



MANAGED ASSET PORTFOLIOS

FOCUSED • DISCIPLINED • TRANSPARENT



## 2012 Investment Outlook

Equities Remain 'Asset Class of Choice'

February 9, 2012



# Investment Climate

- US Economy Continues to Remain Challenged
  - Recovery lagging prior periods
  - Supply of real estate far exceeds demand
  - Too much debt in the system
    - No 'quick fixes'
- European Woes Far From Resolved
  - But we know that...
- Global Government Actions to Keep Interest Rates Low; Drive Inflation over the Long-Term
- View Stocks as the 'Asset Class of Choice'
  - Valuations compelling
  - Yields attractive
  - Continue to 'play defense'



# US Economy: Still on the Mend

## Labor Force Participation Rate

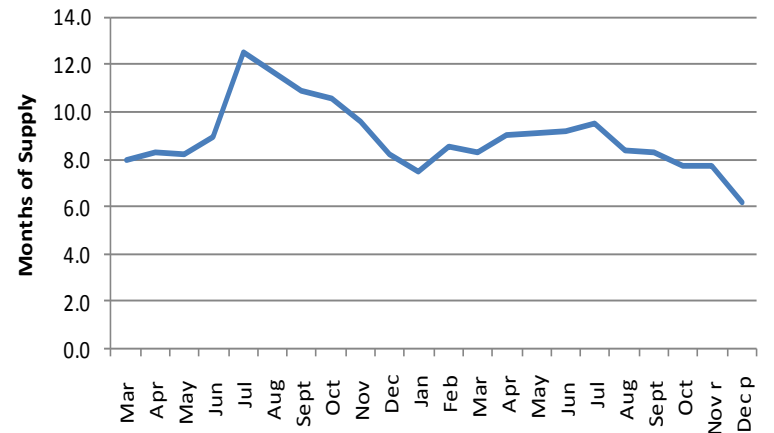
...but fewer Americans are working or looking for work.  
Share of population in the labor force



Source: Wall Street Journal 12/3/2011

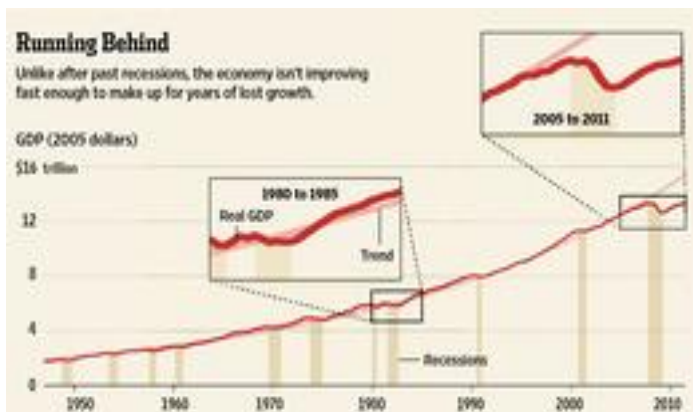
- In November, the US unemployment rate fell to its lowest level in 32 months
- While encouraging, about ½ of the improvement came from people **dropping out** of the labor force
- In January, the participation rate dropped to 63.7%

