TFC Financial Management

TFC Market Update
March 6, 2012

A Game Changer . . . (But Global Financial Market Hurdles Remain Formidable)

With the December labor market report published in late January, the macro-economic backdrop in the U.S. shifted from neutral to semi-positive. A monthly new job creation rate of 243,000 reinforced a trend that began earlier in the fall. This, followed recently by a somewhat stronger-than-expected 4th Quarter Gross Domestic Product (GDP) improvement of 3%, confirms our domestic economy is moving in the right direction.

If the monthly job creation rate remains positive (next report due this Friday), by the end of this year, the economic and politically important unemployment rate could be below 8%. This would further bolster consumer confidence. Investor sentiment improvement has already been evident since the beginning of the New Year. Equity markets worldwide are off to their best start since 1989. The combined effect of this *is* a game-changer for heretofore patient equity investors and adds to the unease of the many risk-averse investors sitting on the sidelines with hordes of cash awaiting a clear signal to get back into stocks. It also alters the American political landscape. But there remain many public policy and geopolitical barriers to overcome before the all-clear signal can be sounded for global stock and bond markets.

Is the financial markets' recently found optimism justified? As has so often been the case, the bond and equity market pendulum swings in extended arcs, but usually reverts to mean valuation readings. Since the high-flying dot.com days of 1Q 2000, global common stock price/prospective earnings ratios had declined from a peak of 26x to a cycle low of 9x in September of last year. During this period, on balance, investors diverted massive amounts from stocks into fixed income investments (e.g., bond mutual funds). Today, stocks seem a bargain when compared to the total return outlook for bonds of all types. But before P/E ratios move back toward even 2007 pre-financial-market-meltdown average ranges, many well-publicized obstacles in the public policy arena need to be surmounted. Too numerous to list here (the most visible, of course, currently being the Euro debt crisis), the essential question is whether representative democracies are constituted to deal with the sophisticated nature of these obstacles. When constituents are uninformed, those with political agendas and special interests are free to demagogue and distort. The ensuing debate then usually ignores what's important and tends to be resolved with lowest common denominator compromises. Often the unintended consequences of these compromised policy remedies are worse than the ailment.

Beyond this, there is another emerging concern with which equity investors and the markets must now contend . . . the remarkable success with which the average American business has faced and dealt with the numerous credit market strains and policy miscues of the past few years. Having responded skillfully to the financial pressures of the Great Recession, most U.S. corporations are now running at peak operating efficiency, profit margins are at or near historic highs, and excess cash build-ups (today in the aggregate exceeding $1.5 trillion) have accumulated in the form of company balance sheet reserves. How this cash is employed in the near-term will, at the margin, have an important impact on the real economy and financial markets.

As a result of improving margins, corporate earnings growth during the past few years has been at double digit annual rates. Can an encore in 2012 ensue? Probably not, but if companies can be persuaded to release, in the form of increased dividend payouts, a portion of what politicians are beginning to characterize as obscene and excessive corporate cash, investors could benefit in perhaps unexpected ways . . . (i.e., through improved investment income). Despite the slight improvement in the economic outlook noted at the outset, corporate executives and directors probably cannot be expected to materially raise dividend payout ratios permanently and across the board, but extraordinary one-time declarations, such as Microsoft distributed in December 2004 could be possible. In a general sense, this could further improve investor sentiment. For this stockholder extraordinary dividend bonus to occur, however, the regulatory and political atmosphere will need to show signs of better balance. (See attached copy of global regulatory topography from Sunday's *New York Times* magazine.) In a presidential election year, perhaps all this is too much to expect, but as the saying goes, "politics attracts strange bedfellows" (or perhaps to avoid service by the PC Police the term should be "bedpersons").

Should you have any questions or comments, please let us know.

Best,

Jim

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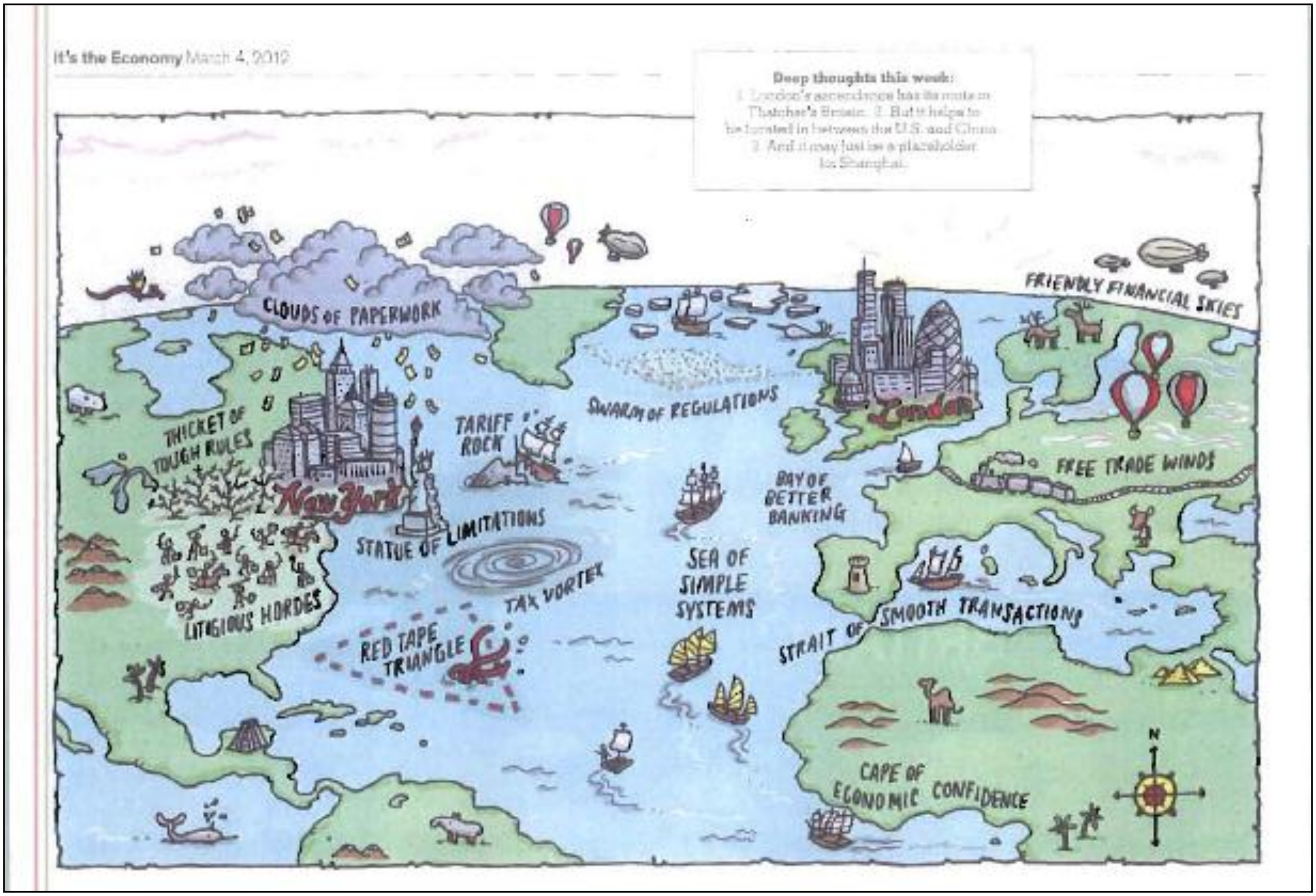

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