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2012 ECONOMIC FORECAST

A YEAR OF UNCERTAINTY

STATE OF THE U.S. ECONOMY

The U.S. economy had demonstrated subpar growth during the first three quarters of the year against the backdrop of elevated oil prices and the negative economic implications of Japan's earthquake. On the upside, the fourth quarter growth will show clear and convincing evidence of an economic turnaround possibly generating growth at 3 1/2%. The positive underlying forces consists of a substantial improvement in both consumer and business consumption, the unemployment crisis is starting to unwind and we will continue to benefit from the rebalancing of global demand in the emerging world. Notwithstanding these positive fundamentals, this growth trend cannot continue in a global environment that appears to be more deflationary rather than inflationary and while economic activity is slowing throughout the entire world. The pre-requisite to growth and prosperity lies in the expansion of consumption whether by governments, businesses or consumers. The Fed will do whatever it takes to reflate demand. As such, we can be assured that monetary policy will remain easy for the next two years. The primary obstacle to growth is the conflicting deleveraging and austerity measures by federal and state governments and consumers at the same time. Abroad, Euro Land is in the early stage of recession and is engrossed in an unmanageable sovereign debt crisis. This will impair our corporate sector's export profits. These negative fundamentals combined with our exploding federal deficits and related $14 trillion in national debt plus unfunded fiscal obligations, the long protracted real estate downturn, our persistent unemployment dilemma and the phase out of the Bush-Era tax cuts will continue to be a drag on consumption and the overall economic growth in the long-term. **A double dip recession, although remote, remains a possibility.** While no recovery is the same, what makes this cycle different from all others is that it will continue to feel as though we are still in a recession until the unemployment trend starts to unwind. When all is tallied, GDP will average 2% and this trend should continue in 2012 which is substantially less than the pre-requisite 3% required for meaningful job creation. **The U.S. economy, the largest in the world, has been resilient on a historic standpoint and tends to surprise on the upside.**

THE GOVERNMENT SECTOR

Our Congress is anti-prosperity and their lack of action and inability to compromise has been the catalyst to a year of uncertainty and volatility in the markets. The debt ceiling debacle caused the market to react violently resulting in a 5% correction. The Republican controlled House of Representatives held the economy hostage by threatening to force the country into default. Since the inception of our country, raising the debt ceiling was merely procedural. The debatable issues applied to the budget. For the first time in our history, our debt credit rating was downgraded. Before the close of the year, the Bipartisan Supercommittee assigned to cut $1.5 trillion from the federal deficit was unable to reach any agreement. Their failure triggers automatic across the board deficit reductions of $1 trillion over nine years evenly split between defense and domestic spending commencing in January 2013. Our Congress passed the two-month temporary extension of unemployment benefits, 2% payroll tax cut, and Medicare reimbursements to physicians because they could not compromise on how to fund it for the year. As such, they will resume their renegotiations in February. It is fiscally irresponsible to hold our economic policy hostage by a dysfunctional Congress. In addition, it makes us appear as a reckless nation throughout the world. Against the backdrop of this absurd political culture, it seems impossible that Congress will institute any solutions to our fiscal disequilibrium. Investors clearly recognize that stock valuations are based upon earnings. In this environment where consumers are deleveraging, basic economic principles dictate that when government spending contracts, so does economic growth and with it, corporate profits resulting in lower stock valuations.

