



December 2011 ECONOMIC REPORT

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President



Economy: US Finishes 2011 on Firmer Footing

Over the course of a difficult and trying year, the domestic economy fought to maintain some amount of positive momentum. After starting the year strong and enduring a mid-year hiccup, it can be said that the economy actually finished on firmer footing than many expected. That does not mean 2012 will be an easy year, however, as the overhang from Europe will remain front and center.

In aggregate, the economy went through a series of three periods during the year:

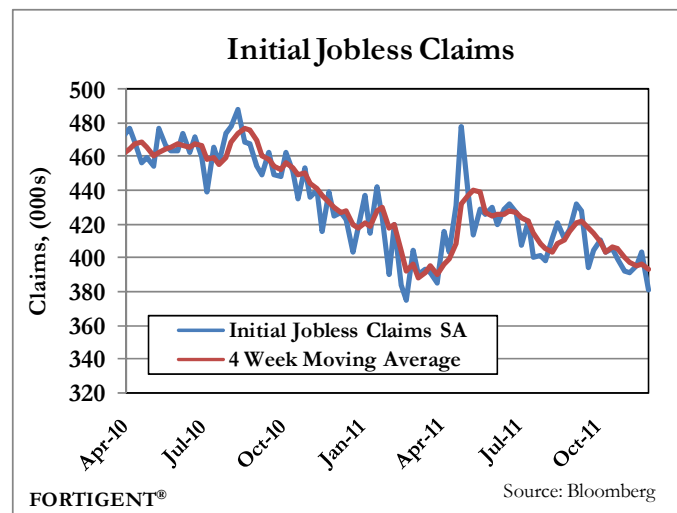
The first third of the year was marked by improving economic growth coupled with a series of abnormal global occurrences, from the Arab Spring to the earthquake in Japan. Those events dampened the global economy in...

The middle third of the year and caused a slowdown globally and in the US. This was most evident in the Citigroup Economic Surprise Index for the US (which measures the gap between expectations and reality), which peaked near 100 in early March before tumbling to -100 by early June. Such a dramatic move was last experienced in fall 2008.

Once it became apparent that consumer spending and corporate profitability was better than expected, the US economy gradually clawed out of its mid-summer doldrums.

In the last third of the year, the Citigroup Economic Surprise Index once again soared, rising to 85 by early December and holding steady through the end of the year.

Finally, Improvement in Jobs: A critical area of focus throughout 2011 has been the labor markets. Despite numerous headlines discrediting improvement in the labor markets, modest job gains occurred during the year and in the past few months. For example, in 2010, private payrolls grew by an average of 98,000 jobs per month. In the first eleven months of 2011, that number rose to 156,000. In addition, the unemployment rate, which began the year at 9.0% and rose to 9.2% by the summer, ended November at 8.6%. In the last positive development, initial claims for unemployment benefits, which hovered just above 400,000 for most of the year, broke decidedly through the 400,000 barrier in December, dropping as low as 366,000. Many economists peg 400,000 as the point at which sustainable job growth begins, so this is a welcome development. Whether the economy can continue that trend into 2012 is a significant unknown.





Consumers feeling pinched: With job growth slightly improved, but still weak, consumers were hesitant to embrace a fully fledged spending binge. Real personal consumption expenditures rose 0.2% in October and November, respectively, to post a 1.7% year-over-year gain. Inflation played a role in driving prices higher, particularly in the first half of the year. That, in turn, left consumers dipping into their savings in order to offset relatively modest wage gains; the personal savings rate dipped from 5% at the end of last year to 3.5% in November.

Federal Reserve: The quarter started comparatively quietly for the Federal Reserve, as the only major news was the standard policy meeting of the Federal Open Market Committee (FOMC). The FOMC chose to reiterate that interest rates would remain low until at least mid-2013 while also confirming that “Operation Twist” would continue as originally planned. One shift was a downgrade to growth expectations for 2011 and 2012. The range of estimates for 2012 growth fell from 3.3-3.7% to 2.5-2.9%. The FOMC did note that “there are significant downside risks to the economic outlook, including strains in the global financial markets.”

