MJM INVESTMENT ADVISORS, LLC

First Quarter 2012 Investment Commentary

"Men are of such simple minds, and so much dominated by their immediate needs, that a deceitful man will always find plenty who are ready to be deceived." - Machiavelli

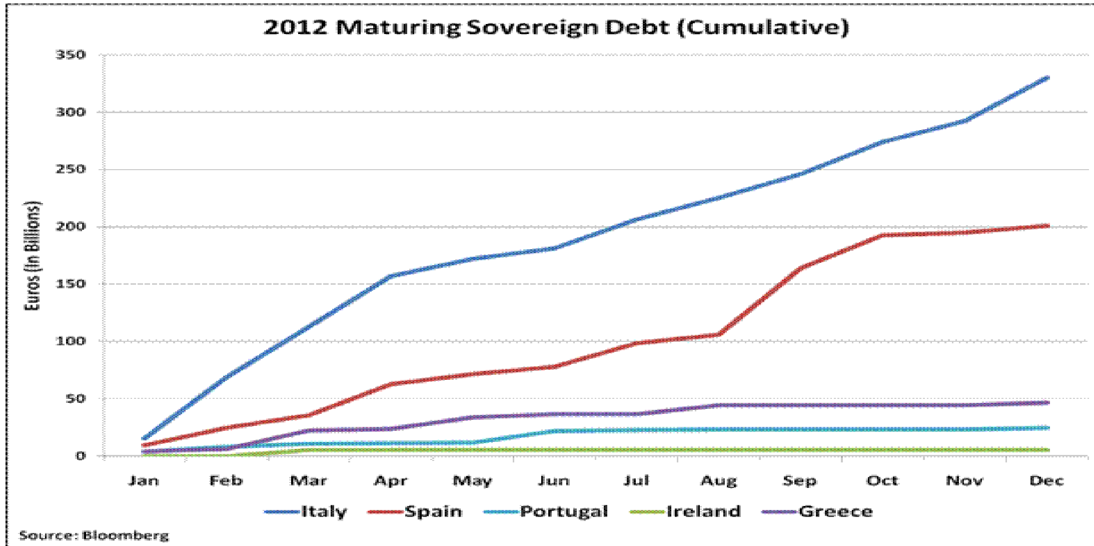
> *"I've always said publicly that [a Greek] default is out of the question." – Former ECB head Jean-Claude Trichet, April 2010*
>
> *"Restructuring is not going to happen. There are much broader implications for the euro zone should Greece have to restructure its debt. People fail to see the costs to both Greece and the euro zone of a restructuring: the cost to its citizens, the cost to its access to markets. If Greece restructures, why on earth would people invest in other peripheral economies? It would be a fundamental break to the unity of the euro zone." - George Papaconstantinou, former Greek Finance Minister, September 2010*
>
> *"There is no bailout and no "plan B" for the Greek economy because there is no risk it will default on its debt"- European Monetary Affairs Commissioner, Joaquin Almunia, January 2011*
>
> *"I would like to say how happy I am that a solution to the Greek crisis, which has weighed on the economic and financial situation in Europe and the world for months, has been found. Today the problem is solved. A page in the financial crisis is turning." - Nicolas Sarkozy, President of France- March 2012*

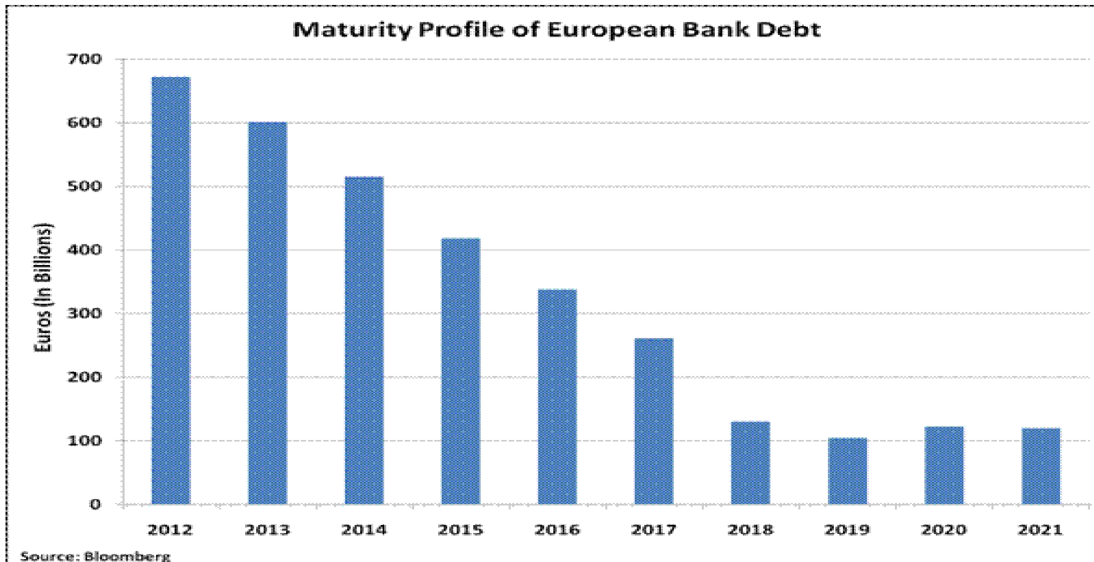
Greece finally had its debt restructuring/bailout, an inevitable mathematical outcome, despite the public demonstrations of various European technocrats and politicians over the past two years. In Europe, the band is still playing on the deck of the Titanic, as evidenced by the absurd commentary of President Sarkozy, which can only be responded to with a Really, dude? While Mr. Sarkozy may be happy the Greece situation is "solved", the citizens of France are unhappy with him, as evidenced by his 36% approval rating with the first round of the Presidential election looming in late April. Given the fate of other ruling European governments during this crisis era, he can't be sleeping very well with the prospects for his reelection defined as dim and dimmer. C'est la vie.