There are two conflicting economic schools of thought. **Friedrich Hayek** believed that the free market system will determine the proper economic equilibrium. This is also known as laissez-faire. On the other hand, **John Keynes** believed in government intervention to smooth out the business cycle. Had the government employed the laissez-faire policies, our great recession would have been the second depression. The Great Depression of 1929 could have been avoided had the government employed quantitative easing and acted as a lender of last resort. Just like Bernanke, they could have purchased government bonds with the objective of increasing liquidity in the economy to boost growth and avoid deflation. The Keynesian economic philosophy has been employed since World War II. His theories advocated that governments during periods of economic expansion should be able to bank enough revenue to support the economy during the periods of downturns. Unfortunately, the fiscally irresponsible Republican mandate to borrow and spend during periods of expansion has created the **Great American Debt Society.** From the birth of our nation to Jimmy Carter, our national debt was actually less than $1 trillion. Our national debt approximates $14.271 trillion of which $4 trillion is associated with the Obama recovery programs, almost $5 trillion incurred during the Bush administration and $7 trillion associated with other Republican administrations. This is merely the tip of the iceberg when you add in the potential $200 trillion of unfunded governmental obligations. When this debt super cycle comes to an end it will be violent and the markets will riot and the dollar will deteriorate. Either way, it is not the time for fiscal restraint or to raise taxes but rather employ Keynesian governmental intervention to reflate demand. Unfortunately, with a “do nothing” Congress, inaction appears to be the rule of law. Yet, history may be about to repeat itself. In 1937, the fragile economy surviving the Great Depression was on the road to recovery. FDR, against the backdrop of enormous deficits, cut spending by 10%. The Dow Jones lost almost 50% in value and the economy transgressed into recession. It took the deficit spending associated with World War II to bring the economy back to full employment. So there is no misunderstanding, our unsustainable debt trajectory must be dealt with. The government needs to postpone short term austerity measures and create realistic long term fiscal reform that will include curtailing entitlements and raise the retirement age given the improvement in life expectancy.

The Fed recognizes that deflation is the most destructive underlying force in any modern day economy. Against a backdrop of contracting global economic activity primarily in the developed world and our own below trend growth rate, the Fed's monetary policy will remain easy for at least the next two years. It is more probable than remote we will witness an interest rate reduction in the first quarter followed by possibly a third round of quantitative easing (QE3) in the second quarter. QE is Bernanke's inflation injection to counter act the persistent deflationary forces infecting our economy. Given the long protracted mortgage and real estate crisis, the Obama Administration recognizes the need for a mortgage modification program that will enable the banks to recoup their losses in the future. Since this administration does not expect any congressional assistance, the Fed may purchase mortgage backed securities in support of reversing this destabilizing imbalance. The Fed will do whatever it takes to reflate demand and smooth out the business cycle in pursuit of perpetual prosperity. If all fails, the Fed can monetize deficits by printing money, nationalize the banks and become the employer of last resort. Some may call this socialism. **Ben Bernanke probably realizes that the greatest obstacle to growth may very well be our own Congress.**

FINANCIAL SECTOR

It appears US bank earnings have peaked after demonstrating two years of powerful growth. 2011 actually produced a 47% increase primarily associated with the reduction in loss provisions estimated at $74 billion. The large banks have had no problem in raising capital and commercial loans grew 9.4% in the year. However, this trend will not continue against the backdrop of weak loan demand, rising loss reserves and the continued liquidation of both distressed and non-core assets. The top 10 US banks control 65% of the sectors assets. Of these, Citigroup and JP Morgan Chase have the greatest exposure to Euro Land's sovereign debt crisis. Most banks have hedged these positions so their losses should be relatively contained and manageable. Both the increased capital requirements due to Basil III and the Dodd-Frank regulatory compliance costs will create an additional drag on both profits and lending. The prolonged mortgage foreclosure crisis remains intact. Residential and to a lesser extent commercial real estate values are more likely to fall rather than rise at perhaps a slower pace. The trend in bank failures will persist and extend into 2013. However, it appears the worst is over with only 92 bank failures in 2011 and 200 banks remaining on the potential failure list. Either way, the banking sector should be avoided in 2012.

