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Inside this issue

Easy Money Made... A Canary on Life Support

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This is a long issue as my annual forecast usually is. Beginning this Sunday, I have a fairly heavy travel schedule over the coming month to Houston, Dallas, San Francisco, LA and Rhode Island. If you are in one of those places and would like to get together for a meal, coffee or adult beverage, please let me know.

A number of you have asked why I no longer schedule media interviews far in advance like I used to. If I had my way, I would love to! But so much has changed over the past few years and the trend is now to schedule as close to last minute as possible since we seem to have an incredible amount of "breaking news".

If you receive our weekly digest from Vestorly, you probably already saw this, but here is my recent segment on Fox Business discussing my **2013 Forecast**. If nothing else, it was certainly spirited! About as far away from that discussion as possible, I was interviewed by Investors Business Daily for an article on divorce. You can find that story **here**.
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Lastly, a quick comment or two on the markets in 2013. January was an incredible month for stocks that was perfectly set up by a topic I covered ad nauseam late last year, the fiscal cliff. I called it the most overhyped event since Y2K and even a hoax. I watched day after day as stocks moved from the hands of weak holders to smart holders and listened to investors rationalize why they sold all of their stocks anticipating a bad outcome out of Washington.

As you know, I had the exact opposite approach, using weakness, especially in November, to take our equity exposure towards maximum limits. Now, after a huge run in stocks, investors are piling into equity mutual funds. I just scratch my head.

Take a look at this article. **Is Main Street set to stock up on stocks?** This one comment sends up a warning flag for me. "it's definitely safe to invest now." While I continue to believe we will see all time highs in the Dow and S&P 500 to go along with the S&P 400 mid caps, Russell 2000 small caps and Dow Transportation Index, I do not agree that risk is lower because the markets have risen. If anything, it's the opposite.

One of my canaries in the coal mine is junk bonds, which began to diverge from stocks on January 25. While that is only a single cautionary flag that can be corrected, my senses are becoming more heightened. The key will come after the next 2-4% pullback to where the markets go from there.

Please contact me directly by replying to this email or calling 203.389.3553 if you would like to discuss protecting your own portfolio or simply want an unbiased analysis.

2012 Fearless Forecast Report Card

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It's that time of year again, a phrase I use often in January and February with the various pieces I create.   In this case, we are going to talk about the Fearless Forecast 2013. As I mention each year, one of the most worthless yet enjoyable topics of the year is the pundits annual forecast. An unusual amount of time is spent discussing this in the media, but after January, few ever review them again nor seem to care. I usually end December with an idea of what I see ahead and then adjust according to how many others agree with me. As longtime readers know, I don't like to be in the majority as consensus thinking hasn't fared well over the years.

Before I get to my forecast, which is not my annual **Shockers** list, let's do
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a quick review of what I envisioned for 2012, which was surprisingly incredibly accurate. For the full 2012 forecast, you can click **Fearless Forecast 2012**. My comments from last January (2012) are in italics with a few sentence update in black, normal font.

Stock Market - *It's no secret that 2012 is a presidential election year and the fourth year of Barack Obama's term. Historically, the stock market has delivered an 8% return on average during this period. Additionally, most years following flat market years have shown solidly positive returns. Wall Street strategists as a whole are forecasting their typically average upper single digit year.*

Given how challenging 2011 was, my initial read is that 2012 possesses the potential for a big year in the stock market, well into double digit returns with the 2011 peak exceeded during the first quarter and possibly much higher after that.

Three straight years of nailing the overall stock market! That is surprising. The bulls came out of the gate in strong fashion and again over the summer with a total return well into the teens.

Europe, there aren't many (maybe any) investors who think their equity markets represent a good opportunity. Given how pervasive bearish *sentiment is, I believe Europe can outperform other areas around the globe, at least earlier in the year. This call may be early (or wrong), but if everyone is so negative on Europe, who is left to really sell it?*

Europe began 2012 very strongly against the rest of the world, corrected during Q2, and then powered its way to close the year at its highs and much better than its developed world counterparts.

It's been five miserable years on balance for the financials and I am going to stick my neck out that they are ripe to reward contrarian investors in 2012, both on an absolute and relative (against an index)basis.

This was the call of the year as financials soared more than 30%, basically doubling what the overall stock market did! 2012 was the first time our sector program took a meaningful position in the sector since at least 2006.