US/Foreign banks: An extension of the liquidity created through US dollar swap lines, coupled with a cut in the financing costs, at a minimum, buys European leaders additional time to work out a long-term solution to their ongoing crisis. Bank stability was a growing area of pressure in Europe, and one that risked plunging the whole economy into a deep contraction. For now, those fears will ease while a coherent solution is debated.

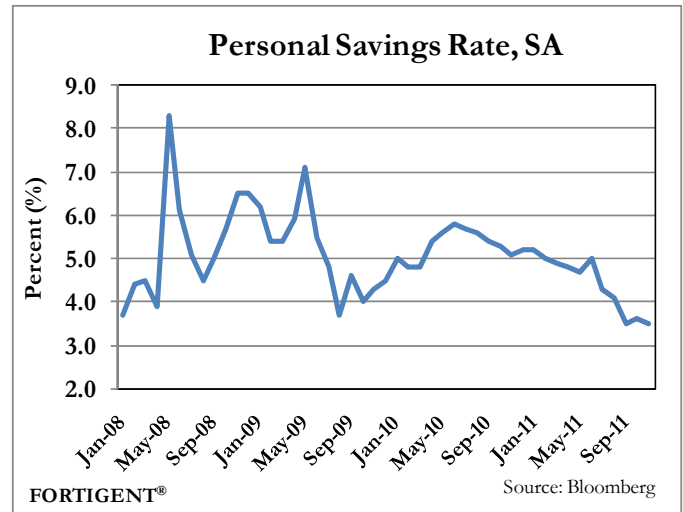
Global Equities: Lackluster Holiday Months Can't Erode October Rally

Global equities finished Q4 in positive territory due to the best October in the 23-year history for the MSCI All Country World Index (ACWI), despite lackluster performance in November and December. Apparent improvement in the European sovereign debt crisis led to optimism early in the quarter; however, in subsequent days it became clear to financial markets that the details of the European Union's latest plan were lacking. This led to a renewed selloff that carried over for most of the year's final months, though a mini three-day rally at the end of November helped keep Q4 returns in the black.

Despite improvement in US economic data, uncertainty surrounding the European sovereign debt crisis and its implications for global financial markets remain. With little indications of a resolution to this issue in sight, investors have little incentive to pile into risk assets. Slowing economic activity in Europe and China unfortunately may act as another detraction heading into 2012.

Domestic Equities: While US stocks were flat from a price perspective (as measured by the S&P 500 index level) in 2011, dividends boosted investors' return to just over 2%.

In retrospect, 2011 can certainly be characterized as a year of volatility, punctuated by the VIX index which finished the year 32% higher than where it began. Still, the year's closing figure of 23.4 represented a significant decline from the peak of 48 in early August (following the confluence of the US credit rating downgrade, debt ceiling debacle, and spike in Italian bond yields). The volatility index remained above 30 for most of the next three months before collapsing in December. This may not last, however, as current futures prices anticipate the VIX returning to the 30 range by mid-2012.





S&P 500 - upward mobility: The upward, albeit volatile, path of the S&P 500 since October has created technical improvement in the markets. Fourth quarter performance has led to an imminent crossing of the 50-day exponential moving average and the 200-day exponential moving average for the S&P 500 – typically viewed as a bullish signal and appear to be signaling a sustained uptrend.

Contradicting these bullish signals, however, is the steep reduction in earnings estimates for US companies. Since the end of Q3, EPS growth estimates for S&P 500 constituents have more than halved.

International Equities: International stocks sharply lagged their US counterparts in Q4, with currency playing only a modest role in the quarter's final numbers.

Europe: European stocks were the exception in Q4, as the index experienced material currency depreciation versus the US dollar. By year end, the euro fell below \$1.30 for the first time since January, reviving the mid-2010 talk of euro-dollar parity. A major European summit in November – one that many expected to finally present a credible long-term solution to the debt crisis – was once again undermined by squabbling between leaders and diluted measures. As a result, many began to seriously question the tenability of the region's monetary union. Meanwhile, the region's banks came under increasing pressure as an agency report showed a dramatic shortfall in capital ratios. The euro fell nearly 9% from a near-term peak of \$1.42 at the end of October.