CORPORATE SECTOR

Corporate America earnings growth has continued to surprise on the upside. Their policy of the enormous layoffs in pursuit of better profit margins has abated. Their strong performance relates primarily to technologically driven enhanced productivity. So there is no misunderstanding, the US is the world's number one manufacturer. Our manufacturing sector is technology based which out produces China by 40% whose sector is labor intensive. The earnings growth trend will continue at perhaps a slower pace. On the upside, earnings will benefit from gains in productivity, falling commodity prices, improvement in both consumer and business spending, healthy balance sheets flush with cash and enhanced availability of credit. On the downside, Euro Land's recession, the slowdown in China and political uncertainty will continue to be a drag on earnings. Although corporate bankruptcies have continued to decline, as the recovery progresses there will be corporate survivors and the ones that fall from grace. Jon Corzine's brokerage giant, **MF Global,** bet everything on Euro Land's sovereign debt and lost. Their bankruptcy is one of the top 10 in American history. Corzine, a former Governor, Senator and Goldman Sachs executive, has been disgraced would rather go to Disneyland rather than prison. **American Airlines** landed in bankruptcy court to squeeze out a better deal from their unions. The only chapter paper manufacturer, **Newpage Corp,** discovered was Chapter 11 when it filed for protection in the courts. **General Maritime Corp's** tankers got decommissioned in reorganization. Finally, there will be no storybook ending for **Borders**. The 40 year old book store became victim to the Internet and liquidated. The growth in earnings is a prerequisite to job creation. Although the earnings growth is expected to slow, this positive trend may be enough to create some jobs and with it enhanced consumer confidence. Notwithstanding the economic risks, corporate America tends to surprise on the upside.

CONSUMER SECTOR

Consumer spending, the primary driving force behind economic growth, has demonstrated a moderate come back. When all is tallied, this Christmas season will show the largest top line revenue growth for the retailers since the great recession. However, their margins contracted due to their deep discounting to attract consumers. The improvement in spending is primarily associated with pent-up demand and has been fueled by savings and credit card debt. The majority of consumers are fully employed and to a lesser extent, subject to debt derailment. On the other hand, the minority of consumers is underwater on their mortgages, drowning in debt and many cannot find jobs. The predominance of consumer deleveraging are mortgage foreclosures and debt defaults rather than actual payoffs. Against a backdrop of anemic wage growth that is less than inflation; real disposable income is no better than it was five years ago. On the upside, the unemployment rate receded to 8.5% implying a turnaround. On the downside, the unemployment trend is more likely to rise rather than fall in the first quarter given the temporary seasonal employment, the Euro Land recession and the contraction in global economic activity. In addition, our domestic subpar economic growth may not support any substantial job creation. When one considers our structural unemployment problem that consists of those who had been unemployed for more than one year, quit looking for jobs and those who settled for temporary work, the unemployment rate actually exceeds 20%. Economists believe that a 5.4% unemployment base rate represents our economy at full employment. I dispute this contention. In our modern economy due to technological productivity gains, there will be many in our workforce that will become unemployable. This should raise the base rate to say 6.5%. Corporate America's job cutting pressures are slowly abating at this stage of the cycle. However, **Merck**, one of the largest pharmaceuticals, announced its intent to lay off employees by the end of 2015 leaving 13,000 in murky waters. The border patrol rounded up all 16,700 employees of **Borders Book Stores** and corralled them to the unemployment line. The largest manufacturer in the world of computer-networking equipment, **Cisco,** short-circuited 6,500 employees because they became obsolete. The **U.S**. **Postal Service** continues to lay off 7,500 male and female carriers by delivering them return to sender address unknown. Finally, thousands of **State Governmental Employees** did not "fare well" at the unemployment office and did not even get a "farewell" given the State’s budget cuts. On a positive note, the housing sector is starting to stabilize and the pace of personal bankruptcies has continued to retreat. **So there is no misunderstanding, the state of the American consumer is fragile at best.**

In sum: The US economy is on a sustainable slow growth trend in an environment full of risks and uncertainties. The primary obstacle to growth is the conflicting deleveraging and austerity measures by both global public and private sectors simultaneously. Euro Land's sovereign debt crisis will continue to have a negative impact on our credit markets but should not dampen the modest improvement in our bank lending. US banking exposure to sovereign debt losses are limited. Euro Land's recession will clearly be a drag on our exports. However, corporate America's strong earnings performance will continue to support our growth but perhaps at a slower pace. The American consumer’s financial position remains tenuous. However, it is more probable than remote that consumer spending will improve against the backdrop of pent-up demand, gains in employment and stabilization in the housing sector. In this environment, a double dip recession, although remote remains a possibility. The Fed will do whatever it takes to reflate demand and smooth out the business cycle in pursuit of perpetual prosperity. They will probably reduce rates within the first quarter followed by **QE3** within the second quarter. Bernanke’s previous quantitative easing program of buying government bonds to stimulate the economy produced almost $77 billion profit to the government. On the other hand, our congressional obstructionists will err on fiscal policy by doing nothing and creating more uncertainty. Although the underlying risks out way the positive forces, the US economy should produce sustainable slow growth of possibly 2% GDP in 2012. Although subpar, the US growth will surpass the GDP of all developed countries. **The incompatible forces between monetary reflation, public and private deleveraging, fiscal austerity and political gridlock breeds uncertainty. Uncertainty perpetuates market volatility.**

