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Marking Time: Back-and-Forth the Pendulum Swings

2011 Retrospective — A Look in the Rear-View Mirror

Mayan calendar aside, many will look forward to turning the page to 2012. Reflections of this past year seem to be visions of tumultuous drama (including the gnashing of teeth and tearing of hair), yet there are scant results to show for it.

- **Riding the Euro-Coaster** — Despite countless summits, the promise of a fix to the European debt crisis remains elusive. Proposed — and rejected — austerity measures in Greece, disappointing bond auctions in Italy and prospects for further downgrades all had the Euro-coaster riding the rails at top speed.
- **Congrexican Stand-Off** — Political gridlock in Washington, DC told the markets that no real solution to the US debt problem would be forthcoming ... at least not until *after* the 2012 elections. Meanwhile, lawmakers continued to raise the roof on the debt ceiling and kick more cans down the road, preferring instead to devote their energy to finger shaking and name calling.
- **Shrinking Middle-Class** — John Mayer's generation is no longer "waiting for the world to change" as the 99-percenters took to their tents, occupying Wall and other Streets across the US. The contagion of European and Middle-Eastern protesters caught hold in 2011. The unpopularity of austerity measures, despots and sustained economic anemia brought Echo-Boomer generations around the globe (accompanied by not just a few of their out-of-work, Baby Boomer parents) shouting that they're "mad as hell and (they're) not going to take it anymore." Behemoth, US retail banks had perhaps the biggest self-induced targets on their backs, prompting a new, "Dump Your Bank" holiday to protest \$5 usage fees on debit cards. (Goliath ultimately backed down when David switched to a local credit union.)
- **Geopolitical Changing-of-the-Guard** — Since we can never separate politics and markets, it's notable when governments change hands. Tunisia, Egypt, Libya, Italy, Greece and North Korea, among others, have all seen old leaders



relegated to the history books while new leadership looks to take hold. What will such sweeping change mean to the global economy? Will new markets emerge?

- **Ratings Right-Sizing?** — Given the prevalence of debt around the world, ratings agencies took a hard look at what really constitutes AAA, downgrading perennial favorites such as the US for the first time in history. Time will tell if the actions of Standard & Poor's were justified, or if it's all just relative in the end. Later, S&P put fifteen of seventeen Euro countries on watch for downgrade. (The remaining two countries, Cyprus and Greece, were already on watch or rated well below investment grade.)

While drama always tends to grab the headlines, the few (relatively) bright spots this year happened quietly — almost entirely under the radar.

- **Bellwethers & Watersheds** — While they may not indicate a complete turning of the corner, these indicators point to what could be sustainable good news.
- **GDP Growth** — Economists forecast that we'll finish 2011 with Gross

Domestic Product at approximately 3% growth in the fourth quarter, ending the year on a reasonably positive note.

- **S&P is Back-in-Black** — After a roller coaster ride of its own, the S&P finishes 2011 just about even at 1250 points, while the Dow captures approximately 6% gains on the year. The US Dollar inched slightly higher — up 0.2% — and the benchmark ten-year US Treasury fell 140 basis points, ending the year at 1.88%.
- **Up with Corporate Profits** — Eleven straight months of rising corporate profits can safely be called a streak.
- **Falling Unemployment** — The four-week average fell to a three-year low (since June 2008) at 375,000, which has optimists expecting a strengthened labor market in the New Year. Economists predict job gains of about 1.6 million or 150,000 per month, which should bring unemployment down to 8.4%.
- **Consumer Confidence** — The Conference Board Index of Leading Indicators rose higher than expected in December (the seventh straight month). And, consumer confidence

was up as well — the fourth month in a row and the highest levels since June. Holiday buying was declared a success, picking up right before the Christmas holiday (although margins are expected to be lower given retailers' deep discounts to shed unwanted inventory).

- **Housing Moves** — Better than expected reports in housing show the highest growth since April 2010 (then driven by the tax credit deadline) at 7.3% versus a 2.0% forecast.
- **Auto-Pilot** — Although there were no blockbuster months in the automobile industry, growth throughout 2011 was healthy and sustainable as the sector seems poised to continue its rebound.

