

The 2011 Crystal Ball Does Look Better

At the end of each year, Wall Street strategists are asked for their forecast for the next. Many prominent analysts (not including me) are featured in a *Barron's* roundtable discussion. Their consensus forecast for 2011 predicts the market will provide a 10% return on average. We tend to disagree with most consensus forecasts. Many times the group forecast can be accurate but often the collective wisdom is wrong. In addition, forecasting results that are within the consensus are comfortable. However, if you are wrong at least everyone in the group is wrong. Many of you know we don't mind deviating from the crowd every now and then. It's just how we see and analyze things.

We expect the market to provide returns in excess of 20% for 2011. Investing is part science and part art. The science portion is the analysis of a company's balance sheet, income statement and cash flows among many other pertinent variables and factors. The art is the look and feel of the market and the economic environment.

Since November of 2010, the mood of the market,

consumers and the economy has changed for the better. Although difficult to measure, it appears that there is renewed energy, enthusiasm and hope for many things personal and professional. We believe that the market will rally from here and the S&P 500 should finish in the 1,600 range (DOW JONES - 14,600), up over 25%. Our forecast for the economy also assumes more rapid growth than the collective market pundits. Consumers have spent the past two years trimming expenses while household savings has risen to 6%. Robust retail sales—in game electronics, clothing, jewelry

and even some automotive sectors—during this past Christmas have demonstrated that people are tired of the current, dull economic environment; they feel a bit more confident and are willing to spend.

We are reducing client cash to approximately 5% reflecting our positive stance on the

market. This cash allocation reflects our most bullish outlook in over a decade. We continue, however, our long held practice of investing in high-quality, blue chip stocks and our philosophy will not change. Happy returns in 2011.



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Paul J. Valickus, CFA, CFP
Chairman, Chief Strategist

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The 2010 Global Investment Symposium: Time to look forward Harvard Club—New York City



Scheduled each year during the U.N. General Assembly, the *Global Investment Symposium* brings together professionals willing to discuss sustainable economic solutions for producers and consumers of products and services world wide.

Carlo Centeno—VP, Marketing & Sales attended and provides this summary.

For the past three years, the International Economic Alliance has been hosting the *Global Investment Symposium*. The IEA is “an alliance between major stakeholders and global leaders in business, government, finance, academia and various associations,” so noted by its director Mr. Van McCormick.

This was not your typical gathering of business executives, as the presidents of Serbia and the Republic of Georgia were also on hand. Various “celebrity” professors and the ministers of trade from several countries were in attendance as well. Here’s a brief summary:

Mr. Paul Volcker, the former Chairman of the Federal Reserve, gave the keynote address. He noted that one big reason why things are not happening is because of regulatory uncertainty. Businesses are bracing for additional rules, and no one is sure what the impact may be.

Mr. Peter Peterson, the former U.S. Secretary of Commerce made it clear that good business leaders need to be in positions of power in [our] government because policy makers are not solution providers. He added that national wealth does not come from

government, but from the private sector.

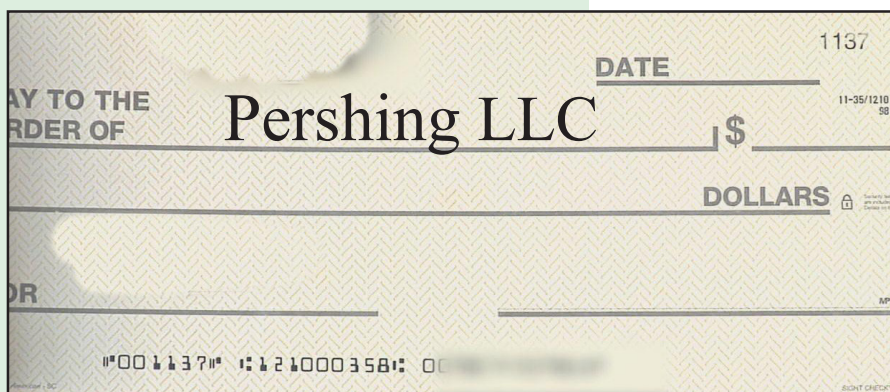
Professor John Quelch of the Harvard Business School noted that Facebook is a “global brand.” While there may be a correlation, the level of consumer discontent is not causation for the growth of that social network. However, it is through this network that others learn more about the diminishing faith in not only government agencies and their leaders, but with corporations and chief executives as well. With that in mind, trust is on the upswing for NGOs [non-governmental organizations].

The CEOs of Sealed Air Corporation and the U.S. Chamber of Commerce collectively noted that both China and India outpace the USA in economic growth. Why? Both countries, while far from perfect, are pushing R&D technologies that *can make a difference in the markets they serve*.