Europe displayed incredibly diverse stock market performance during the quarter and for the year. Tiny Ireland (+22%) led all global MSCI countries during Q4, and finished 2011 as the top market with a return of 14% (more than double the second place country). Alternatively, Greece declined another 27.5% during the quarter, worst among ACWI countries. The epicenter of the European debt crisis, beleaguered Greece dropped an astounding 63% in 2011, easily eclipsing all other countries in the index (including Egypt, which suffered dramatic political strife and saw its stock market shut down for more than a month). Ultimately, Europe's performance in Q4 and 2011 was driven by the United Kingdom (36% of the index), which was among the top performing global markets this year.

Japan did not participate in October's rally and finished with poor performance for the quarter. Despite retaining safe-haven status at the currency level – the yen was one of the few currencies to appreciate relative to the dollar this year – Japanese equities failed to recover fully from the natural disasters in March that disrupted supply chains and eviscerated mid-year GDP. Evidence of a slowdown in China further reduced investor confidence in a country so dependent on external demand (due to an aging demographic and poor domestic consumption trends).

Emerging markets posted disappointing performance in Q4, considering the developed market rebound. After leading global returns during October's rally, the index suffered in November, due in large part to Asia (read: India). Despite an absence of the fiscal issues plaguing the developed world, emerging markets were targeted as a high risk market segment in 2011. While a significant chunk of losses were due to currency depreciation, the index underperformed Europe even on a local currency basis, reflecting investors' continued aversion to these markets in uncertain times.

Frontier markets also posted disappointing performance in Q4, falling 2%. This was largely the result of the index's failure to rally in October alongside other global equities (only a 2% gain versus emerging market's 13% rise). For the year, frontier markets performed in line with emerging markets, declining 18.4%.

Source: MSCI, Bloomberg, WSJ, The Economist, Morgan Stanley, Bespoke, FactSet, Russell, Reuters, J.P. Morgan



Fixed Income: 2011 - No Bubbles Bursting or Mass Muni Defaults

US Taxable Markets: The fourth quarter and 2011 return for core taxable bonds, as measured by the BarCap Aggregate index, was approximately 1.1% and 7.8% respectively. In a quick review of the year's performance campaign, the summer months were strongest with Q2 and Q3 producing the bulk of 2011 return. US rates fell in a broad based flight from risk assets. In addition, Federal Reserve activity forced rates lower.

US investment grade credit produced 1.9% and 8.1% for the quarter and year. In Q4, performance was mostly driven by income.

High yield corporate bond performance was exceptionally volatile. Based on BarCap High Yield index data, investors realized a 6% rebound in Q4. This led to a 2011 return of approximately 5.4%, which was slightly less than income generated for the year.

Leveraged loans produced a gain of approximately 3.1% for the quarter and 1.1% for the year based on BarCap index data. The Fed's pledge to maintain its key rate until 2013 led investors to reduce capital held in this market. Fourth quarter results were relatively strong and reflected price appreciation along with income. The average loan price increased from approximately \$89 to \$90 in the quarter.

Agency Mortgaged-Backed Securities generated 0.9% and 6.2% returns for the quarter and year. 2011 performance reflected income and mild price appreciation with the space benefiting from a flight to quality that occurred in Q3 and the Fed's purchase activity. Q4 performance largely reflected income. Based on the Mortgage Bankers Association refinancing index data, fourth quarter refinance application activity was 17% above the five year average. October and December were particularly strong months as mortgage rates remained at record low levels.

Municipal Market: The Q4 and 2011 performance for core tax exempt bonds, as measured by the BarCap 1-10 year index, was approximately 1.0% and 7.3%, respectively. The muni market was under considerable pressure at the start of 2011 as investors sold on worries of mass defaults. As tax exempt yields reached levels more attractive than traditional taxable bonds, institutional investors allocated capital to munis, forcing a rather quick turnaround midway through the first quarter. The December price rally resulted in munis essentially producing a return that equaled Q4 income.

