



POTOMAC  
STRATEGIC INVESTMENT

## CAPITOL MARKET REVIEW

In This Issue: Year Winds Down, Weary Investors Face Losses, Only Nimble Traders and Gold Bugs Have Gains.

At Mid-Day: SPX 1254 US10Y 1.95% Gold \$1609 Oil \$99.92 Dec. 22, 2011

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With a half-dozen market days left in the year, the trades that have defined 2011 have been booked. Stock indexes remain largely flat. Therefore most institutional investors have made money only in their bond portfolios.

To the extent that aggressive traders will post gains, these gains have been from highly risky transactions. And considering that equity markets have not expanded, as retail investors have continually drained assets from stock mutual funds, investment performance has been a “zero-sum-game.”

2011 will be seen as the year of the aggressive hedge and prop fund trader. The year the tail truly wagged the dog and safety consistently trumped risk.

There were sectors that out-performed and CMR has trumpeted these themes in the past. Winners were utilities, dividend paying stocks, consumer staples, a few tech stocks, gold and oil. However, for any manager running a traditional long-only diversified fund, this has been one of the worst years in stock market history.

2011 has been a year of hope. And in this regard it should be noted that stocks are the ultimate “hope” trade. After all, what is an equity share in a company? Setting aside complex value metrics, equity participation in a company is the equivalent of a long-dated call option. Factors impacting valuation often do not correlate with underlying balance sheet metrics.

In spite of incessant cheerleading for US stocks, and for the American free enterprise system, public companies had a lackluster year, punctuated by violent downdrafts and dramatic recoveries; the latter always stalling at key valuation points.

The Dow Jones Industrial Average is just 30 stocks. In rough numbers, the Dow’s up 6%. The next measure is the SP100, (the leading US multi-national stocks.) Considering quantitative easing, the fact that the largest US companies have pristine balance sheets, can borrow at 0% and were the prime beneficiaries of a cheap US dollar and global growth, one would assume this index was a clear winner this year. The return of the SP 100 is less than 1%. With all the advantages of global clout, sophisticated management and accommodative monetary policy, America’s leading companies returned about 1%.

But wait, what about growth companies, led by Google and Apple? The measure here is the Russell 1,000 Growth Index and is represented by the ETF with symbol IWF. Certainly this sector was a winner. The Russell 1,000 Growth index is up less than 3% on the year.