## Existing Home Sales

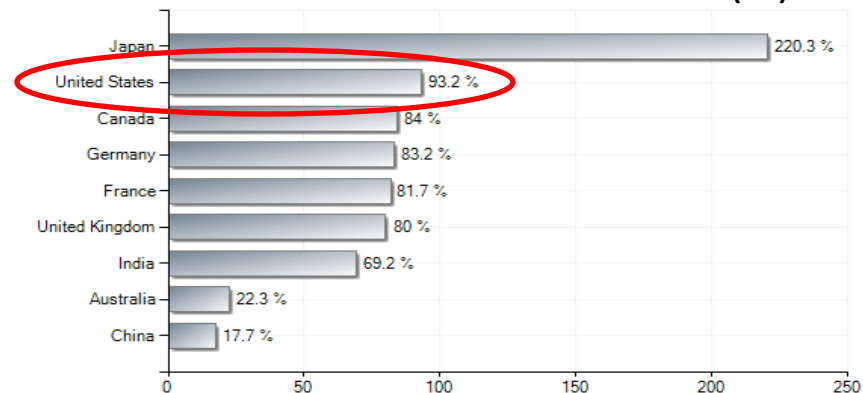


Source: National Association of Realtors

## GDP (2005 Dollars)



## Government Debt to GDP (%)

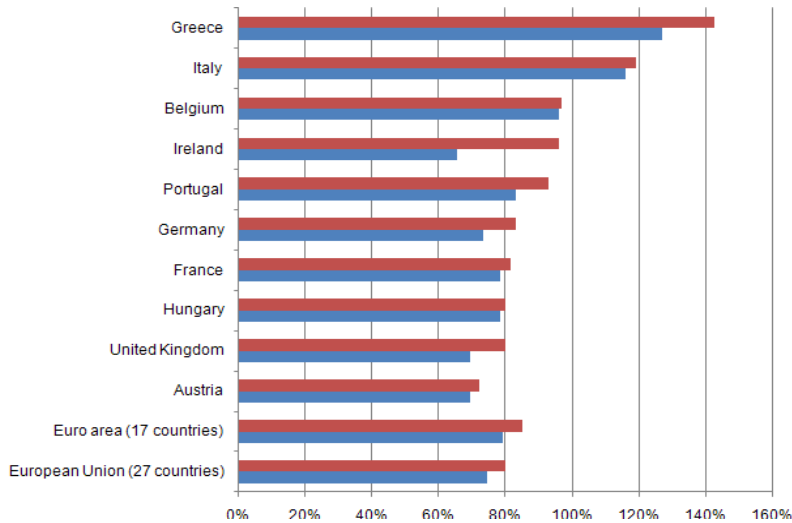


Source: www.trendingeconomics.com

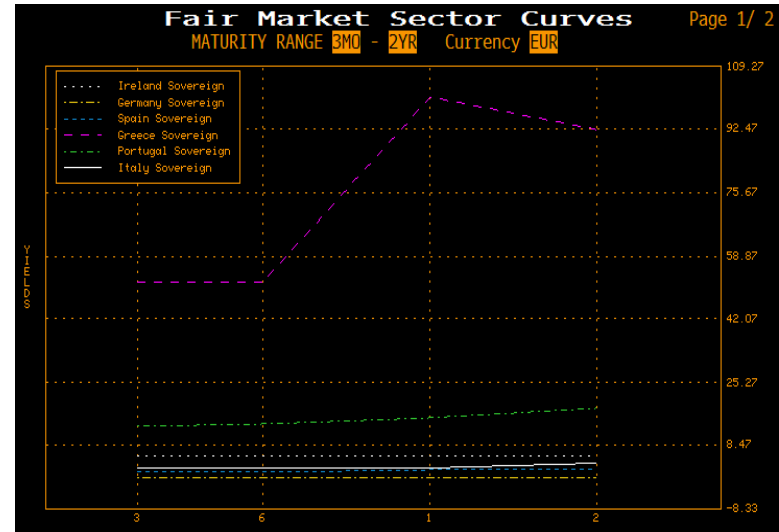


# European Woes: Going No Where Fast

### Debt to GDP (%)

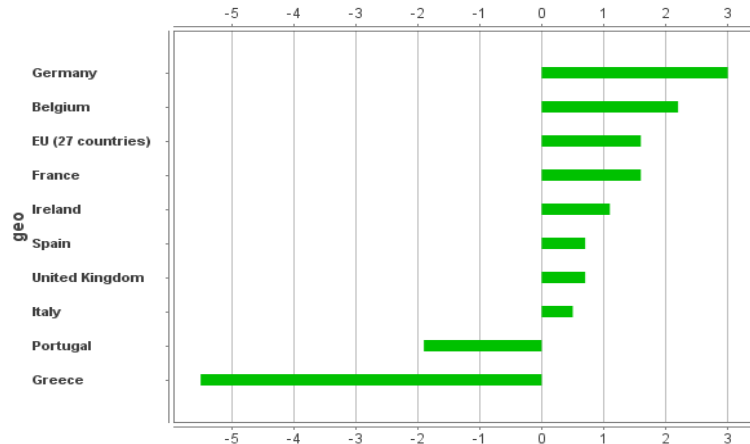


Source: Eurostat



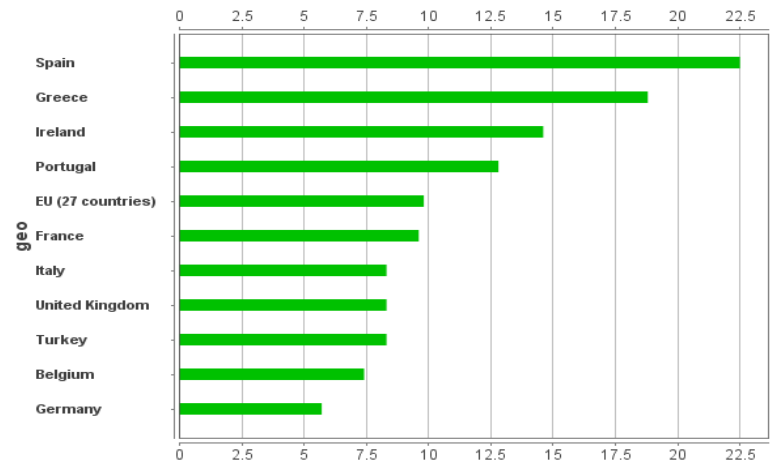
Source: Bloomberg

### Real GDP Growth Rate(%)



Source: Eurostat

### Unemployment(%)



Source: Eurostat

# Government Policy: Drives Interest Rates/Inflation

- The ECB has lowered their key interest rate - with two 25 bp cuts – to a record low 1%
  - We view further action as necessary
- The US Federal Reserve extended their expectations for a period of low interest rates out to late 2014 from mid-2013
  - Signaled the potential restart of their bond-buying program
- We continue to anticipate some form of ‘QE3’ down the road coupled with further expansion of the Fed’s balance sheet
- The FED also set a long-term inflation target of 2% per year
  - However – it was suggested this rate would be able to run above that rate for a period should it help lower the unemployment rate
