American Heritage Securities, Inc.
affiliated with EGI Financial, Inc.

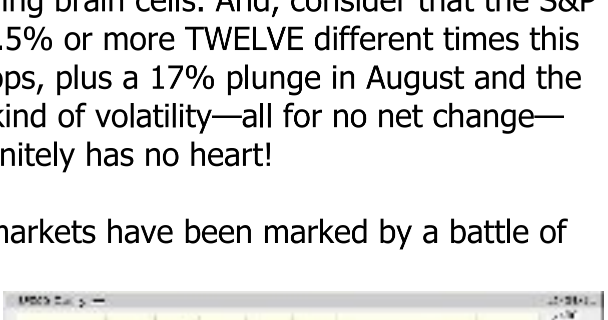
December Market Comment

Market With No Heart

December 12, 2011

Flatline: According to Webster's, from a medical perspective, **flatline** means "*to register on an electronic monitor as having no brain waves or heartbeat, or, die"*. An alternate definition is *"to be in a state of no progress or advancement"*. The "no progress or advancement" definition seems an accurate description of the overall return of the stock market for 2011 since, with just three weeks remaining, the S&P 500 sits just 0.3% higher than its close of December 2010.

But after considering the definitions, "having no brain waves or heart-beat" might be the better description. It hasn't been unusual this year to see stock prices bolt up or down by as much as 3% to 5% in a day—irrational moves for functioning brain cells. And, consider that the S&P has swung up or down by 7.5% or more TWELVE different times this year, including two 10% drops, plus a 17% plunge in August and the 17% gain in October. That kind of volatility—all for no net change—shows the stock market definitely has no heart!



Throughout 2011 financial markets have been marked by a battle of impressive corporate profits versus deteriorating macro-economic conditions and political incompetence. The bulls were winning until late summer when the fragility of the **global** economy became a growing concern. The catalyst was realization that the recovery in global manufacturing was encountering strong headwinds. At the root of the slowdown is a chronic and long festering problem—too much debt. Excessive consumer and government debt is an issue which cannot be resolved quickly and requires innovative solutions, austere measures and effective leadership, all qualities that have been nearly nonexistent this year.

Historically, the Fed has had reasonable success in repairing our economic woes. However, it is increasingly evident that the Fed has exhausted its options. Unfortunately, the fate of the economy and stock market rests on the ability of politicians to solve our difficult problems—a concept that completely spooks investors. It seems somewhat rash to make elected officials the scapegoat for our problems because even the "experts" can't agree on the right prescription to heal our woes—and there also is little consensus from the man-on-the-street except for agreement that we are on the wrong track. Still, politicians are an easy and deserving target for our frustrations!
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The good news is that our problems are solvable. The Eurozone as a whole is solvent so long as the core countries stand behind the peripheral weaker countries. Some constructive movement from EU leaders has helped stock prices over the past two weeks. In the U.S. , even modest changes to social security, Medicare, our tax system, and discretionary spending could go a long way to controlling our debt and deficits. Regulatory reform could unleash the massive potential of our economy to create a flood of new revenue (i.e. taxes – but don't use that word) that would do wonders for the deficit.

Growth is still a viable concept. While consumers in the developed markets may be constrained by debt, low income growth and sparse jobs, emerging market consumers are getting richer. China 's consumers were outspent only by their U.S. counterparts last year and the Economist Intelligence Unit expects China to overtake the U.S. as the world's largest retail market by 2013. There are still great opportunities in China for multi-national consumer product companies.

Even with Europe 's recent positive strides, the continent will remains a huge risk for financial markets for months (maybe years) to come. Further, it appears earnings expectations are beginning to decline and investors are likely to apply lower multiples to stock valuations as we enter 2012. These issues are serious enough that we continue to take a very cautious approach to the market. Still, a lot of risk is built into stocks at current levels and continued slow improvement in the economy is supportive for the financial markets.

Despite our concerns there are opportunities, especially in the mega-cap, multi-national arena where valuations are attractive and yields are high. Investors enjoy a unique epoch where they can own very high-quality stocks and generate a **sustainable and growing income stream** well above money market or good quality bond rates. High-quality, big cap stocks have started to outperform after being ignored over the past decade. We believe this asset class is underrepresented in institutional portfolios and will benefit as money managers rediscover the value in this area.

It looks like 2012 will see continued on/off crises related to debt problems and the fragile economic recovery—in addition to increasing political rhetoric leading up to an election that will, hopefully, provide direction to our leaderless leaders. We expect the investment landscape will continue frustrating and volatile, but still offer opportunities for those willing to approach it rationally.

Best regards,

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