STATE OF THE GLOBAL ECONOMY

Global economic activity is contracting simultaneously throughout the entire world. The path of future growth rests upon the outcome of the severity of Euro Land's recession and whether or not China can engineer a soft landing. In substance, the retrenchment in global demand triggered by public and private deleveraging and fiscal austerity in the developed world will place persistent downward pressure on growth. This is a recipe for disaster and this trend will continue in the long-term. **Euro Land's** sovereign debt crisis has been the catalyst to the curtailment in credit and loss in confidence. Both Greece and Portugal are already in recession. Italy, France and Spain will follow. Germany may ultimately succumb to the same fate given the European Central Bank's (ECB) inability to contain the contagion. The temporary solution to remove turmoil in the markets is to give the ECB the authority to become the lender of last resort. Given lower interest rates, their debt will become more manageable. The risks associated with a run on their banks and a collapse of the euro will have diminished. Finally, this will force the EU members to find and legislate solutions to their structural fiscal imbalances associated with the enormous disparity in their economies of scale. Although **China's** housing sector continues to contract, the belief that they will have a hard landing is unfounded. The majority of the homes are purchased for cash. The banks are government owned and the properties that are financed require a 25% down payment. China, with the best demographics in the world, holds the global rebalancing card. No country will be immune from a Euro Land recession. China's growth will surpass the rest of the world but trend lower than their historic averages. Given the abundance of their fiscal and monetary treasure chests, the odds favor a soft landing in China. **Other emerging markets** will demonstrate continued growth at perhaps a slower pace. The growth in countries such as Russia, Brazil, Australia and Canada will rise and fall along with the value of commodities and be further effected on the downside by weaker global demand. Given the anxiety over growth expectations in an environment that appears more deflationary rather than inflationary, central banks throughout the world will ease their monetary policies. During 2011, the ECB actually tightened their monetary policy which contributed to their current dilemma. Against this backdrop, it is more likely the ECB will err on the side of inaction making Euro Land the global wildcard. It will probably take a 10% to 20% drop in global equities before the ECB takes appropriate action.

In sum: On the downside, Euro Land will fall victim to a double dip recession. It may be quite austere. This contagion will spread across Europe engulfing the emerging European countries. On the upside, China will achieve its soft landing. A global double dip recession is not in the cards. Although remote, if the euro collapsed, international trade would plummet and all bets would be off the table. **Notwithstanding the forecast is encumbered with risks and uncertainties, global growth will trend lower producing 3%.** This growth needs to be bifurcated between the developed economies producing 2% and the emerging economies producing 6%. The U.S. will be in trend at 2%, Euro Land will be negative and China will outperform the world at possibly 8%. Either way, any geo-political issues or disruptions in the supply of oil will have a negative impact on the global growth outlook.