  - **Translation: The FED prefers inflation over deflation**

# Equities:

## Remain the 'Best House in a Bad Neighborhood'



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### Cash

- Schwab's Money Market Fund (SWMXX) yields a paltry 0.01%<sup>1</sup>

### Bonds

- 2-Year AAA Corporates Yield 0.81%<sup>2</sup>
- 2-Year AAA Municipals Yield 0.33%<sup>2</sup>
- Average Junk Bond Yields are at 7.613%<sup>4</sup>, well below 2008 peak levels of over 21%<sup>3</sup>
- 10-year Treasury Yields 1.84%<sup>4</sup>

### Real Estate

- Prices Remain Depressed
- Inventory Remains High
- Foreclosures/Delinquencies Remain a Concern

### Stocks

- Compelling Valuations
- Large Overall Cash Position
- Attractive Dividend Yields
- Tend to Perform Well During Inflationary Periods

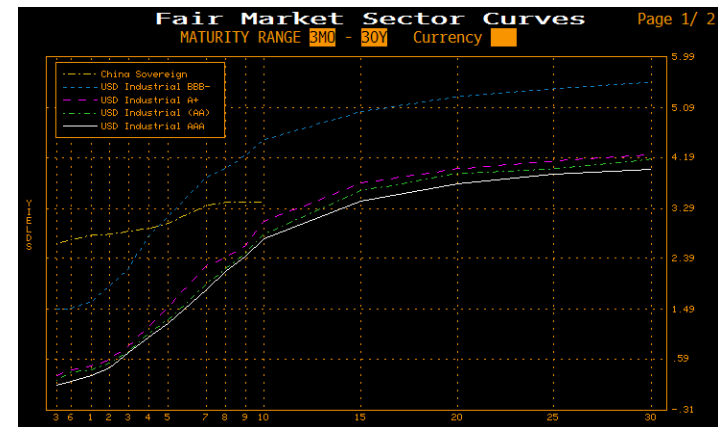


Chart Courtesy of Bloomberg

<sup>1</sup>Schwab Institutional 1/31/2012 <sup>2</sup>Vanguard 1/31/2012 <sup>3</sup>Merrill Lynch US High Yield Master II Index 1/31/2012 <sup>4</sup>US Treasury 1/31/2012



# Compelling Valuations

- As the chart below illustrates, U.S. stocks are trading at their cheapest levels since at least 1990...