While Greece commanded plenty of attention and headlines during the first quarter, it mattered little to the market. In retrospect, the market was already pricing in a Greek restructuring and was relieved to have the event behind it. Perhaps I shouldn't mention (but I will anyway) that the new Greek bonds received for the old Greek bonds as part of the "solution" are trading at around 20 cents on the dollar in the open market. Be that as it may, the market has now moved on to the next targets in Europe: Portugal and Spain. Post the latest Greek bailout, credit default swap spreads are starting to head higher on the bonds of these two countries, an early warning sign. Portugal looks to be the next Greece sometime within the next year (its public deficit tripled in the first two months of 2012) and don't look now but Spain is rapidly approaching in the rearview mirror.

In addition to its government debt problems (80% of GDP), private debt is also a major problem in Spain (200% of GDP), with bad loans at Spanish banks hitting a 17-year high in March. Prime Minister Mariano Rajouy told the rest of Europe that Spain won't abide by the budget deficit rules in which everyone else agreed. Unions are now implementing national strikes to protest austerity measures ($27 billion of cuts). Clearly, Spaniards have learned well from Greece, whose economy is imploding under the severe austerity measures demanded (as described in a 195 page document, no less) by the rest of Europe in order to receive bailout funds. Spain is no Greece in the sense that Spain matters (sorry Greeks) to euro zone legitimacy because it is the 14th largest economy in the world and 4th largest in Europe. Perhaps I shouldn't mention (but I will anyway) that Spanish unemployment is 23% and youth unemployment now exceeding 50%.

The global economy remains in uncharted waters as central banks have massively expanded their balance sheets and made short-term interest rates artificially (repressively) low. These unorthodox monetary policies create a whole new set of unintended consequences. The long-term problems are still aplenty in Europe, as noted in the following two charts. So, despite a booming first quarter of returns, it's a bit premature to take a victory lap. The economic data in Europe continues to weaken. The euro zone jobless rate edged up to 10.8% in February, the highest in 15 years, with 17 million out of work. There was further gloom in the March manufacturing European PMI reading, which fell to 47.7 from 49.0 in February.





Source: Bloomberg

First Quarter Market Review

There were two major factors at work during the first quarter, which had the greatest impact on the global stock market rally. The first was central bank liquidity induced asset inflation. Whatcha talkin' about, Willis? Central banks of the world are flooding financial markets with massive liquidity injections to stave off the next financial crisis and to prop up economies. The Fed got the dance floor rocking in late 2010 with its Quantitative Easing policy and the European Central Bank joined the party by introducing the Long-Term Refinancing Operation (LTRO) program. The LTRO enabled banks to borrow from the ECB at low rates, and then the banks used the loan proceeds to buy sovereign debt in the open market at much higher yields. In other words, the ECB is having the banks do its dirty work by loading them up with sovereign debt. This backdoor monetary policy had the effect of putting a natural bid under sovereign bonds and driving their prices up and yields lower. For example, the Italian 10-year bond yield declined from just over 7.0% to 5.0%. The two LTROs, one in December 2011 and another in February 2012, were a massive infusion of liquidity into the financial system, creating nearly $675 billion of new money to chase assets. Voila! European bond markets rallied and global stock markets rallied and everyone and everything is just chipper. The LTRO was the European version of "Don't Fight The Fed". For now, let's not think about what happens down the road when this process has to unwind.

The second major factor driving the stock market higher during the first quarter was the grinding improvement in U.S. economic data. Over the past several months, job creation has steadily improved and unemployment claims have steadily declined. Car sales were above expectations and new housing data has also shown some signs of life. As the LTRO did its thing and with the U.S. economy showing an improving trend, the stock market became more emboldened and rallied strongly and without any material setbacks throughout the first quarter. 60% of the trading days in the first quarter generated positive returns and the worst daily performance was only -1.5% and that didn't last very long.

One issue in the U.S. that needs to play out over the next couple of months is to assess any pull forward effect of this past winter. The winter of 2011-2012 was the warmest on record in North America since 1895 (conversely, China had its coldest winter in 22 years). Winter normally puts certain activities on hold, particularly housing and car sales. That wasn't the case this year, as the unseasonably mild winter (there are undoubtedly a whole bunch of new global warming enthusiasts) allowed car sales for January and February to exceed expectations and new housing sales as well. Is this a result of improved job gains and increased consumer confidence, or is it just because the weather facilitated better than expected activity earlier than usual? The data for March and April will provide more evidence of whether the recent improved trends are for real.