GEO-POLITICAL RISKS: A WORLD OF UNREST

Obama took out Osama bin Laden and with him, our fragile alliance with Pakistan. This country supports terrorism and protects the Taliban within their borders. This nuclear armed country is in the midst of a Supreme Court sanctioned coup supported by their military. Their political system is in chaos and their democracy is at risk. In 2014, we start drawing down our troops in **Afghanistan**. For good reason, this country is impossible to conquer. The Persians, Alexander the Great and the British Empire all failed. Russia tried and went bankrupt. As Obama promised, we have vacated Iraq leaving a fragile democracy under threat of a sectarian civil war. After spending $1 trillion and losing 4400 American lives in this war, Shiite **Iran** will have more influence over Iraq than any other country. Iran remains allied with Syria, supports Al-Qaeda and finances Hamas in Gaza and Hezbollah in Lebanon. A nuclear armed Iran is approaching reality. In response to the severe UN sanctions, Iran has threatened to close the Strait of Hormuz where 20% of the world's oil passes through. Iran is a crisis ready to explode. The **Arab Spring** revolution was born in **Tunisia.** This violent unrest spread to Egypt, Bahrain, Libya, and Syria. Their historic pursuit of democracy might not be what they fought for. **Egypt** elected Islamist to Parliament and has a military that appears unlikely to relinquish their power**. Syria's** revolution has taken 5000 lives with no end in sight. Protests and demonstrations have even spread to **China** and **Russia**. In addition, you never know what to expect from **Venezuela** and **North Korea.** On a positive note the Israelis and Palestinians had their first meeting in more than a year. These geo-political risks will continue in the year of living, perhaps more dangerously than in the past. World disorders give rise to both the climate and environment for future crisis, chaos and conflict. **There is no prosperity without world peace.**

POLITICAL ROUND UP

On Election Day November 6, 2012, we will be voting into office the President of the United States, the entire House of Representatives and 33 Senate seats. President Obama's best form of advertising is the Republican debates and candidates. If these are the best candidates the Republican Party can deliver then they have a serious problem. Newt Gingrich is an exaggerator, fabricator and big bag of wind. Mitt Romney is a flip flopper and false advertiser. Ron Paul is simply an absurdist. Either way, the winner of the Florida primary will get the Republican nomination. Actually, President Obama has many positive forces going into this election. On a foreign policy standpoint, he took out public enemy number one, Osama bin Laden. He pulled us out of Iraq, has scheduled the end of the Afghanistan war and supported Libya. On a fiscal policy standpoint, he rescued the American auto industry and with it an enormous amount of jobs. He bailed out our financial sector and made $12 billion on Citigroup. The TARP program prevented a depression and the quantitative easing program produced a profit of $77 billion. Finally, Obama care became law. **In sum, if the economy continues to improve, he will be very difficult to beat.** Our anti-prosperity Congress has an 84% disapproval rating. The primary cause is the Tea Party. This minority group of Republicans was able to exercise control of the majority. **It is more probable than remote the Democratic Party will take control of both the Senate and the House of Representatives.**

2012 ECONOMIC FORECAST

Equities: A year of almost no returns. My prior year expectations were clearly too optimistic. The Dow closed the year at 12,218 eking out a 5.5% rate of return in a year of volatility. The S&P 500 closed at 1,258 which is exactly where it opened while the NASDAQ closed at 2,650 generating a 1.8% loss on the year. In the prior year, I expected the DOW to trade between a range of 10,800 and 13,500 in a year of elevated turbulence. It actually traded between 10,650 and 12,811 in a year that may be characterized as a wild roller coaster ride ending up where you began. Actually U.S. treasuries rose 9.6% and outperformed stocks. The markets dismal performance primarily relates to Euro Land's sovereign debt crisis which still remains an unresolved catastrophe in the making. On a technical perspective, the prerequisite for a bull market run lies in abundant liquidity, equity valuations and earnings expectations. Liquidity remains positive and QE3 may make it exuberant. Equity valuations are reasonable .The S&P is trading at 12 times earnings rather than its historic 15 times. The issue is earnings expectations. Our government cannot afford to play any fiscal cards to stimulate demand. When government spending contracts, both economic growth and corporate profits follow suit. We cannot expect our fragile American consumers to fill the demand void. Against the backdrop of the global slowdown in economic activity and Euro Land's reversal of fortune, corporate America's earnings growth will continue but in a slower pattern. On a historic standpoint, equities have performed well even after their profits had peaked. Either way, corporate America has a tendency to surprise on the upside. **The stock market is predisposed to a Euro Land induced correction. The odds favor a 10% to 20% correction within the first quarter in this year of uncertainty.**