High yield munis produced a 9.2% return for the quarter and 0.8% year-to-date, based on BarCap index data. The high yield muni market was relatively well balanced in Q4, as hefty supply was met with solid demand from institutional investors and mutual fund complexes.

The quarter was not without its major headlines. AMR Corporation, which is responsible for the cash flow payments of several airline-related municipal issues, declared bankruptcy. Such issues represented less than 2% of the BarCap index at the start of the quarter. Other issuers in the headlines that may have affected this market include Harrisburg, Pa., Jefferson County, Ala., and Central Falls, R.I.

AAA Municipal Yields

Security	9/30/2011	12/31/2011	Change
2 Year	0.48	0.47	-0.01
5 Year	1.27	1.10	-0.17
10 Year	2.55	2.28	-0.27
30 Year	4.31	4.22	-0.09

SOURCE: BLOOMBERG



International Markets: Much like the US fixed income markets, the international sovereign bond and currency markets were dominated by events in Europe. For the year, unhedged strategies for US investors were impacted by the general weakness of emerging market currencies. The currency weakness overwhelmed the solid income and general price appreciation of emerging market bonds and currencies. As a result, as measured by JPM indices, EM bonds lost 1.8% for the year while cash and short term securities lost 5.2%. Developed hedged bonds performed well in the year, producing a return of 5.9%, driven by a flight to quality that occurred in the later part of Q2 and Q3. The fourth quarter was relatively calm for developed markets outside of Europe. The main highlight in the international space was EM bonds denominated in US dollars. This area of the market generated a 5.3% return in Q4 and 9.2% for the year. This reflected the decline of US rates and a compression of spreads as investors searched for quality yield.

Sources: Barclay's Capital, Bloomberg LP, Financial Times, J.P. Morgan, Municipal Market Advisors, US Treasury

Liquid Real Assets

Commodities: There was a rebound in some of the most beaten down commodities during the quarter, most notably oil, copper, and select grains.

Oil benefited from tighter than expected year-end supply in the US and ominous missile brandishing by both sides in the Strait of Hormuz.

Copper rebounded during the quarter, with demand from China holding up better than a hard-landing would otherwise dictate. Nevertheless, the metal finished the year with its first loss since 2008.

Within grains, Q4 could not correct the YTD bifurcation between corn and wheat. Not since 1996 have corn futures traded at a premium to wheat, but that is exactly what happened in the second half of the year, due to strong wheat bumper crops around the globe and tight corn supply. CBOT wheat normally trades at a premium to corn because it yields fewer bushels per acre (45 bushels vs. 145 for corn¹) and has higher protein content. Humans also primarily consume wheat; whereas corn is more often utilized in cattle feed.

Demand for ethanol and livestock brought support for corn, but this price parity is in danger in the coming months. Livestock producers are starting to convert to wheat and (corn) ethanol demand is in limbo. The \$6 billion per year, 45 cent/gallon US government ethanol subsidy expired on December 31, 2011, leaving a huge question mark for the ethanol industry going forward.

Gold: Although higher for the year, gold struggled in Q4 despite accommodative European and US monetary policy decisions. A weak rupee was part of the story. India is the largest importer of gold in the world and higher prices in USD terms (gold bullion is priced in USD) resulted in December imports falling by 50% relative to last year. Policy decisions abroad also contributed to the decline. In Japan, for example, a new law was passed requiring bullion retailers to report gold and platinum transactions worth more than ¥2 million yen (~\$26K USD) to tax authorities effective January 1, 2012. This resulted in a rush for the exits by many investors, requiring bullion dealers to open on Thursday, December 29 (normally a public holiday).

Managed Limited Partnerships: It was an eventful quarter and year for MLPs. In the first half of 2011, discussion of public partnership taxation overhaul dominated headlines. As we moved into Q3 and Q4, rhetoric moved toward the Keystone XL Pipeline and the future of Canadian tar sands. If built, the Keystone pipeline would send approximately 830,000 barrels of oil per day from Alberta to Texas, reducing US dependence on seaborne oil. Opponents of the pipeline cite various environmental concerns, from endangered wetlands in Nebraska to the safety of the Ogallala Aquifer.