With the LTRO propping up the European banking system and bond markets and the U.S. economy getting its sea legs, market fears rapidly receded during the first quarter as the Volatility (VIX) Index declined 35%. In a complete reversal of 2011, the first quarter experienced a risk-on reversal trade as cyclical sectors such as Information Technology (+21%) and Financials (+21%) were the market leaders. Defensives sectors such as the Utilities (-3%) and Telecom (+1%) sectors were the big laggards. One stock alone, Apple (+48%), contributed 15% to the S&P 500 Index return for the first quarter, the biggest contribution of any single stock since Microsoft in 1999.

It is very important that financials have taken a leadership position in the market after four LONG years of lagging performance. The most recent "Stress Test" results released by the Fed in March gave the green light to many financial institutions, allowing them to implement shareholder friendly capital returning actions such as dividend increases and share buybacks. Many major banks immediately announced substantial increases in both. This news provided the market with another boost of confidence. One can easily argue that as long as Financials stay in a leadership role, the broad market is unlikely to experience a large sell-off. The Financials are up 45% from their November lows but still down 60% from their 2007 highs. How's that for some perspective?

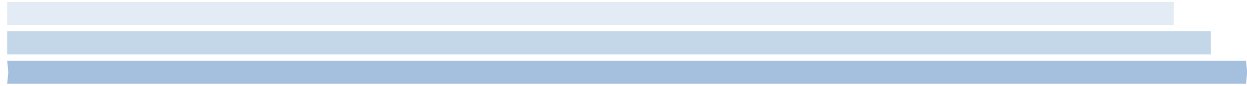
The following chart is a snapshot of major ETF performance (price only) for the first quarter of 2012.

Key ETF Performance (%)

US Related ETF	Description	Last Week	MTD	YTD
SPY	S&P 500	0.83	2.77	12.20
DIA	Dow 30	0.92	1.94	8.17
QQQ	Nasdaq 100	0.91	4.88	20.99
IJH	S&P Midcap 400	0.04	1.63	13.25
IJR	S&P Smallcap 600	0.16	2.59	11.73
IWB	Russell 1000	0.66	2.73	12.38
IWM	Russell 2000	0.16	2.17	12.28
IWV	Russell 3000	0.64	2.57	12.27
NYC	NYSE Comp	0.43	0.42	9.62
IVW	S&P 500 Growth	0.65	2.91	11.78
IJK	Midcap 400 Growth	0.09	1.49	13.89
IJT	Smallcap 600 Growth	0.21	2.69	10.90
IVE	S&P 500 Value	-0.08	2.77	12.28
IJJ	Midcap 400 Value	0.02	1.70	12.41
IJS	Smallcap 600 Value	0.13	2.63	12.63
DVY	DJ Dividend	-0.05	0.97	4.07
RSP	S&P 500 Equalweight	0.39	1.97	12.08
FXB	British Pound	0.78	0.53	2.91
FXE	Euro	0.49	0.08	2.95
FXY	Yen	-0.49	-1.86	-7.15
XLY	Cons Disc	0.99	4.40	15.56
XLP	Cons Stap	0.95	2.56	4.89
XLE	Energy	-0.71	-4.18	3.79
XLF	Financials	0.41	7.01	21.50
XLV	Health Care	2.70	3.95	8.42
XLI	Industrials	0.69	0.50	10.86
XLB	Materials	0.16	0.00	10.36
XLK	Technology	0.58	4.20	18.51
IYZ	Telecom	-1.51	-0.27	5.71
XLU	Utilities	1.29	0.44	-2.60

Global ETF	Description	Last Week	MTD	YTD
EWA	Australia	1.34	-1.01	9.65
EWZ	Brazil	-1.75	-6.53	12.67
EWC	Canada	-0.11	-2.34	6.54
FXI	China	-0.68	-8.99	5.15
EWQ	France	-0.81	-0.18	12.72
EWG	Germany	-0.04	1.44	21.12
EWH	Hong Kong	-0.54	-4.38	12.77
INP	India	1.38	-4.51	21.13
EWI	Italy	-1.88	-2.17	9.09
EWJ	Japan	1.85	1.85	11.69
EWW	Mexico	2.68	5.36	16.29
RSX	Russia	-1.48	-6.50	15.85
EWU	UK	-0.63	-1.31	7.05
EFA	EAFE	0.20	0.42	10.82
EEM	Emerging Mkts	0.10	-3.12	13.19
IOO	Global 100	0.39	1.18	9.75
EEB	BRIC	-0.95	-4.52	12.70
DBC	Commodities	-1.20	-1.77	7.30
USO	Oil	-3.59	-4.13	2.94
UNG	Nat. Gas	-10.71	-22.61	-38.39
GLD	Gold	0.36	-1.32	6.66
SLV	Silver	0.45	-6.47	16.48
SHY	1-3 Yr Treasuries	0.06	-0.12	-0.21
IEF	7-10 Yr Treasuries	0.18	-1.75	-2.17
TLT	20+ Yr Treasuries	-0.89	-4.45	-7.46
AGG	Aggregate Bond	0.14	-0.82	-0.36
BND	Total Bond Market	0.14	-0.74	-0.31
TIP	T.I.P.S.	-0.22	-0.86	0.82