Chart Courtesy of Bloomberg



# Compelling Valuations

➤ ...holds true for global stocks as well...

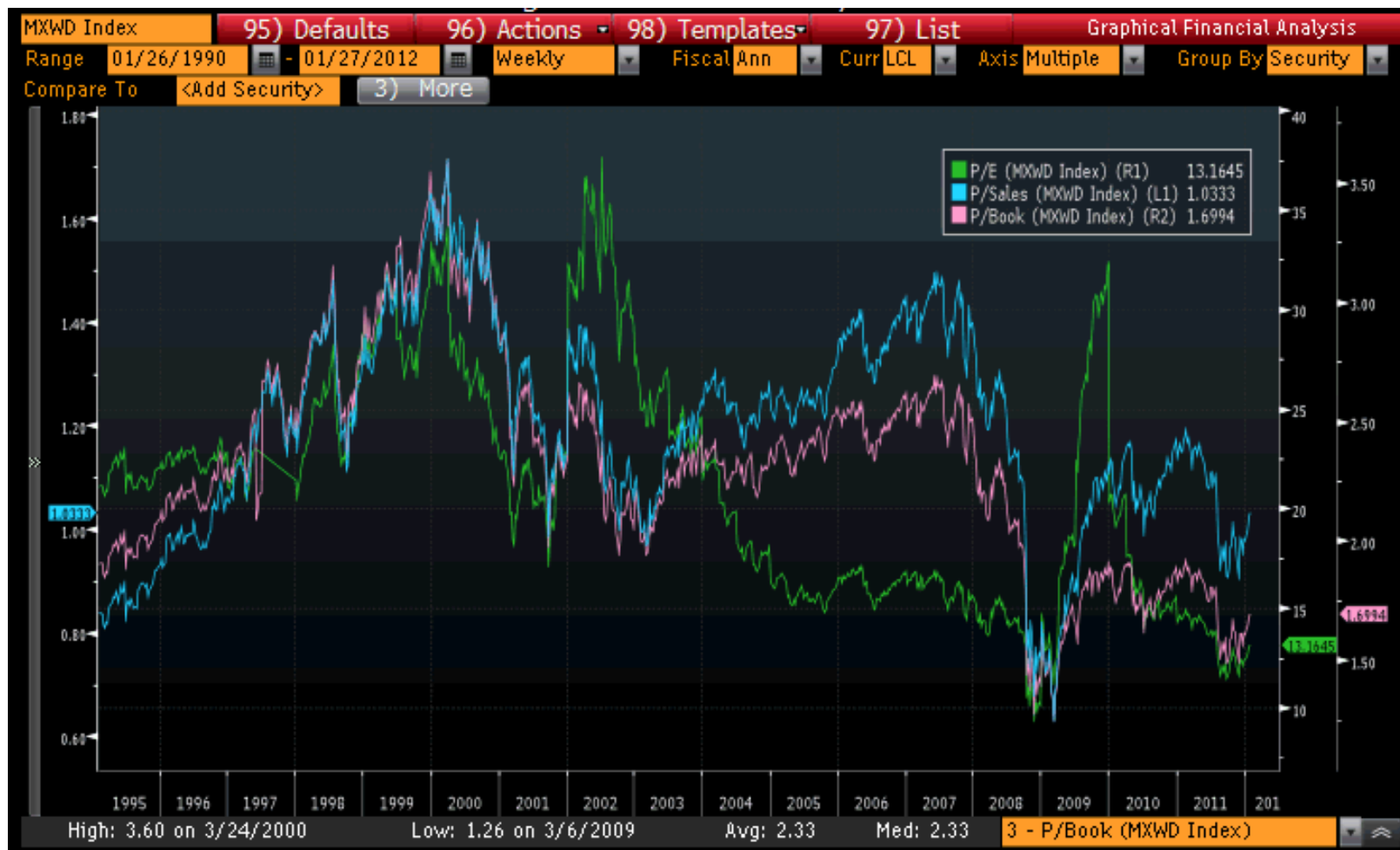


Chart Courtesy of Bloomberg



## Cash Rich...

- Nonfinancial companies in the Standard & Poor's 500-stock index held more than **\$2.1 trillion** in cash and other liquid assets at the end of September<sup>1</sup>
  - Near highs last seen in the 1960s
    - Represents 7.2% of all company assets
    - The same companies spent 108% of their combined free cash flow on stock buybacks during the same period<sup>2</sup>
- Anticipated cash usages include strategic acquisitions, further share buybacks, and **dividend initiations/increases**
  - The percentage of profits paid out by companies in dividends is near an all-time low at 28%
    - This rate has averaged 40% over the past 20 years<sup>3</sup>