The latest wrinkle in the debate came from Canada, which showed reluctance to stand idly by while the US decides. Prime Minister Stephen Harper noted in a recent CTV news interview that Canada is “very serious” about selling its oil to China if the US cannot make up its mind.

REITs: Across the globe, the quarter ended much like it began, with cyclical REITs recovering from August lows. For the year, however, US REITs was the only major region in positive territory, outperforming European and Asian securities by more than 20%.

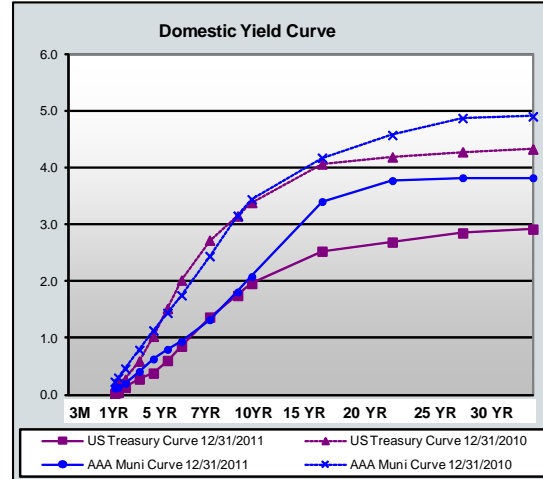
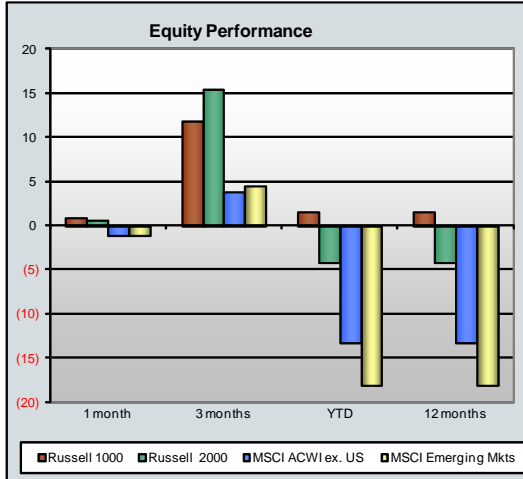
In the US, capital raises were the theme for the year, though activity did slow in Q4. Through November, REITs raised \$50 billion in equity and debt offerings, the largest figure ever. Equity issuance in particular was 31% higher than any previous year, and this with only 11 months of activity.

Domestic equity REITs finished the year yielding less than 4%, Mortgage REITs, which comprise approximately 10% of US REITs, but are excluded from the MSCI US REIT Index, finished the year with a yield of 15%. An interesting issue not often discussed is the distribution component of REITs. Many believe that because of the REIT structure, all distributions are treated as ordinary income. In actuality, in the US approximately two-thirds of distributions are taxed as ordinary income, 20% as long-term capital gains, with the balance distributed as return of capital.

Sources: hardassetsinvestor.com, MLPHINDSight, S&P, WSJ, CBRE, Cohen & Steers, FactSet, Alerian, commodityonline.com, fxstreet.com, USDA, IndexUniverse.com



MONTHLY PERFORMANCE FLASH REPORT
December 31, 2011



	1 month	3 months	YTD	12 months
Large Cap				
S&P 500	1.02	11.82	2.11	2.11
DJIA	1.58	12.78	8.38	8.38
Russell 1000	0.84	11.84	1.50	1.50
Russell 1000 Value	2.02	13.11	0.39	0.39
Russell 1000 Growth	(0.32)	10.61	2.64	2.64

	1 month	3 months	YTD	12 months
Small/Mid Cap				
Russell 2000	0.66	15.47	(4.18)	(4.18)
Russell 2000 Value	1.57	15.97	(5.50)	(5.50)
Russell 2000 Growth	(0.22)	14.99	(2.91)	(2.91)
Russell Microcap	1.39	13.83	(9.27)	(9.27)
Russell Midcap	(0.12)	12.31	(1.55)	(1.55)
Russell Midcap Value	1.25	13.37	(1.38)	(1.38)
Russell Midcap Growth	(1.50)	11.24	(1.65)	(1.65)