Dollar - *In mid 2008, I opined that the U.S. dollar was embarking on a long-term bull market. Nothing has changed to alter that view. When the Fed was printing money at the fastest pace in history, it spoke volumes that the dollar did not even make new lows below the March 2008 bottom. Now that Europe is no longer the western economic leader and longer-term devaluation is inevitable, the dollar should retain and increase its long-term value.*

The U.S. dollar was essentially flat in 2012, but we stick by our long-term bullish forecast.

Gold - *The metal's 10+ year secular bull market has been called into question following the $400 decline from its all time high last summer. For now, that bull market still looks alive with $2000 achieved in 2012. Gold has a habit of near vertical rises followed by multi month or quarter periods of digestion. Since last summer, it looks more like consolidation than the end of the bull market. The longer this period lasts without significant downside damage, the higher the metal is likely to shoot when the digestion ends.*

The shiny metal gained 7% in 2012, but fell short of our $2000 target. I thought it was interesting that so many people called it a "disappointing" year. I guess 12 straight positive years will do that to investors!

Residential Real Estate - *There are enough initial signs that at least stability is returning to this market after so many years of disaster and rubble. With Obama desperately needing an election year boost to housing, expect the government to unveil a slew of new mortgage alteration and principal forgiveness programs to goose the market. Home prices have historically gained roughly 4-5% per year and 2012 should get back to the norm.*

I am really proud of this forecast since I went out on a limb and so many people disagreed. Stability finally returned to housing prices and values increased in line with historical averages.

Inflation - *I continue to have the same view on inflation as I have had since 2008. Whatever price increases we see are likely to be temporary or as Ben Bernanke said, "transitory". I believe the headline number will outpace the core (ex food and energy) until the economy goes through another recession. Deflation is and has been a much bigger and more widespread problem to deal with. Housing, money velocity, capacity utilization, wage growth are just a few ingredients in the deflationary formula. Just ask Japan about it. They have been fighting it on and off* *since 1990!*

Another win for the forecast as inflation was tame all year!

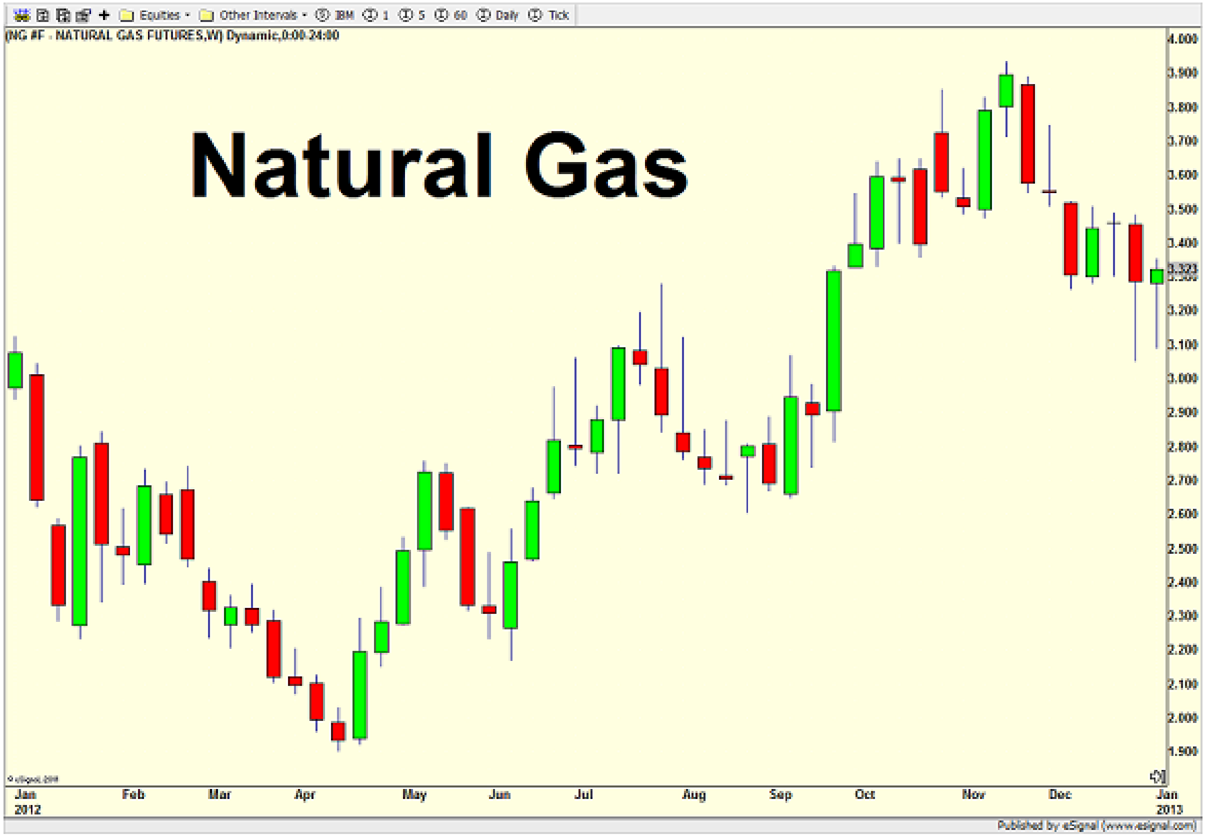
Economy - *The global economy continues to repair itself from the damage caused by the financial crisis. It took decades for the world to leverage up (borrow) and it should take at least a third as long to unwind that and deleverage. That cycle will be with us in 2012 as the economy plods along, tempting and teasing on the upside, while occasionally threatening on the downside.*