Yes, 2011 was a rocky, raucous year of tremendous ups and downs around the globe. In the end, though, it could prove to be much ado about nothing. Noted philosopher Nostradamus is credited as saying that the more things change, the more they stay the same. Perhaps it's all just relative. But, while we wait for the pendulum to swing back a bit, let's look ahead to what 2012 might bring.

2012 — A Look into the Crystal Ball

▪ **Europe & the US** — Many prognosticators see the European crisis escalating. The debt powder keg that is the Eurozone has far-reaching consequences potentially affecting every economy in this global village. If the current pace of growth and positive news in the US stalls out, we have only to look across the Atlantic to understand why. European economic contraction at (0.1%) may be a sign of continuing recession in the region. As old-world countries struggle, investors are fleeing sovereigns and demanding US dollars (USD) amid that uncertainty. With the Euro weakening by 3.3% versus the dollar, it's possible that we could see USD and Euro parity somewhere in our future. The UK has become vocal on the sovereign debt crisis even though they don't share the Euro as currency. Clearly, everyone has a dog

in this fight. We could also see a slow-down in emerging markets as things get worse in Europe.

- **Selling Debt Wholesale** — Refinancing trends in Europe have governments selling their bonds to investors who seem to be reluctantly comfortable with shorter-term debt. In contrast, ten-year Italian bond yields were last rising above 7%, indicating that investors are nervous about Italy's ability to repay in the future. Meanwhile, the European Financial Stability Fund's ability to bring in additional cash to the Eurozone could be jeopardized if contributing countries are downgraded further.
- **Currency & Safe Havens** — Contrary to the 1990s when individual investors made their buying power known, it is companies that are doing the purchasing these days. Gold and hedge funds were the investments of choice in 2011, but December equities

(i.e., mutual funds), bank savings and bond funds could point to the next trend. Our predictions? With a dearth of investments to buy, it's clear that the flight to safety is here to stay at least for a while. Perhaps the best choices for 2012 lie in US Treasuries, United Kingdom gilts, Australian and Canadian debt as well as German debt if Euro investments cannot be avoided.

- **Actions & Reactions** — The Federal Reserve Bank continues to warn of slow growth in the coming year. No tightening is expected. In fact, the Fed may announce a third round of long-term bond purchases (QE3 follows QE2). Such a move will keep rates from heading too much higher, but Treasury yields could shoot further north. On the ratings front, Moody's has indicated first quarter Euro country reviews. It's possible that we will see zero AAA-rated Euro currency sovereigns at some point soon.



- Chinatown, Coming to a City Near You** — The latest expansion of China's influence features "Yahoo!" as an acquisition target by that country's Alibaba Group. (The organization hired a US lobbyist to help them in their efforts.) This nation, too, has its share of challenges, including a housing bubble they have tried to avoid, but we have yet to see if they will experience a hard or soft landing. With an anticipated 8% growth versus their usual 10 - 12%, one might think China's doing well. And, relatively speaking, they probably are, but it's all relative for such a giant economy.
- Nuclear Tinderboxes** — These relatively isolated nations clearly have not taken notes on what has gone on in other regions of the world.
 - North Korea** — Following the death of Kim Jong-il, the first

communication of his twenty-year-old son, Kim John-un, portends that North Korea's confrontational stance toward their southern neighbor will remain unchanged. Labeling opponents as "foolish," the newly dubbed leader indicates that his country will stick with their current policies, including moves to develop nuclear weaponry. The stability of South Korea is of moral and economic importance as they are the fifteenth largest global economy and the seventh largest US trading partner.

- Iran** — Meanwhile, farther west, Iran seems intent on playing a game of chicken with the entire world by threatening to close off the Strait of Hormuz. This warning is in retaliation to US sanctions meant to force Iran to play nice in the sandbox

with the United Nation's nuclear watchdog group. Possible disruption of oil supply could bring the price of oil to nearly \$150 per barrel — again.

The more things change ...

We face multiple headwinds heading into the New Year: excess government debt / sovereign debt crises, housing market weakness, languishing labor markets, Congressional gridlock and business condition uncertainties. Yet, looking back through history, there have been many times of even greater challenges than we face now. So, unless the world ends next December (as some have predicted), let's toast the end of 2011 and look forward to 2012. Here's to better days ahead.

Cheers!



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