration of investor complacency often found late in bull markets. For example, during one stretch in late summer, the volatility index persisted at an abnormally low level of 15 or below for 20 out of 31 trading sessions. **CONCLUSION: LATE BULL MARKET BEHAVIOR**

Investor Sentiment. Investor sentiment as measured by polling has turned bullish in recent months. For example, The American Association of Individual Investors, Investors Intelligence, and Market Vane have consistently polled a lopsided number of bulls relative to bears for most of the second half of 2012. From a contrarian's standpoint, this lengthy period of lopsided bullishness would ordinarily be viewed bearishly. But polling data is in direct conflict with what retail investors are actually doing. What they have been doing virtually non-stop since the bull market began in March 2009 is consistently pulling money out of equity mutual funds and ETFs, and plowing vast sums of money into fixed income mutual funds and ETFs. One condition for the wind-up of a bull cycle is the retail investing public's conversion from **contempt and disdain** for the stock market to an attitude of **acceptance and euphoria**. We're not anywhere close to that happening anytime soon. Perhaps a perceived positive resolution of the fiscal cliff mess could be the trigger for the "euphoria" stage of the bull cycle. **CONCLUSION: BULLISH**

Economic Conditions. The economy is growing slowly with annualized GDP growth being in the neighborhood of 2% in recent quarters. Earnings of publicly traded companies hit a record in the 3rd quarter. However, numerous earnings and revenue misses and layoffs announced by a slew of prominent corporations argues for earnings growth in 2013 to be flat to modestly higher. Investors know that impending recessions produce bear markets. A recession in the United States does not appear to be imminent at this time. **CONCLUSION: BULLISH**

Fiscal Cliff Update: It was much to do about nothing. On the last days of December, and first days of January, the sun did, in fact, rise, and the "fiscal cliff" hysteria came and went. I wouldn't mind going a real long time without hearing those two words. The result of all of the gnashing of teeth is that income taxes were generally not raised for most of the population and for the real rich folks, were raised just a little. The dividend and capital gains rates are unchanged for income levels less than $250,000. The estate tax threshold stays put at $5,000,000. Generally, the "deal" is taxpayer friendly. No spending cuts were announced at this time. As more detailed information comes available over the next few weeks, I will summarize the details in another mailing.

Happy New Year

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