As other folks have coined, the "new normal" led to very mediocre economic growth last year as the world continue to methodically reduce debt, except of course, for the governments!

Federal Reserve - *It's not too difficult to make a forecast here since Ben Bernanke has already said that short-term interest rates aren't likely to move for at least another few years. I continue to see the Fed aggressively intervening in the global markets with coordinated efforts as well as efforts to keep to mortgage rates low or stable at a minimum. We are far from the time when the Fed's balance sheet and operations will return to historical norms.*

And "aggressively intervene" they did! QE, QE and more QE!!

Natural Gas - *I am going to the well once again here! If and when it ever goes up, I can just play Wall Street and say that I wasn't wrong, I was just early!! Yes, I know that we have a 500+ year supply and a glut on the market. But this commodity is still way too cheap to be priced with a "2" as the first digit. I have heard people ask if natural gas will have a "1" handle in 2012. Not from my seat. Not only do I think it's going to rally and do well in 2012, but I also believe it outperforms its energy cousin, crude oil.*



Boom goes the dynamite to finish the report card on 2012! Natural gas did rally in 2012 AND it outpaced its energy cousin, crude oil.

With global events more fluid now than ever, getting a few items in the forecast correct is a reasonable goal. But the 2012 forecast was probably my best ever with almost all of the calls in the correct column on the heels of very accurate forecasts for 2011 and 2010. You know what that means don't you? I will likely lay an egg in 2013!

Fearless Forecast 2013

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So now, let's get to my forecast for 2013. The sooner I get it out there, the sooner I can be proven wrong, especially given how well we fared in 2012! As always, I had a lot of fun thinking about it and creating it, although it has no bearing on how we manage money for our clients.

Stock market - 2013 is the first year of the president's new term, which is historically a challenge, but less so for a reelected president. I see the 2013 price pattern of the stock market similar to 2000 and 1987 in that the year will be front loaded with gains and all time highs almost across the board.
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Corrective behavior will increase the further into the year we get. While I do not believe we will see a stock market crash like 1987 or bursting of any bubble like 2000, the easy money will be made early with the potential for sizable losses during the second half of the year. Overall, I see a less than average year with total return performance in low to mid single digits at best.

On the sector front, it's another tale of two markets with the higher beta (riskier, more volatile) sectors leading the way early and taking it on the chin later in the year. Industrials, transportation, energy and healthcare are the early winners with utilities, consumer staples and telecom coming from behind to take over leadership during the second half of 2013. Technology will tease and tantalize but only perform with the market on a best case scenario and severely underperform worst case.

Long-term treasuries - Usually the most hated investment year after year, long dated treasuries will hang in tough against early in the year, falling but not nearly as much as equities rise. I expect to hear cries that interest rates are beginning their vertical ascent to correct their 30+ year bull run. When the stock market finally peaks, treasuries should find their footing and offer capital appreciation along with the income. One of these years, the bears will be right and the 30+ year bull market will end, but it's unlikely we will see that rate spike in 2013.

Corporate bonds - The greatest wealth decimation of the modern investing era is coming, but it won't be in 2013. High yield (junk) bonds will lag all year and send up continuous warning flags about the health of the bull market. Investment grade bonds remain stable but without the big capital appreciation of previous years.