Despite the uncertainty, not one executive, minister of trade, economist, professor or business consultant expected to see an “economic apocalypse” of global proportions. They’re doing what we’re doing: looking forward.

Important— Please Read

When making deposits to your account[s], please make sure you write it out to **Pershing LLC**. Compliance *no longer allows* checks made out to St. Germain Investment Management. This includes any IRA contributions for 2010. *Don’t wait until April!*



Remember some 1099s won’t arrive until February 15th. Check with a tax professional before filing your taxes.



What about bonds...?

What can investors expect to see in bonds for 2011? Being a key member of the Investment Policy Committee, Lou Bartenstein—VP, Fixed Income, tackles a commonly asked, but challenging question.

Commencing in the third quarter of 2007, the Federal Reserve began an ongoing effort to stimulate the faltering U.S. economy. At the forefront of these actions were a series of cuts in the Fed Funds Rate (the interest rate that banks charge each other to lend funds overnight). From a rate of 5.25% the target rate has been set at 0% to 0.25%. The Fed has made a concerted effort to increase the amount of loans extended by the banking system by allowing financial institutions access to “cheap” money. The effect of this inflow of funds into the financial system has been the lowering of interest rates across the yield curve (the 10 year Treasury has declined approximately 40%). During this period, fixed income securities have performed as well as or better than most other asset classes. In periods of falling interest rates, bond prices will rise (vis-a-vis the see-saw image; when interest rates go down, bond prices go up). For investors in bonds who have sought yield (for our purposes the income that flows from the bonds’ interest payments) it has been a period of declining income coupled with rising market values. As we view the economic horizon, the natural concern for fixed income investors is, *“What does the future hold for bond investments?”*

Acknowledging that no one may be certain as to what the future economic landscape may look like, there are some portents upon which we may base our forecast. We may first expect that interest rates will rise as the recovery strengthens and the employment and housing market return to more normal status. With recovery, the Fed will cease its “easy” money status by raising rates and reducing its balance sheet. For bonds this will mean a reduction in market values accompanied by the opportunity for income investors to increase their cash returns. During the period of the Fed’s easing policies, the real return for fixed income investors has suffered (taking the differential between the 10 year Treasury bond and the year over year change in the consumer price index). Real rates of return have ranged from a high of 5.95%, a low of -1.98% and an average of 1.74%. This means that an investor earned approximately 1.75% better than inflation during this period. During the 30 year period of 1980 to 2010 the average real rate of return was approximately 3.60%. With an increase in inflation (currently a policy goal of the Fed) and an increase in bond rates, the expectation is that bond investors will enjoy nominal returns of 4% to 6% and real rates of returns closer to the historical norm.

The outlook then is for greater income returns in an investment environment that provides bond investors the stable cash component that allows bonds to be that core asset class in an investors’ diversified portfolio. The greatest uncertainty we face is not the question of whether the economy will recover but when.

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Michael R. Matty, CFA, CFP
President

On being local and independent

In many ways, the world was a different place when D.J. St. Germain, Inc. was founded in 1924. Correspondence from our office was written with a fountain pen, not a ballpoint. Statements were done annually, tapped out manually on a typewriter. The Great Depression, which helped form our conservative investment philosophy, hadn't even happened yet. There obviously were no computers, the big technology for stock quotes was the ticker tape. And incredibly, the phone number for St. Germain was 3-5111 (it has since expanded to 733-5111!).

We are now entering our 87th year within a few blocks of where we started in 1924. While we are one of the biggest independent investment management firms in western Massachusetts, we don't think we've lost sight of our roots. In an industry fraught with mergers, takeovers, and buyouts, we remain committed to remaining a local and independent firm.

We also remain committed to serving you, the client. We are honored by the trust you place in us, and thank you for the opportunity to serve you. To help in that effort, we expanded our client service staff over the past year. While we are always striving to improve, we think our sales, service, operations, and investment management staff are top notch. We are not always perfect though and if you've had an experience with us which did not meet your expectations, I want to hear about it personally. And as always, when you call, a live person will be answering the phone, not a "push-the-button" menu. It's just an additional part of our commitment to service, and improving our service.

While I am sure I will not be around to celebrate the entire next 87 years for St. Germain, rest assured that I am proud of the past 87 years. And I remain as committed to remaining a local and independent firm as DJ St. Germain himself was. I think he'd be proud to see where his firm has grown, and even prouder of the stellar reputation that it has maintained for all these years. I know I am.

On behalf of everyone here at St. Germain, past and present, we thank you for the opportunity to serve you.

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