IdahoTrust

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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

Despite continued volatility, stock markets rallied in the fourth quarter of 2011. The domestic economy has had a rash of good economic indicators recently indicating that the economy may be healthier than once was thought. Even the stubborn housing and employment markets have shown signs of improving. This month's Market Insight provides a broad update on primary investment markets.

Domestic Stocks

The fourth quarter of 2011 brought signs that the U.S. economy is healthier than previously thought. The Federal Reserve's Open Market Committee acknowledged as much in their December meeting.

> *"The economy has been expanding moderately, notwithstanding some apparent slowing in global growth."*

The index of leading economic indicators rose 0.9% in October; consumer confidence is at its highest since last July; manufacturing expanded in November at a rapid pace, considering its last five months; the four-week moving average of jobless claims has trended downward. Even non-farm payroll numbers have improved.

Domestic stock markets had a great fourth quarter of 2011 with the S&P 500 returning 11.8%, although, it may take some time for prices to recover from the steep declines experienced in the third quarter of 2011. Overall, stocks still appear to be attractively priced given the level of corporate earnings. As earnings continue to grow and prices remain under pressure, price-to-earnings ratios—a measure of a stock's relative attractiveness—are still trading below their 20- and 50-year averages.

In late 2011, value investments—companies that are attractively priced—outperformed growth investments—companies that are experiencing earnings momentum. However, for 2011 growth investing provided superior returns compared to value investments. Non-cyclical defensive sectors performed the best during last year's volatile market. Utility, health care, consumer staples and industrial companies—who are typically known as defensive positions—outperformed their more risky cyclical peers. This is not surprising given the amount of risk aversion prevalent in the markets in 2011. If volatility levels and pessimism persist in 2012 we may see a continuation of this trend.

International Stocks

Global investors are still closely watching developments coming from Greece, Italy and Spain whose sovereign debt yields remain elevated. European leaders are vying to further coordinate fiscal policies within the European Union in hopes of relieving the current debt crisis and securing the future of the Union.

Economists have now widely predicted that Europe is headed for a recession. Knowing this leaves U.S. investors wondering how insulated our fragile domestic economy is from Europe's grim outlook. While it is impossible to know with certainty how our economy will be affected by a European recession; a recession in Europe could, at the very least, hinder U.S. exports. However, it would take much more than that to push the U.S. into a recession.

2011 Index Returns

S&P 500 Index	2.09%
MSCI EAFE Net Dividends Index	-12.14%
Barclays US Aggregate Bond Index	7.84%
Barclays Municipal Index	10.70%
DJ US Select Real Estate Index	6.05%
DJ UBS Commodity Index	-13.32%

Emerging market economies have recently lost some of their appeal given that their economies are slowing and the monetary policy challenges they currently face. China—the largest of emerging economies—is currently in a state of flux; facing a slowing economy, cooling real estate market and declining domestic demand. The Chinese economy is of significant importance to emerging economies because of its size and its integration with other emerging economies.

Domestic Bonds

In general, bonds had a good year in 2011 as investors shunned riskier investments. However, most of their performance was reserved for the most

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risk-free sectors like government securities. Corporate bonds—regarded as a having more risk than government securities—have had much lower returns despite offering much more attractive yields than government securities. So far, the preference for less risk caused investors to choose government securities which drove government yields so low that for most tenors investors are earning negative real returns. For example, if an investor purchased a 1-year treasury bond at today's market yield of 0.10% the investor would make -3.30% real return after considering the current annual inflation rate. This is a steep premium to pay for safety's sake. In all, treasury securities returned 9.81% for 2011 and high grade corporate bonds returned 7.11% largely because of investor's preference for safety over the opportunity to earn higher yields.

Municipal debt has rebounded from the late 2010 sell-off to post impressive returns in 2011. Similar to taxable government securities, investors seeking safety and tax exempt income have rallied municipal debt. Municipal securities returned 10.70% in 2011.

International Bonds

A recent study conducted by Vanguard reveals that international bonds are the largest component of the total global capital market's capitalization followed by international stocks. U.S. investors typically have a domestic bias favoring the U.S. when allocating their bonds and stocks. That being said, most U.S. investors have embraced the benefits of having an allocation to international stocks in their portfolios. However, the concept of investing in international bonds is still a relatively new concept, largely due to the barriers of investing overseas.

Allocations to international bonds play an import role of diversification and can pay much higher yields than domestic bonds. Exposure to international bonds has become more accessible through the use of exchange-traded-funds (ETF). They provide a low-cost broadly diversified structure that dramatically eases the barrier of entry into this formerly inaccessible asset class. International bonds can also help produce income for investors who depend on investment income which is difficult to obtain given our current low-rate environment.

Alternatives

Both real estate and commodities had volatile years in 2011. Commodities ended the year in the red in terms of total return, this is not surprising given the weak demand from our struggling economy. Metals and agriculture prices declined in 2011; gold being the exception. Energy prices have increased except for crude oil and natural gas which declined sharply in price. The Dow Jones UBS Commodity index returned -13.32% in 2011.

Real estate investment trusts (REIT) ended the year better off than commodities, which were helped by the income that real estate investments generate to offset volatile price fluctuations. The DJ U.S. Select REIT Index returned 6.05% in 2011.

S&P 500

3 Month	11.80%
Year-to-Date	2.09%
1 Year	2.09%
3 Year	14.12%
5 Year	-0.25%

MSCI EAFE

3 Month	3.33%
Year-to-Date	-12.14%
1 Year	-12.14%
3 Year	7.66%
5 Year	-4.72%

Barcap Aggregate Bond

3 Month	1.12%
Year-to-Date	7.84%
1 Year	7.84%
3 Year	6.77%
5 Year	6.49%

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