

THE CONSULTANT



IN THIS ISSUE

GREETINGS FROM GEORGE

NEW YEAR'S RESOLUTIONS
AND INVESTING

MARKET TREND WATCH

GREETINGS FROM GEORGE

We are delighted to send you the 2012 first quarter publication of *The Consultant*, our new quarterly newsletter. With all of the events that have come to define 2011 as one of the strangest years ever, many of our clients have asked us to give our thoughts on the year and what lies ahead.

Last June, I had the opportunity to take my family to Europe. While in Paris, my daughter and I visited Versailles where she heard the story of Marie Antoinette, Louis XVI, and the French Revolution. After a long discussion, we decided to read together Charles Dickens' *A Tale of Two Cities*, a classic I read at her age. As we began this great novel, Dickens' famous first line read:

"It was the best of times, it was the worst of times, it was the age of wisdom, it was the age of foolishness..."

Dickens could have been writing about the year 2011. Last year was "the best of times" for some, and "the worst of times" for others. It was a year when governments and politicians showed both "wisdom" and "foolishness."

We didn't experience a French Revolution as Dickens wrote about, but we did witness revolutions in Egypt and Libya, and political unrest in many other places. In 2011:

- We experienced a major earthquake and tsunami on the northeastern coast of Japan, killing over 20,000 people.
- We observed "financial earthquakes" across Europe due to mounting debt burdens.
- At home, we witnessed the downgrade of our own U.S. debt from AAA to AA+, while our national debt eclipsed \$15 trillion.

✚ CONTINUED ON PAGE 4

NEW YEAR'S

RESOLUTIONS + INVESTING

“NO THING IN MODERATION” = BAD IDEA FOR YOUR INVESTMENTS

THERE IS NOTHING ON THE grocery store produce aisle more perishable than that most common of January traditions, the New Year's Resolution. By the time you are reading this, yours have probably bit the dust, as have ours. In fact, only 8% of Americans are always successful in achieving their resolutions, while almost 75% are virtually never successful.¹ Why are we so notoriously bad at keeping our resolutions? Extremism and lack of discipline, plain and simple. Whether it's losing weight, working out, or giving up a bad habit, we tend to make extreme resolutions and fail to create a disciplined approach to help keep us on track. Okay, so what does this great American tradition (for a small few) have to do with investing? Everything.

Let's take a quick look at the two most recent extremist views on the markets and how they played out. In the spring of 2009 we all heard investment pundits as well as friends, neighbors, co-workers, etc. exclaim, “sell all of your stocks while you still can!” From the bottom of the market on 3/9/09, the S&P

500 was up 97.2% thru 12/31/11.² Over that same time period, most major international indexes were up between 60% and 160%.³ In late 2010 and most of 2011, we were warned that interest rates had nowhere to go but up, so we often heard “sell your bonds.” As of 12/31/10, the yield on 10-year U.S. Treasuries was 3.30%. To the surprise of virtually the entire investment world (most notably, Bill Gross at PIMCO), those same Treasuries were yielding 1.89% on 12/31/11 which resulted in a 17% return for the year.⁴

Both the run-up in the stock market following the Great Recession and the 2011 mini-bull market in bonds were seen as highly improbable events by many, yet they occurred. So, what did we learn from them? Investors seldom calculate the opportunity cost of being all in or all out of an asset class (otherwise known as “market timing”) until it is entirely too late. Creating a disciplined approach or strategy to avoid making extreme and irrational decisions at the worst possible time is critical to long-term investment success.



BE PREPARED

CREATE A DISCIPLINED APPROACH

When asked about how to prepare for the next major crisis, Barry Ritholtz, the author of [Bailout Nation](#) and CEO of [Fusion IQ](#), says the following:

“The time to look for the emergency aisles and where the exits are located is before takeoff, not after the wings fall off the plane. You must have a plan in place to deal with unanticipated events, a just-in-case things head south scenario.

Ideally, you put this plan together when you are objective and unemotional and calmly contemplative — not when things are figuratively and literally melting down.”⁵

¹ Interesting New Year's Resolution Statistics - <http://www.steveshapiro.com/2008/12/11/interesting-new-years-resolution-statistics/>

² JPMorgan Guide to The Markets

³ Dshort Website - <http://www.advisorperspectives.com/dshort/updates/World-Market-Snapshot.php>

