QUARTERLY NEWSLETTER

Volume 15, Issue 2

April 12, 2012

KARAGOSIAN FINANCIAL SERVICES, INC.

BULLETIN:

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MARKET AND ECONOMIC OUTLOOK

STOCK MARKET

After an essentially "flat" year for the U.S. stock market in 2011, major stock indices roared back in early 2012. All major U.S. stock market indices posted impressive gains in this past quarter. Continuing the momentum from last year's fourth quarter when the NASDAQ rose 8%, the tech laden index had its best first quarter performance since 1991, rising over 18% in the first three months of 2012 after underperforming the Dow Jones Industrial Average (DJIA) last year. Also, both the DJIA and the S & P 500 had their best first quarter since 1998 (up 8% and 12% respectively) Even with this dramatic market increase, the forward 12 month Price/Earnings ratio for the S & P 500 Index is still notably below its ten year average (12.9 versus average P/E of 14.5). .So far in April there has been no carryover of this rally, but in the past the average fourth year stock market return when a Democrat is President has been 14%.

The market sectors that performed the best include the financial stocks which last year were the worst performing industry, increasing over 21% in the first quarter of 2012. Technology stocks, as we know helped tremendously by Apple, rose as a group 18.5% last quarter. Aided by the increase in employment here in the U.S., consumer discretionary stocks also improved as a group 15.6%

In a turnaround from a dismal performance in 2011, the first quarter of 2012 proved to be a prosperous one for foreign stock markets. Non-U.S. equity index MSCI EAFE gained 11% in the first quarter, the best first quarter showing since 1998. Foreign stocks, as in the U.S., were led by financials and consumer discretionary stocks. For the developed markets, the best returns were found in Germany and Japan, helped by accommodating central bank policies such as the European Central Bank providing banks ample liquidity with its Long-Term Refinancing Operation and the Bank of Japan surprisingly announcing additional quantitative easing. As far as emerging markets, there was a significant reversal from last year's market meltdown. Based on MSCI (Morgan Stanley Capital Index) country indices with U.S. dollar based returns, India increased 20% last quarter, after declining 37% in 2011. Also Russia, Mexico and Brazil posted double digit percentage declines last year, but had fantastic performances in the first quarter gaining 19%, 16% and 14% respectively.

Bond Market

It appeared as if the long standing rally in U.S.Treasuries had ended in the first quarter when interest rates started to rise. The 10 Year Treasury Note, after having closed 2011 at 1.89%, the yield ended the first quarter at 2.23%. Also, rates on very short 3 Month Treasury Bills which ended last year at a miniscule .02% have bumped up somewhat but are still at an extremely low level of .09%. Treasuries in general had a negative return last quarter. However, the net supply of Treasuries (gross issuance minus the amount of maturing debt) will fall this year again which should provide some support to the Treasury market. In addition, the flight to quality attracts Treasury investors as the number of alternatives have decreased. The number of AAA issues in a Bank of America Merrill Lynch index shows the number

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MARKET AND ECONOMIC OUTLOOK *(CONTINUED)*

has dropped from 5,331 in 2007 to 3,611 currently. Also, banks need to add safe assets to meet new reserve requirements, therefore increasing demand for the safety of Treasuries. It is hard to say then where Treasury yields are heading in the near term.

Outside of Treasuries most bond sectors showed positive returns for the first quarter of 2012. Yield spreads tightened which allowed these bonds to show gains even though their comparable maturity Treasuries declined in value. The more traditional riskier bonds such as high yield (junk) and emerging market sovereign bonds showed the greatest returns last quarter as investors reached for greater yields. Municipal bonds still had positive returns at the start of this year, even after performing better than expected last year.

Forecast

On Wall Street there is a saying that you “buy on the rumor and sell on the news”. In the current environment, where people are skeptical of a prolonged rise in the market, they seem to be “selling on the rumor, and buying on the news”. And as we have illustrated in the past two or three newsletters, the news has most often been positive. This presents an opportunity, in our opinion. Investing in equities when the market is moving in a deliberate uptrend is the definition of momentum investing. Momentum investing often leads to bubbles which we would all like to avoid. We maintain that equities (stocks) are the place to be for the next few years, based on the historically low valuations (12.9x forward P/E vs. about 15x for the ten-year average), albeit with a large amount of volatility. Stocks give us the best chance for long-term returns that will surpass inflation and taxes. Bond yields being near record lows gives us great confidence that it will not be a good asset class over the next 10 years. With the ten-year treasury bond yielding 2.0%, and inflation the last two years averaging 2.5%, and averaging about 3% over longer periods, treasury bond holders are losing money in real value each year if held to maturity. A strong blue-chip company with a strong franchise, or a utility company, can raise prices to offset inflation costs and have the potential to expand sales in other ways, as well. Let’s not forget that in taxable accounts, interest income from fixed income securities are currently taxed at a higher rate than dividends or capital gains. Should the Bush tax cuts end in 2012, the most likely scenario is that dividends will have the same tax rate as interest income but still be lower for capital gains.

At Karagosian Financial Services, we broadly forecast our expectation of the market by observing the stages of the economic cycle. In our view, U.S. companies have reached the first stage of a recovery. Companies have slashed costs and shored up their balance sheets with a record amount of cash. The second stage will entail greater spending by consumers. Banks in turn will actually start lending which should allow for greater economic expansion. This has already started occurring on a broad scale and should accelerate over the coming 18 months, in our opinion. Inevitably, the economy will become overextended again, but to borrow from baseball, we are likely only in the third or fourth inning.