Source: Bespoke Investments – www.bespokeinvest.com



Charts, Charts, and More Charts

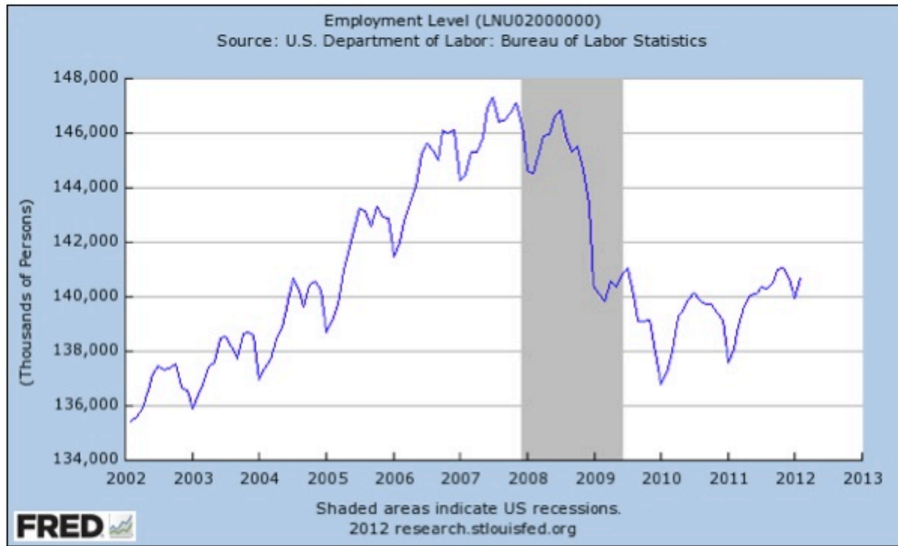
The remainder of this quarter's commentary will walk through a series of charts that will help provide a snapshot of the current investment landscape.

Let's start off with the most important factor to the economy and stock market sentiment: jobs. During the last few months, jobs data has come in better than expected and prior months have been revised higher. This data has given encouragement to the stock market (and has President Obama smiling more) that the jobs outlook has finally turned the corner. Improved jobs growth means more consumers with more money to spend which means better economic growth. It is important to put the recent monthly job gains, while decent, into the proper historical context. The following table shows annual U.S. jobs growth all the way back to 1990. You can see the devastating impact the financial crisis of 2008 and 2009 had on job losses. In the past, after such severe recessions, the U.S. has usually seen a robust jobs recovery. When you consider how severe the job losses were in 2008-2009, the jobs recovery in 2010-2012 has been particularly weak with the exception of a few months in early 2010. Keep in mind that just based on population growth alone, the U.S. economy needs to create 125,000 jobs a month just to keep the unemployment rate (now 8.2%) stable. News flash: March employment came in at 120,000, below the 200,000 consensus expectation and an indication that the mild winter may have created some pull forward effect for January and February.

Year	Annual Growth		Year	Annual Growth
1990	311		2000	1948
1991	-858		2001	-1761
1992	1154		2002	-545
1993	2788		2003	84
1994	3851		2004	2057
1995	2153		2005	2498
1996	2794		2006	2068
1997	3355		2007	1100
1998	3002		2008	-3603
1999	3174		2009	-5060
2000	1948		2010	1027
			2011	1840
			2012	511

