Fourth Quarter 2011 Market Review

2011 was a year in which the actions (or I should say little action) of policy makers throughout the world were the main catalysts that drove our markets.

More than ever, our reports have focused as much on political activity as economic data. Fourth quarter was no different. Did you ever believe our markets would react to Italy's debt auction or Greece's tax collecting ability? Did you ever believe America would not be a AAA risk free state with one reason being policymaker's inability to make timely decisions? Many are calling it a "new normal", I prefer no normal. What happened to the days when regulators and legislature carefully and quietly operated to assist our markets? That world no longer exists. Today, as one commentary I read reports "Regulators and legislators……………………… take such large actions that they threatened not only to fix what was broken but break that which was working."

Now onto the markets. For fixed income investors, 2011 ended on a solid note with total returns up across all sectors. We saw in just three months after the American central bank purchased $600 billion Treasuries (QE2), the FED announced "Operation Twist", where it sold $400 billion short term Treasuries and bought longer maturing ones to keep rates low in an effort to stimulate the economy. By year end the US interest rates were at historical lows. The 5-year Treasury yield went from 2.01% at the end of 2010 to 0.88% at year-end 2011. The 10 year went from 3.29% to 1.88%. US Corporate bonds had their best year since 2008, posting positive returns and outperforming most major stock markets. Amid strong economic data, the US dollar surged in the fourth quarter, pushing it to a 15-month high against the euro.

Going Forward

With government interest rates at historical low levels and expected to remain there through 2014, the ability to produce reasonable returns in the investment grade intermediate bond sector will be more difficult than in the past. In fact, the Treasury Inflation Protection Securities (TIPS) market currently shows the 5 year TIPS real yield at a negative 90 basis points.

For insurance companies that rely on cash flow, the Feds Quantitative Easing (QE) strategy produces mixed results. While current portfolios show substantial gains, future purchases to maintain proper cash flow become difficult to find without additional risk. As a result, some insurance companies in order to meet their cash obligations, should allocate a portion of their portfolio to "high-end" non-investment grade bonds and/or dividend paying equities.