# Dividend Yields Attractive

- The yield on the S&P 500 Index is higher than that of the 10-year Treasury – representing only the second period since the 1950s in which that was the case<sup>1</sup>
- Fixed Income Giant Bill Gross of PIMCO has gone on record stating that “if you can get long-term returns of 5 percent from either stocks or bonds, you should consider yourself or your portfolio in the upper echelon of competitors.”<sup>2</sup>
  - **We believe the way to get there is through dividends rather than bonds**

| Dividend Paying Stocks vs 10-Year Treasuries |  |             |             |             |             |             |             |             |             |                            |
|--|--|-------------|-------------|-------------|-------------|-------------|-------------|-------------|-------------|----------------------------|
|  | Year 1   | Year 2      | Year 3      | Year 4      | Year 5      | Year 6      | Year 7      | Year 8      | Year 9      | Year 10                    |
|  | (assumes 7% yearly growth in dividends and no capital gains) |             |             |             |             |             |             |             |             |                            |
| <b>Dividend Rate</b>                         | 3.60%  | 3.85%       | 4.12%       | 4.41%       | 4.72%       | 5.05%       | 5.40%       | 5.78%       | 6.19%       | 6.62%                      |
| \$1,000,000                                  | \$1,036,000  | \$1,075,907 | \$1,120,252 | \$1,169,657 | \$1,224,851 | \$1,286,696 | \$1,356,212 | \$1,434,612 | \$1,523,349 | \$1,624,171                |
| <b>Interest Rate</b>                         | 2.00%  | 2.00%       | 2.00%       | 2.00%       | 2.00%       | 2.00%       | 2.00%       | 2.00%       | 2.00%       | 2.00%                      |
| \$1,000,000                                  | \$1,020,000  | \$1,040,400 | \$1,061,208 | \$1,082,432 | \$1,104,081 | \$1,126,162 | \$1,148,686 | \$1,171,659 | \$1,195,093 | \$1,218,994                |
|  |  |             |             |             |             |             |             |             |             | <b>Difference in Value</b> |
|  |  |             |             |             |             |             |             |             |             | <b>\$405,177</b>           |