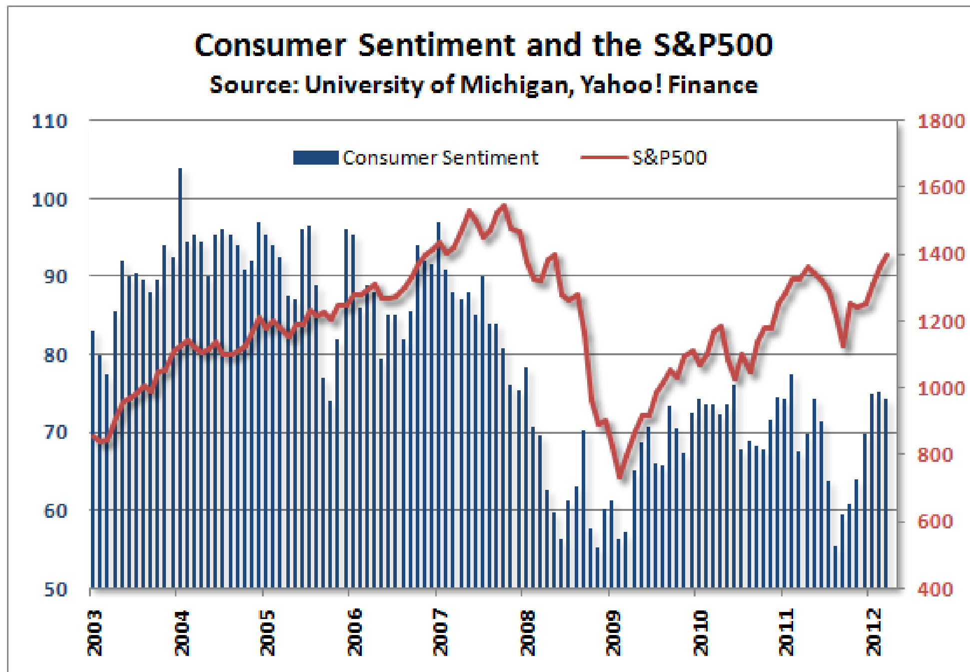
Source: Bureau of Labor Statistics

As the next chart shows, the total employed population remains well below 2007 peak levels by around 7 million jobs. Yes, the recent monthly gains in the 200,000 to 250,000 range are a welcome sign, but there is a long way to go before these numbers put a serious dent in both the unemployment rate and the number of full-time employed. It would take 350,000 job gains per month to get the unemployment rate down towards 7% by the November election.



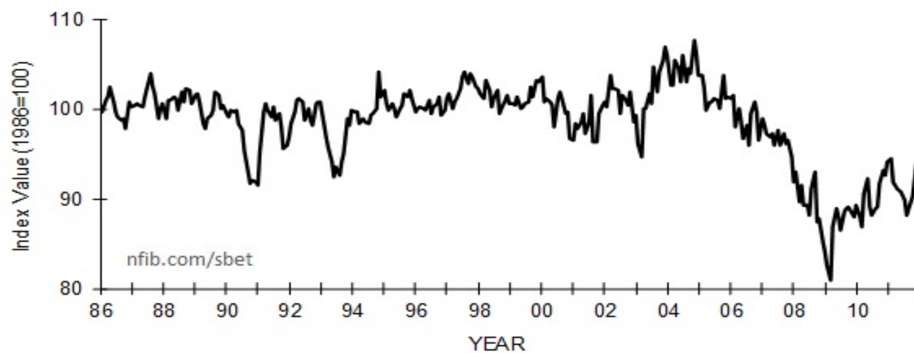
Source: St. Louis Federal Reserve

Jobs are an important factor on consumer sentiment. The following chart plots changes to the University of Michigan Consumer Sentiment Index and the S&P 500 Index. After a drop last summer, the Consumer Sentiment Index has again recovered but is still a long way from the readings of the mid-2000s and still barely above recessionary levels.



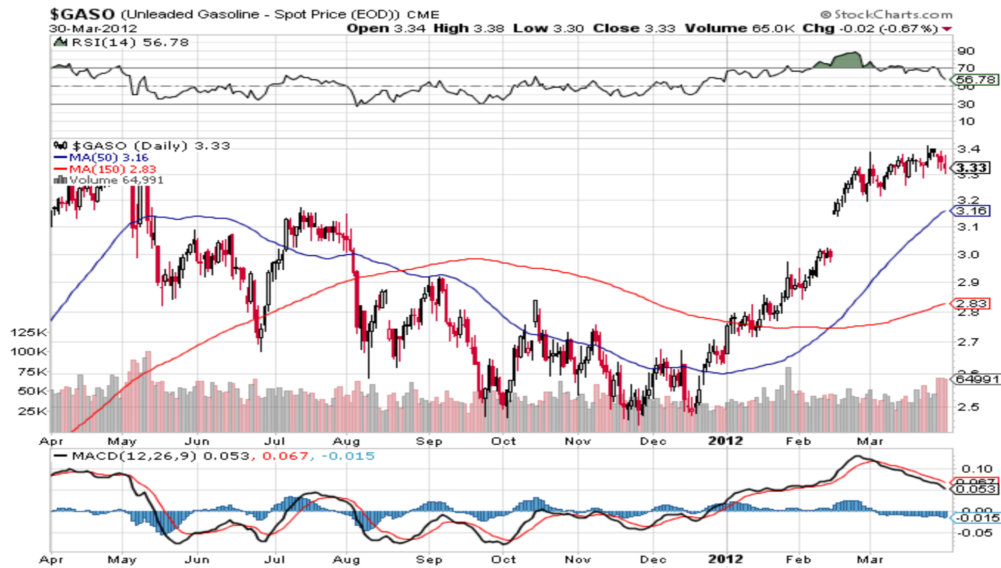
An extremely important driver of U.S. job growth is the small and medium business (SMB) segment of the economy. The National Federation of Independent Business (NFIB) conducts a monthly survey of its SMB members to assess their outlook. Below is the chart of the NFIB Optimism Index going back to 1986. When the

economy is normal and functioning properly, the Optimism Index reading is typically near 100. The most recent reading of 94 is well off the depths of the depressed levels during the heart of the financial crisis, but still well below normal levels. As noted by SMB respondents, the two biggest factors holding the NFIB survey back (and restricting job growth) are unreasonable government regulations/red tape and taxes. If government can get out of the way (yes, I know, when pigs fly) and unleash the small and medium business jobs engine, the U.S. employment situation will get much better.