	1 month	3 months	YTD	12 months
All Cap				
Russell 3000	0.82	12.12	1.03	1.03
Russell 3000 Value	1.98	13.33	(0.10)	(0.10)
Russell 3000 Growth	(0.31)	10.94	2.18	2.18

	1 month	3 months	YTD	12 months
International Markets				
MSCI EAFE	(0.94)	3.38	(11.73)	(11.73)
MSCI ACWI ex. US	(1.10)	3.77	(13.33)	(13.33)
MSCI Europe	(1.53)	5.45	(10.50)	(10.50)
MSCI Japan	0.84	(3.85)	(14.19)	(14.19)
MSCI AC Asia Pacific Ex - Japan	0.04	4.37	(15.38)	(15.38)
MSCI EAFE SMID	(1.37)	0.46	(14.59)	(14.59)
MSCI ACWI ex. US SMID	(1.48)	1.26	(16.59)	(16.59)
MSCI Emerging Mkts	(1.20)	4.45	(18.17)	(18.17)
MSCI EMEA	(6.51)	2.90	(20.18)	(20.18)
MSCI Latin America	(1.56)	8.81	(19.15)	(19.15)
MSCI Frontier Markets	(1.12)	(1.92)	(18.38)	(18.38)

	1 month	3 months	YTD	12 months
Sectors (S&P 500 GICS)				
Consumer Discretionary	1.28	12.58	6.13	6.13
Consumer Staples	2.76	10.26	13.99	13.99
Energy	(1.02)	18.20	4.72	4.72
Financials	1.76	10.82	(17.06)	(17.06)
Healthcare	2.92	9.96	12.73	12.73
Industrials	1.17	16.52	(0.59)	(0.59)
Information Technology	(0.87)	8.72	2.41	2.41
Materials	(2.11)	15.39	(9.75)	(9.75)
Telecom Services	3.97	7.90	6.27	6.27
Utilities	3.37	8.28	19.91	19.91

Source: Bloomberg, FactSet

	1 month	3 months	YTD	12 months
Fixed Income				
BarCap US Agg	1.10	1.12	7.84	7.84
BarCap 1-10 Muni	1.34	1.61	6.76	6.76
BarCap HY Muni	1.79	0.79	9.25	9.25
BarCap Inv. Grade Credit	2.14	1.93	8.15	8.15
BarCap Muni Long Bond (22+)	2.39	2.01	14.88	14.88
BarCap US Agg Securitized MBS	0.70	0.88	6.23	6.23
BarCap US TIPs	0.04	2.69	13.56	13.56
BarCap US Treasury Interm	0.57	0.72	6.57	6.57
BarCap US Treasury Long	3.10	1.86	29.93	29.93
BarCap US High Yield Loans	0.47	3.08	1.06	1.06
ML US High Yield BB/B Rated	2.37	5.88	5.40	5.40
ML US Convert ex-Manadatory	0.25	4.22	(3.42)	(3.42)
JPM GBI Global ex US Hedged	2.11	0.80	4.47	4.47
JPM GBI Global ex US Unhedged	1.03	(0.24)	5.91	5.91
JPM GBI-EM Global Div	(1.47)	0.48	(1.75)	(1.75)
JPM ELMH+	(1.54)	(1.00)	(5.19)	(5.19)
JPM EMBH+ Composite	1.27	5.26	9.20	9.20

	Latest Month end (12/31/2011)	3 Months ago (9/30/2011)	Latest Year end (12/31/2010)	12 Months ago (12/31/2010)
Currency				
U.S. Dollar Index Value	80.18	78.55	79.03	79.03
USD vs. Yen	76.91	77.06	81.12	81.12
Euro vs. USD	1.30	1.34	1.34	1.34
Commodities				
Gold (\$ per troy ounce)	1563.70	1623.97	1420.78	1420.78
Crude Oil (\$ per barrel)	98.83	79.20	91.38	91.38



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