<sup>1</sup>Bloomberg <sup>2</sup>CNBC



# Dividends vs. Bond Yields

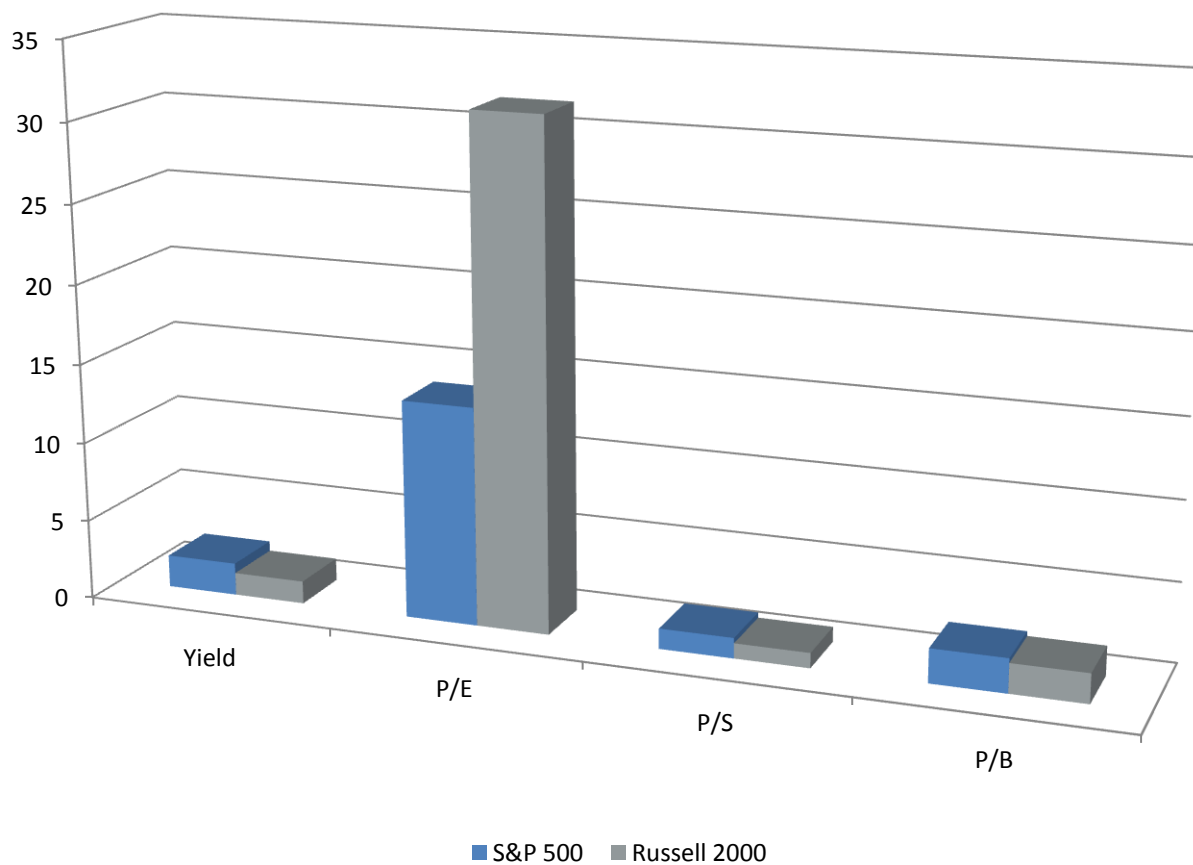
| <u>Company</u>      | <u>Annual Dividend</u> | <u>Dividend Yield</u> | <b>Similar Bond</b> |                        |
|---------------------|------------------------|-----------------------|---------------------|------------------------|
|                     |                        |                       | <u>Yield</u>        | <u>Coupon/Maturity</u> |
| Abbott Laboratories | \$1.92                 | 3.50%                 | 2.497%              | 4.125% 05/27/2020      |
| Campbell Soup       | \$1.16                 | 3.70%                 | 3.380%              | 8.875% 05/01/2021      |
| Johnson & Johnson   | \$2.28                 | 3.50%                 | 3.545%              | 6.95% 09/01/2029       |
| Statoil             | \$0.94                 | 3.70%                 | 3.169%              | 6.50% 06/07/2021       |
| Total               | \$2.51                 | 4.70%                 | 2.803%              | 4.125% 01/28/2021      |
| Vodafone            | \$0.95                 | 3.50%                 | 4.430%              | 7.875% 02/15/2030      |