⁴ JPMorgan Guide to The Markets

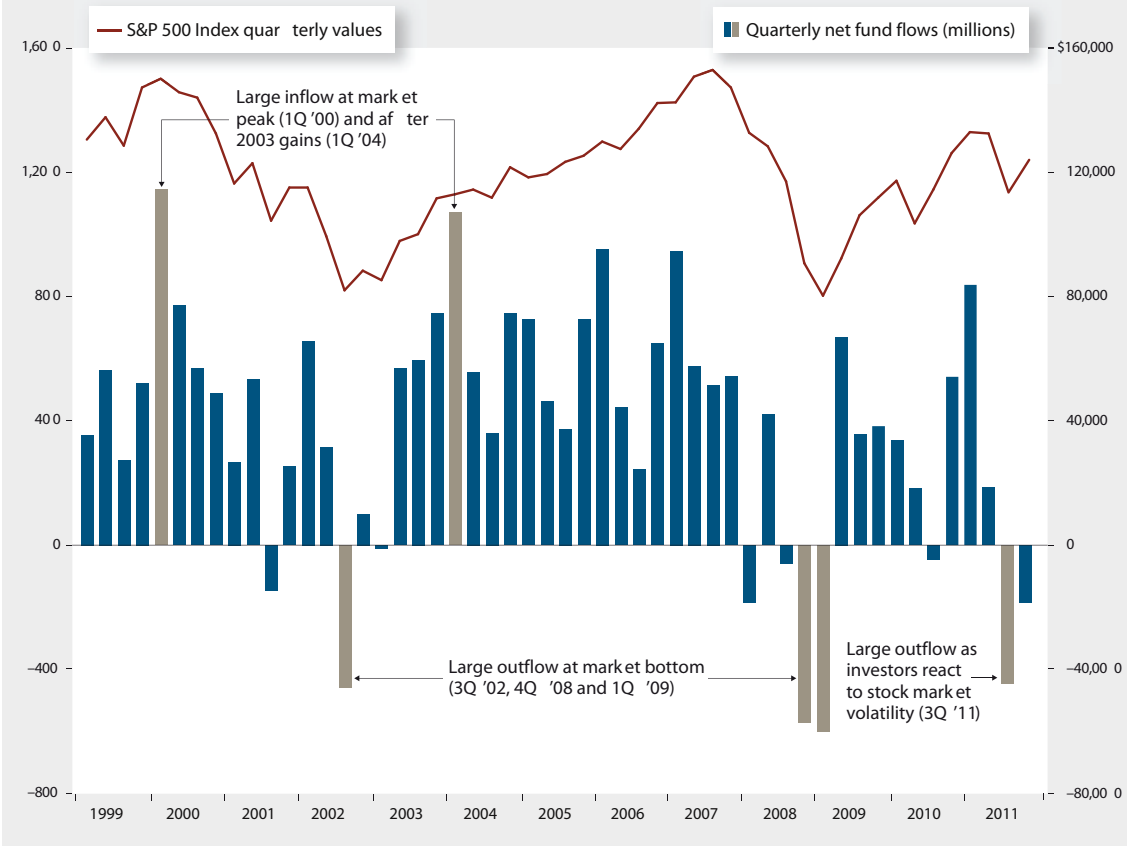
⁵ The Big Picture Blog <http://www.ritholtz.com/blog/2011/03/black-swans-100-year-floods/>

⁶ “Getting the Most Out of Equities” – Investment News Dec 5-9, 2011 by James O'Shaughnessy

2012 will undoubtedly be full of surprises, but don't let them derail your strategy. In the words of James O'Shaughnessy, author of *What Works on Wall Street*, "if you use even a mediocre strategy consistently, you'll beat almost all investors who jump in and out of the market, change tactics in midstream and forever second-guess their decision."⁶

Volatility can lead to herd mentality and cause investors to rush for the exit

Buying high, selling low – fund flows have closely traced the highs and lows of the market



Sources: Standard & Poor's and Strategic Insight. Net fund flows represent domestic and international equity mutual funds and exchange traded funds. The most recent data shown for S&P 500 Index values and net fund flows are through 11/30/11. Standard & Poor's 500 Composite Index is a market capitalization-weighted index based on the average weighted results of 500 widely held common stocks.

“You can have cheap equity prices or good news, but you can't have both at the same time.”

- Joe Rosenberg, Chief Investment Strategist, Loews Corporation/Tisch Family (source: Barron's, Dec. 3, 2011)

GREETINGS FROM GEORGE

CONTINUED FROM PAGE 1

The following stock returns illustrate companies that experienced the “worst of times:”

Research In Motion	-75%
OfficeMax	-74%
Bank of America	-58%
Goldman Sachs	-46%
Alcoa	-44%

Yes, the “worst of times” and “the age of foolishness” can easily be seen in 2011. So where is Dickens’ “best of times” and “age of wisdom?” For one, many U.S. companies did very well. Over 70% of the companies in the S&P 500 beat their projected earnings in 2011. This leaves the trailing price-to-earnings ratio for the S&P at approximately 13.6, which is fairly cheap by historical standards.

Second, many domestic corporations had great equity returns during 2011:

MasterCard	+66%
Humana	+60%
Dollar Tree	+48%
Starbucks	+43%
Rite Aid	+43%

Third, in 2011, we experienced an 8.4% return with the Dow stocks and a 2.1% return with the S&P 500 stocks.

Can you believe that after everything that happened in 2011, the domestic large capitalization markets were up?

Yes, 2011 was a year that we will never forget. Only time will tell if we will experience the “wisdom” that Charles Dickens refers to.

Take care and God bless!

Sincerely,

George H. Edmiston, Jr.

Nothing contained in this material is intended to constitute legal, tax, securities, or investment advice, nor an opinion regarding the appropriateness of any investment, nor a solicitation of any type. The general information contained in this publication should not be acted upon without obtaining specific legal, tax, and investment advice from a licensed professional.

MARKET TREND WATCH

■ UP VS. DOWN

The split between “up” and “down” days for the S&P 500 over the last 50 years (1962 – 2011) is 53% up and 47% down. The split for 2011 was 55/45, a surprising result considering the index was up only 2.1%.

■ MISSING THE BEST

If you had missed the best three days last year, your return from the S&P 500 would have fallen from +2.1% to -10.7%.

■ AVOIDING THE WORST

If you had avoided the three worst days last year, your return from the S&P 500 would have increased from +2.1% to +20.2%.

■ IN AND OUT

The top performing stock in the S&P 500 in 2011 (+101%) was ranked #461 out of 500 in 2010 (-13%). The top-ranked stock in 2010 (+140%), was ranked #393 in 2011 (-20%).

■ FEW STOCKS, LARGE IMPACT

The 10 largest stocks in the S&P 500 (2% of the stocks) made up 20% of the value of the index because the S&P 500 is a market-cap weighted index.

■ BETTER THAN THE REST

U.S. equity markets fared better than 45 of 48 markets tracked by MSCI.

(sources: Direxion Funds, Leuthold Weeden Capital)

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