Source: National Federation of Independent Business – www.nfib.com

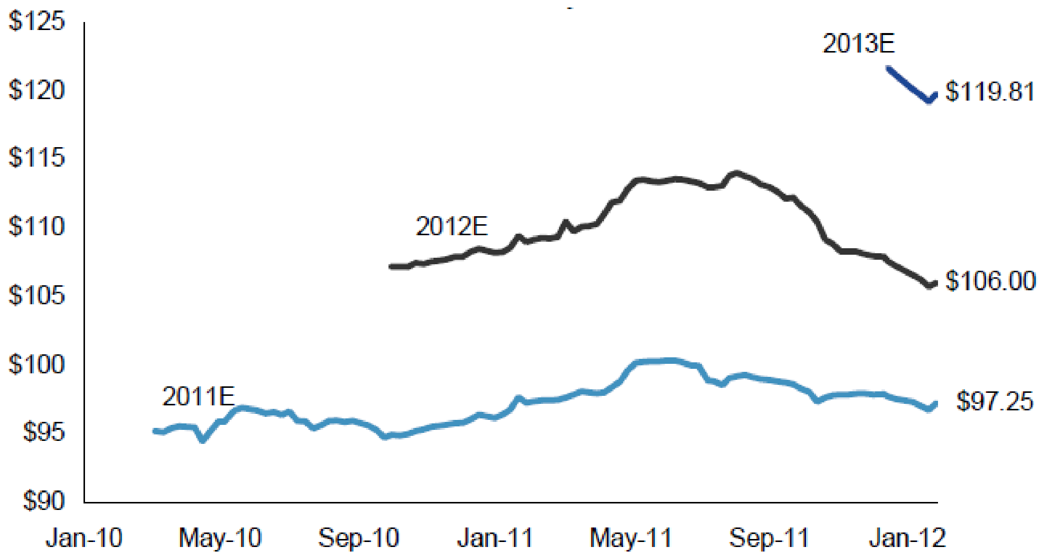
Just as the employment situation appears to be getting back on track, along comes another headwind that hurts consumer confidence. As the next chart shows, gasoline (the chart excludes state and federal gasoline taxes) has seen a sizable and rapid increase of $0.80/gallon since December, an unusual circumstance. This price increase has occurred despite a massive increase in oil inventories since January. Typically, gasoline prices in winter remain stable. Then, as the refineries shutdown to switch from winter grade to summer grade gasoline, the price begins to rise and typically peaks around Memorial Day when demand is the strongest. In 2012, the price increase has come much sooner. There are always various geopolitical factors impacting oil, the most recent being the Iran situation. If the gasoline price seasonality works the same as in past years, we may see additional price increases into late May and gasoline could move towards $4.00+/gallon (including taxes) on a national average basis. Given the tepid nature of the economic recovery and consumer spending, any additional price hikes from here will add more headwinds to economic growth and negatively impact consumer confidence and spending.



Source: Stockcharts.com

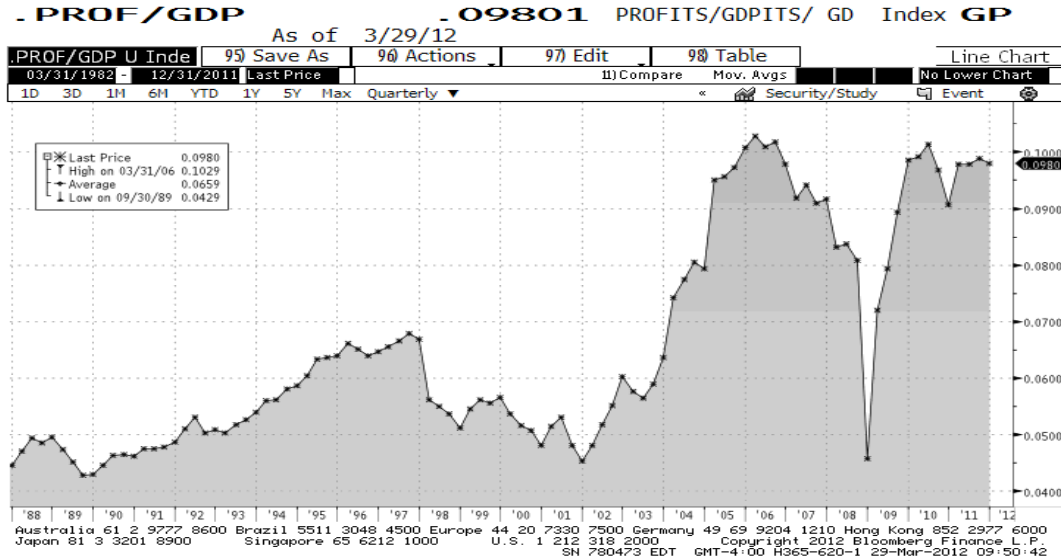
Earnings growth is a key driver of stock market returns. As noted in the following chart, S&P 500 Index earnings estimates for 2012 have bottomed at $106/sh while 2013 estimates are presently near $120/sh. Since 2012 and 2013 estimates have moved lower, positive earnings revisions are not behind the first quarter's market move. Rather, multiple expansion has been the key factor behind the market's strong move higher as investors were willing to pay a higher multiple as some of the aforementioned risks declined.