Source: Bloomberg



# Equities: Not Created Equal

**We Prefer Large Caps (S&P 500) vs.  
Small Caps (Russell 2000)**



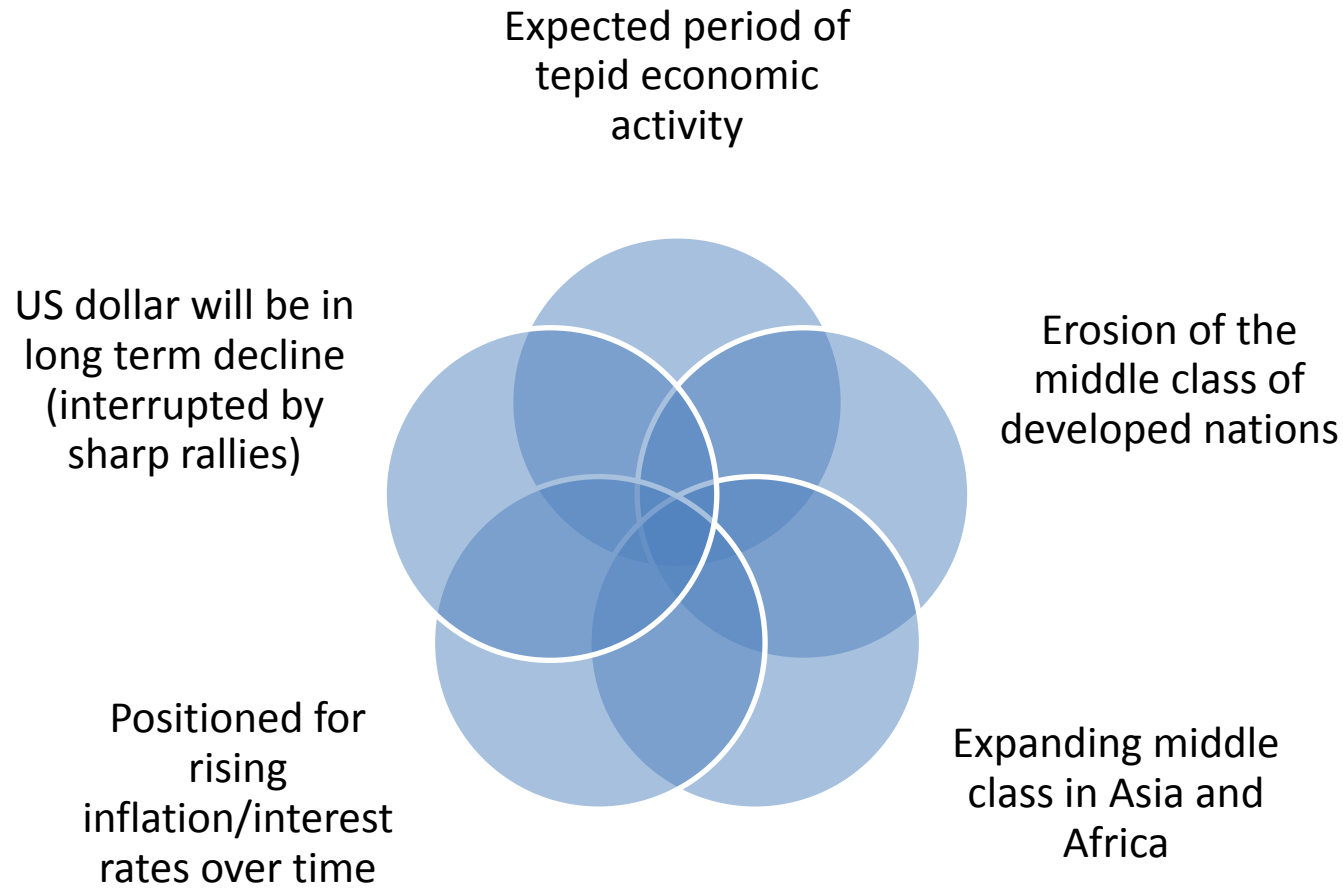


## Selectivity is Key

- Emphasis On:
  - Attractive Valuations
  - Companies with Pricing Power
  - Exposure to Emerging Markets
  - Compelling Dividend Yields
  
- Shy Away From:
  - Excessive valuations
  - Names that rely solely on US and European markets for growth
  - Companies that lack Pricing Power



# Thematic Filters





# Summary Investment Approach

## FIXED INCOME

- Continue to keep WAM relatively short as we focus on slightly lower quality issues in order to enhance yield —————> Do not rely on ratings agencies
  - Fed actions offer “green light” to extend maturities slightly

## EQUITIES

- Stock Pickers Market – Opportunities Exist
  - Keen eye on Valuations; Selectivity is key
  - Increasingly favor strong dividend payers over paltry bond yields
  - Maintaining a defensive global stance
    - Focus on Foods, Beverages, Pharma and select foreign names (Asia, excluding China and India; South Africa)
  - Anticipate increased purchases of commodities as an inflation hedge
- Continue to execute covered call writing strategy
  - Mitigate Risk
  - Enhance Return
  - Generate Additional Income
- Take advantage of pullbacks in the broader markets to add to/initiate positions



WWW.MANAGEDASSETPORTFOLIOS.COM

950 W UNIVERSITY, SUITE 100  
ROCHESTER, MI 48307

(248) 601-6677

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