In sum: In a world of low returns, reflation trade strategies, ones that favor stocks over bonds will outperform after the correction in this slow growth economic environment. Until the correction, investors should be more concerned with capital preservation rather than appreciation**.** Investors should remain in safe havens that include U.S. treasuries, municipal bonds and foreign debt of countries that have their own central banks. After the correction and in the near-term, Wall Street will outperform the global markets. Portfolios should maintain a heavier concentration of U.S. large-caps since they can weather market uncertainties better than their counterparts. The strongest global growth will be found in the emerging countries, as such, their markets should be considered by mid-year. Investors should consider exchange-traded funds (ETFS) with heavy exposure to Brazil and China, moderate exposure to India and light exposure to commodity based countries such as Australia and Canada. Completely avoid corrupt Russia and Euro Land. Cash flow is everything in a deflationary environment. As such, your primary objective should be investing in high-yield dividend equities. With respect to sectors, consider overweight positions in technology, energy, pharmaceuticals and healthcare and underweight positions in real estate and consumer staples. Financials should be avoided but may prove to be a profitable contrarian play. While on the other hand, investment banks should be considered given the probability of expanding merger and acquisition activity. The U.S. government is legally insolvent. Our Congress' inaction on our unmanageable debt trajectory is not dissimilar from that of Euro Land. When our debt super cycle comes to an end, it will be violent, the markets will riot and the dollar will no longer be the trading currency of the world. The conflicting forces between monetary reflation, global deleveraging through the developed world and both Congressional and European inaction procreates uncertainty. Uncertainty breeds market volatility. Why should this year be any different?

> **Absent any geo-political and/or natural disasters, the forecast assumes resolution of Euro Land's sovereign debt crisis and a soft landing in China's economy. Against this backdrop, the DOW may trade between a range of 10,000 and 13,000 closing the year at 12,900. The NASDAQ and S&P 500 may close the year at 1,350 and 2,850 respectively. The trading year will be one of pronounced turmoil where the market will rise on good news and fall on bad. It is more probable than remote the market will be temporarily impaired by a Euro Land induced correction between 10% and 20% within the first quarter of this year of uncertainty. This will represent a buying opportunity rather than a bear market. The fourth quarter will outperform the year in this sustainable global slow growth environment.**

<u>Interest Rates:</u> **Contrary to my belief, U.S. treasuries last year outperformed equities producing a 9.6% rate of return.** In this deflationary environment monetary policy will ease rather than tighten and interest rates will fall rather than rise. U.S. treasuries, a safe haven for global investors, may very well show appreciation but not to the extent of equities or as in the prior year. The Fed will probably reduce their discount rate from .25% to zero in the first quarter and institute QE3 by the close of the second quarter. The 30 year and 10 year treasury yields closed the year at 4.21% and 3.30% respectively. These yields may drop as low as 3% and 2% respectively and with it, mortgage rates will hit historic lows. Given the mounting risks and uncertainties, the Fed will do whatever it takes to reflate demand. As such, investors should consider investment-grade high-yield corporate bonds, and with the exception of Euro Land, sovereign debt that has underlying strong currency fundamentals.

<u>Muni Bonds</u>**: The yields on high-quality bonds continue to remain attractive relative to treasuries.** Structurally, state governments face unfunded pension plans and other budgetary commitments that may very well be unmanageable. However, unlike the federal government, the states are required to balance their budgets on an annual basis. The risks of loss remain benign as compared to any other debt instruments. In 2011 the default rate was less than 1% none of which were rated bonds. Contrary to Meredith Whitney's belief, there were less defaults in 2011 as compared to 2010. In the unlikely event of mass defaults, the Fed will Institute QEM, quantitative easing for municipalities and purchase their bonds in order to contain any financial crisis. Investors should consider general obligation bonds targeting A or better and avoid municipal bond funds.

The U.S. Dollar: The long-term bear market remains well established. However, the current dollar's firmness represents a short-term rally triggered by Euro Land's dilemma. The dollar is destined to ultimately trend lower given our fiscal disequilibrium and will do so over the long-term. This positive force will benefit our export sector and help unwind our current account deficit. The rest of the world will enable the dollar to depreciate in a relatively benign manner. Although no country wants a strong currency during a recovery, they do not want to create a currency crisis either. The dollar will rise against the euro and fall against all other currencies. The power of the dollar in the global marketplace will remain intact and the bear market has many years to run.