As of 12/31/11, the S&P 500 Index was valued at 11.6X CY12 earnings estimates of $108/share. Since then, the market multiple has increased to 13.3X on the current CY12 earnings estimate of $106/share with the S&P 500 Index closing at 1408.47 on 3/31/12. The big question is if real US GDP growth is struggling to achieve 2.5%, is the current 2013 earnings growth expectation of +13% ($120/$106) realistic? Will the current upswing in economic momentum be sustained to support the CY13 earnings estimates? If so, then we can have confidence in the forward earnings outlook. If we apply that current 13.3X market multiple to the current CY13 earnings estimates of $120/share, it suggests a fair value for the S&P 500 Index would be 1596 as we move into early 2013 or 13% upside from the end of March.



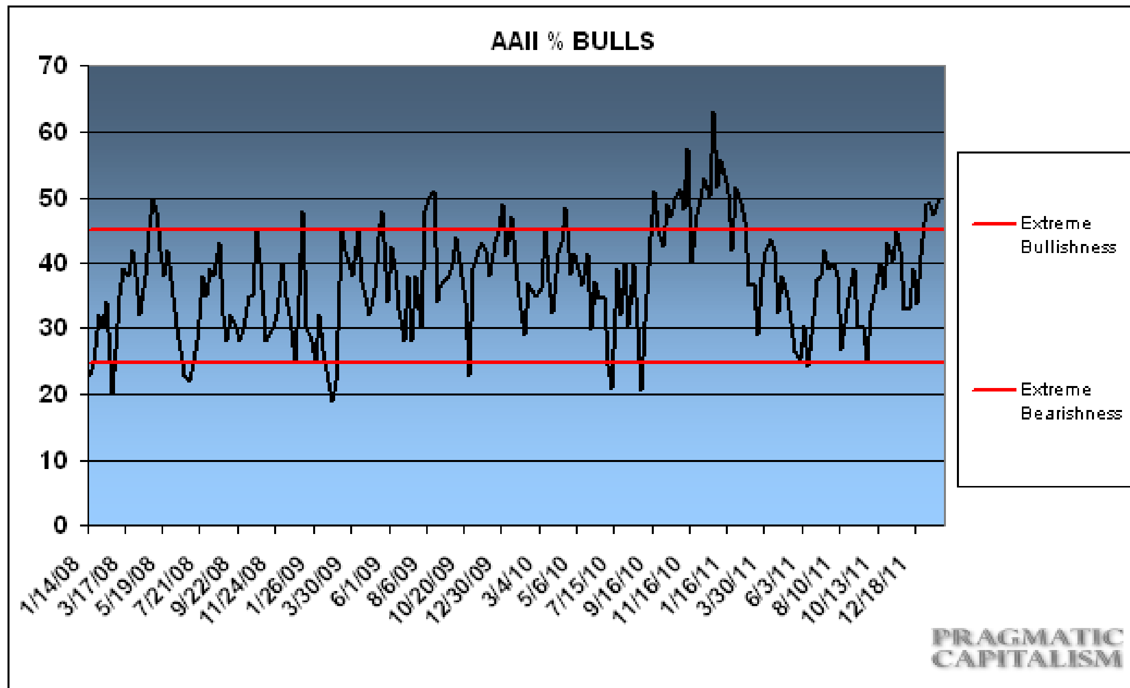
Source: Morgan Stanley, Factset

Despite the weak economic recovery and pullback in earnings estimates noted in the chart above, corporate profits as a percent of GDP are back to near record levels as shown in the next chart. How can that be? Easy, hiring has been weak since the economy bottomed so labor costs are below trend. As a result, companies are seeing record profits and record amounts of cash on their balance sheets too.



Source: Bloomberg, BNP Investment Partners

Individual investor sentiment has improved as the market rallied. As shown in the next chart, the AAII survey shows the current bullishness of individual investors is exceeding the upper range of extreme bullishness readings. Sentiment readings are contrarian indicators, so when this reads extreme bullishness, one must consider an opposite tact, and vice versa.