Dollar - Since THE bottom in 2008, the dollar has been in a trading range which I have stated is the beginning of a new, long-term secular bull market. Anyone who has bought strength or sold weakness has been punished and that's likely to continue for a while before the greenback finally breaks out above 90 on its way to target number one at 100 over the coming years.

I remain bullish on the buck but see more weakness before the next intermediate-term rally begins later this year.

Gold - The 12 year secular bull market in gold is not over. With 12 straight years of gains, I expect lucky 13 in 2013 as long as real interest rates remain negative. But it won't be that easy, at least not yet. Gold should see more weakness during the first half of the year before hammering out a bottom and beginning the march to new highs and beyond.

Commodities - I favor the agricultural and tropical commodities like wheat, corn, beans, sugar, coffee, cocoa and cotton over the rest. They have been under pressure for a while and weakness should be viewed favorably. Copper looks like it is coiled for a breakout to the upside to challenge its 2011 peak.

Inflation - I feel like a broken record year after year, but I don't have many concerns about inflation, at least not until we get to the other side of the next recession. The Fed is trying to engineer some healthy inflation, but without their help, I think it falls back towards 0%.

Economy - Contrary to popular opinion, I do not see the economy spurting to the upside this year. Too many people are still clinging on to the growth rates we saw before the financial crisis, well north of 3%. The economy has performed exactly how almost every single post financial crisis economy has, in frustrating fashion with stubbornly high levels of unemployment. That trend continues this year with less open focus on deleveraging. On the other side of the next recession, which could begin later this year or in 2014, unemployment falls back into the historical norm range and we finally see growth at 3% and above.

Federal Reserve - The Bernanke Fed will go down as the single best group using jawboning as a monetary tactic. The Fed has been printing money for almost five years, yet they have amazingly kept inflationary expectations to a minimum. It seems like each and every time they QE, they float trial balloons and then make comments about stopping and even reducing their balance sheets. Just brilliant!

I believe the Fed will continue their easy money path in 2013 as well as growing their balance sheet towards my long standing nonsensical target of $5 trillion.

Unemployment - I don't have much new here. I see unemployment remaining elevated and unable to break below 7% until we get to the other side of the next recession. Ticking much above 8% will send up warning flags that recession is close by or here.

Residential Real Estate - While my 2012 forecast was an outlier, the outlook for 2013 is probably shared by many which makes me a little nervous. I see continued stability in housing with modest gains across the board.

Investment Quotes/Adages To Live By

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"When in doubt, get out!"

"If it's obvious, it's obviously wrong."

-Joe Granville

"It's ok to be wrong, but it's not ok to stay wrong."

"This time is different."

"The markets require the patience of a dozen men."

-Robert Rhea

"Luck is the residue of effort."

"The most bullish thing a market can do is go up in the face of bad news."

"The most bearish thing a market can do is go down in the face of good news."

"The market can stay irrational longer than you can stay solvent."

-John Maynard Keynes

"Government is best which governs least" - Thomas Jefferson

Inflation is the one form of taxation that can be imposed without legislation.

-Milton Friedman

"You cannot legislate the poor into freedom by legislating the wealthy out of freedom. What one person receives without working for, another person must work for without receiving. The government cannot give to anybody anything that the government does not first take from somebody else. When half of the people get the idea that they do not have to work because the other half is going to take care of them, and when the other half gets the idea that it does no good to work because somebody else is going to get what they work for,that my dear friend, is about the end of any nation. You cannot multiply wealth by dividing it." - Dr. Adrian Rogers, 1931

"Bear markets seem to be divided into three phases: the first being the abandonment of hopes upon which the final uprush of the preceding bull market was predicted; the
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second, the reflection of decreased earnings power and reduction of dividends, and the third representing distressed liquidation of securities which must be sold to meet living expenses. Each of these phases seems to be divided by a secondary reaction which is often erroneously assumed to be the beginning of a bull market."

- Robert Rhea via Tim Woods

"Free enterprise is a rough and competitive game. Nobody too big to fail. Nobody too small to succeed. It is a hell of a lot better than government control." - Ronald Reagan via Dan Kennedy

"A government big enough to give you everything you want is big enough to take everything you have." - Gerald Ford via Dan Kennedy

"The problem with socialism is that, sooner or later, you run out of other people's money." - Margaret Thatcher

"Diversification alone is no longer sufficient to temper risk... You need something more to manage risk well."

- Mohamed El-Erian

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