Gross Domestic Product (GDP): When all is tallied, 2011 subpar growth will be below trend at 2%. The U.S. economy remains on a sustainable slow growth trend in an environment full of risks and uncertainties. Our economy, the largest in the world, has been resilient and tends to surprise on the upside. Our economy may squeeze out growth of 2% in 2012. This is far below the required growth to produce meaningful job creation. Unemployment is more likely to rise rather than fall in the near-term. It is still possible that the unemployment rate could drop a half a point closing the year at 8%. It may take another 2 to 3 years of above trend GDP before the unemployment rate falls to 6.5% which I contend is the correct level for full employment.

Inflation / Deflation: The world is clearly more deflationary rather than inflationary. This is bifurcated between the former being the developed world and the latter being the emerging world. Deflation is the most destructive underlying force in any economy. Bernanke and the Fed's war against deflation is the creation of inflation by employing quantitative easing. Their actions contributed to the CPI rising to 3.7% in 2011. We can expect QE3 by midyear. However, the CPI will probably fall rather than rise closing the year at 2% due to the persistent deflationary forces in the economy.

Gold / Silver: The inflationary expectation of currency debasement and global financial instability will continue to support the enhancement in the value of gold. In 2011, I predicted gold would hit $2,000 an ounce. It actually hit its high of $1,878 in August only to recede to its close of $1,567 producing a 12% rate of return. Gold is a currency that cannot be debased and rises in times of war, chaos and crisis. It is more probable there will be a selloff in the event of the market correction. This should represent a buying opportunity. Gold has not lost its luster and may surpass $2,000 per ounce this year. Gold should be part of everyone's portfolio but probably not to exceed 10%. With respect to **HI-HO Silver**, in 2011, I predicted it would hit $50 per ounce. In March, it actually did only to recede to its close of $28 per ounce generating a loss of 12% on the year. Silver is an industrial metal and its value will be affected by both diminished demand and supply constraints. However, silver may continue to shine and may surpass $40 per ounce this year.

Other Commodities: The commodities bull market has run out of gas, or is that natural gas? Both hard and soft commodities have fallen victim to the laws of supply and demand. On the other hand, this could all change if China's growth accelerates. Natural gas will remain in a bear market until our government passes legislation requiring its usage. Given our enormous natural gas reserves, this country should be energy self-sufficient.

Oil: The probable turmoil in oil may prove to be the 2012 commodity wild card. The demand for oil has retrenched along with the contracting global economy. The price per barrel should hold reasonably steady, in a trading range of $90 to $100. On the downside, the Geo-political risks associated with Iran may create elevated turbulence in the trading year and push prices to $120 per barrel. We are the world's largest importer of crude oil. Yet, crude oil products consisting of gasoline, diesel and jet fuel have become our largest dollar value exports. Given the fact that crude oil is traded in U.S. dollars, the long-term perspective of this commodity remains extremely bullish.

Real Estate: I actually hear a heartbeat. There are signs of life in the real estate marketplace. On the upside, construction of apartments and condominiums are on the rise. New home construction is not enough to keep up with the population. This year mortgage rates will reach historic lows. Finally, the unemployment crisis is slowly unwinding. On the downside, approximately 25% of mortgages are underwater and the foreclosure process remains a mess. All these fundamentals imply that our real estate crisis is stabilizing and probably will continue to trend lower over the next few years but at a much slower pace. Resolution to our dilemma does not take a genius but requires congressional action. Our government needs to create a mortgage modification program that will enable the banks to recoup their losses in the future. Another alternative was introduced by Sen. Barbara Boxer, D-Calif. Her plan called for eliminating the regulatory requirements imposed on both Fannie Mae and Freddy Mac to enable mortgage refinancing on properties no matter how much they are underwater. **In sum, this is a case of good ideas and bad government.**

The Outlook is clouded with risks and uncertainties. I am less optimistic than a year ago.

Disclaimer