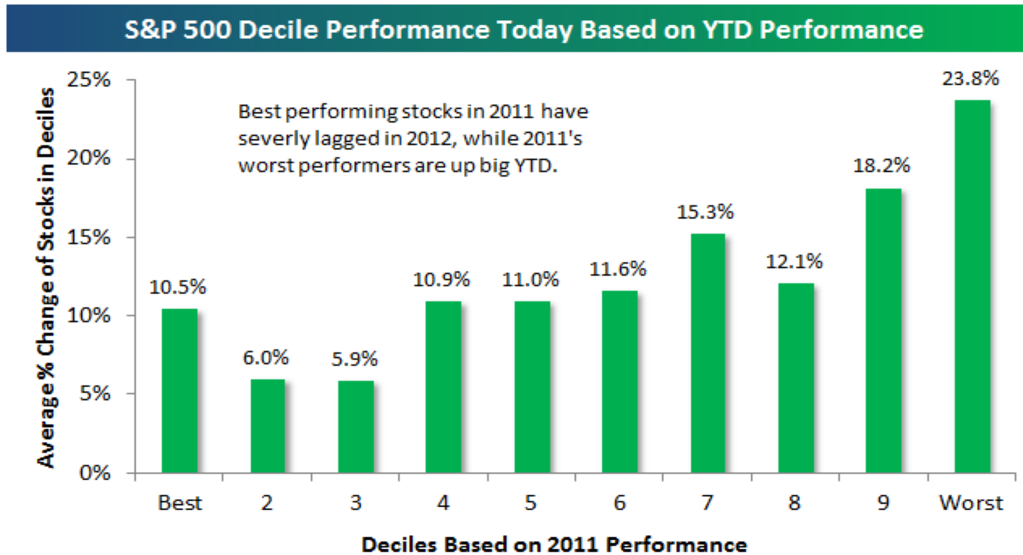
Source: American Association of Individual Investors, Pragmatic Capitalism

As the stock market rallied, short-term market volatility readings registered a dramatic drop. As shown in the next chart, the Volatility Index (VIX) has again reached levels that were registered after the market had a big run in early 2010 and 2011 and complacency started to permeate investor sentiment. The current VIX level suggests a more cautious stance near-term may be warranted.

Source: Stockcharts.com

If the start of 2011 has a familiar ring to it, it should. As it did in 2010 (5.4%) and 2011 (5.9%), the S&P 500 Index for 2012 (12.6%) has started off the year robustly. In 2010 and 2011, the market hit a wall in late April (Sell in May and Go Away) as optimism faded and macro risks dominated the investment landscape. Is the setup for 2012 the same, or will the stock market break from the pattern of the past two years? We should know shortly as we get more economic data points for March and April and as first quarter earnings season begins in mid-April.

As with sector performance, at the stock level, 2011's losers have been 2012's winners so far.



Source: Bespoke Investments – www.bespokeinvestments.com

Summary

For investors with stock exposure, it's all been good so far in 2012 and is a welcome respite after a challenging and frustrating 2011. Who doesn't like low double digit returns from their stock portfolio in just three months? It sure beats a stick in the eye. Nonetheless, it is no time to get complacent given the still prevalent macro risks that exist, with the European sovereign debt crisis and China's economic growth outlook two of the biggest. The U.S. economy has provided the biggest upside surprise so far in 2012, but will the current trends be maintained in the face of high gasoline prices and the Age of Austerity quickly approaching our own shores? One shouldn't underestimate how much influence the latest round of central bank induced liquidity injections had on global equity markets. The heroin addict always feels euphoria just after mainlining (so I've heard) but when the drug effect starts to fade, watch out! The withdrawal symptoms are brutal. Riddle me this, Joker. Will the drugs prescribed by the ECB allow Europe to avoid a more pernicious outcome that could drag the rest of global growth down with it? Stay tuned, same Bat time, same Bat channel.

Mark J. Majka, CFA
Chief Investment Officer
www.mjminvtadvisors.com

April 2012

IMPORTANT DISCLAIMER:

This report and all content on mjminvtadvisors.com is presented for educational and/or entertainment purposes only. Under no circumstances should it be mistaken for professional investment advice, nor is it intended to be taken as such. The commentary and other contents simply reflect the opinion of the author alone on the current and future status of the markets and various economies. It is subject to error and change without notice. The presence of a link to a website does not indicate approval or endorsement of that web site or any services, products, or opinions that may be offered by them. Neither the information nor any opinion expressed constitutes a solicitation to buy or sell any securities or investments. Do NOT ever purchase any security or investment without doing your own and sufficient research. None of the parties adding to or affecting the content of mjminvtadvisors.com in any way shall have any liability for any loss sustained by anyone who has relied on the information contained herein. Neither mjminvtadvisors.com nor any of its principals or contributors are under any obligation to update or keep current the information contained herein. The principals and related parties of mjminvtadvisors.com may at times have positions in the securities or investments referred to and may make purchases or sales of these securities and investments. The analysis contained is based on both technical and fundamental research. Although the information contained is derived from sources that are believed to be reliable, they cannot be guaranteed.

FAIR USE NOTICE: mjminvtadvisors.com and reports downloaded from the site contain copyrighted material the use of which has not always been specifically authorized by the copyright owner. We are making such material available in our efforts to advance understanding of issues of economic and social significance. We believe this constitutes a 'fair use' of any such copyrighted material as provided for in section 107 of the US Copyright Law. In accordance with Title 17 U.S.C. Section 107, the material on the site and in reports downloaded from the site is distributed without profit. If you wish to use copyrighted material from this site for purposes of your own that go beyond 'fair use', you must obtain permission from the copyright owner.