Winter 2012

Happy 2012. With the run for the US presidency gearing up, President Obama's opponents are sure to make the economy a main talking point. They're also likely to recall, along with Ronald Reagan's, the legacy of the Abraham Lincoln, to whom the party still attaches its name. And with good reason. He's nearly unanimously thought of, by people of both parties, as the greatest president in US History. On rare occasions, a survey might list Washington or FDR first, but Lincoln never falls below second.

But Lincoln's rise was a rocky one, and without his strong backbone and mighty fortitude he'd never have risen to the highest office in the country. You may have seen the list in your inbox, likely with "failures" in the subject line, of the myriad setbacks Lincoln faced before ultimately winning the presidency. This list is generally sent around in order to inspire people to overcome adversity.

We see lots of parallels between last year's economy and the career of the United States' sixteenth president. Namely this: both continually suffered ostensibly crippling setbacks but, because of a resilience born from a strong foundation, continued to get stronger and move forward. (The analogy may seem a bit of stretch at first, but, if nothing else, it's fun.) So, partly because in the interest of trivia, in this, an election year, and partly because we find the analogy fairly apt, the below highlights the biggest career setbacks Lincoln faced and the biggest setbacks to last year's economy (omitting impacts that include the death of Bin Laden, the Slave Lake wildfires, Manitoba floods, and the death of Steve Jobs), as well how they both rebounded.

In 1832, Lincoln was defeated for the Illinois state legislature. Two years later, he ran again and was elected.

While the beginning of the "Arab Spring" traces its roots back to Mohamed Bouzizi's self-immolation in Tunisia in December of 2010, the February ousting of Egypt's President Mubarak was the first time the markets paid close attention to the rolling revolutionary wave. While the sudden ending of Mubarak's 30-year presidency didn't cause the markets to be particularly volatile, the fear of harsh ramifications and wait-and-see attitude of investors slowed the markets.

The events in the Arab world that followed, including the removal of Muammar Kaddafi, had investors both excited and uncertain. While the situations in all the transitioning countries remain fluid, there is a growing optimism in the global economic community as free elections loom. Freedom and the possibility of self-determination should help these countries economically and open up new global markets.

In 1836, Lincoln was re-elected to the Illinois state legislature. Two years later, was defeated for speaker, but reelected to house.

Calling the March tsunami that hit Japan devastating is a monumental understatement. The terrible loss of life, of course, was the most tragic result. But the crippling of infrastructure and the nuclear crisis caused a major slowdown in global manufacturing and huge supply disruptions.

The immediate reaction to the devastation was a 4% drop in global markets. The rapid response by Japan and others to repair or replace the supply chain, however, has been remarkable. And the reconstruction projects are adding to Japan's economy and will help stimulate their GDP this year and the next few years. The disruption also has allowed other countries to become competitive in the supply chain, reducing the dependence on one supplier, and will continue to stimulate the growth of manufacturing around the globe.

In 1846, Lincoln was defeated for nomination for Congress. Two years later, he won election. Two years after that, lost his nomination.

In May, the Euro zone crisis escalated (and continued throughout the rest of the year). Each proposed "solution" caused emotions to escalate and huge ups and downs in the market. Worse, European banks came under stress with their exposure to sovereign debt in the weakest European countries.

From May to June the markets fretted about the magnitude of the problem. Was it contained in Greece? What would happen to the other weaker European nations? This worry took the global equity markets down 8% and the US down 7%.

While the US budget talks soon pushed these worries aside, they returned again, with even fervor, as Italy, Spain, Ireland, and the European banks joined Greece as focuses of consternation. The fear of repeating the financial crisis as we experienced in 2008, with the European banks leading the way, knocked any momentum out of the equity markets, from late July to early October, plummeted 20% globally.

But the lack of confidence the markets showed during this time forced stronger regulation and capital requirements for the European banks, as well as stronger, more-focused austerity measures across the weaker Euro nations.

In 1854, Lincoln was defeated for U.S. Senate. Two years later, he was defeated for nomination for vice president.

In July, the US budget impasse caused the loss of the country's AAA credit rating. The political games caused an entire summer of market volatility.

Going into the budget negotiations, the market expected the usual political rhetoric and jockeying but also some sort of resolution allowing the global and US equity markets to rally, from their June lows, up 6% and 7%, respectively. What wasn't expected was the lack of progress and ultimate downgrade of the US sovereign debt rating by Standard & Poor's, causing the equity markets to drop 4% globally and 3% in the US.

This slap in the face has caused the US to refocus efforts to get spending and receipts in line with the needs of the country. Much needs to be done, but the opening salvo has been fired. This new year and beyond will see renewed focus on fiscal responsibility within the US, and elsewhere.

In 1858, Lincoln was again defeated in his bid for the U.S. Senate.

In November, after a summer of volatility and what appeared to be some resolution, the Euro crisis escalated once again. The Greek prime minister decided to put the "latest solution to debt and austerity program" to a national vote, causing another setback to the equity markets of 2011.

The markets had started back to the positive in October, with a global equity rally of nearly 18%, but the unexpected decision caused another drop, this time around 13%. While the global markets were shaken by this unforeseen decision, we believe it was the correct one. The Greek populace must buy in to the austerity measures. The images of rioting in the streets and possible fall of the government only make the global economy more unstable.

The tough decisions were made and, as we expected, the austerity measures are beginning to take hold. Patience and a consistent effort to move forward are still needed. It took years to arrive at this point, it will take time to solve.

If that wasn't enough, new concerns were raised when the Italian bond yield rose above 7%. Conventional wisdom states that as yields rise above 7% in Italy, it becomes too burdensome and failure is inevitable. This caused the fall of the ruling party and the replacement of a coalition government. Ostensibly problematic, the change was needed to remove a scapegoat and create austerity measures all parties could agree to.

The new government is addressing concerns and the markets have rallied enough to drive rates below the dreaded 7%. Similar debt rallies have allowed other European countries to raise needed cash through bonds sales as well. Looking past the yield worry, we see an Italy that is much stronger, and nowhere near Greece, when it comes to spending problems and over-extended debt burdens.

In 1860, Lincoln was elected president.

Despite all of the economic, natural disaster and political setbacks of 2011, the global economy has emerged stronger and more resilient. The early disruptive events of 2011 were mitigated by strong economic numbers as growth around the globe continued. Corporate profitability was high and remains so today. Interest rates are at historic lows and inflation is, for the most part, tame. The measured slowdown in China and other emerging economies should keep inflation in check throughout 2012. Only the continued onslaught of bad news and concern over the Euro and possibility of the European crisis pulling us into another financial scare stopped last year's markets from advancing.

As we enter 2012, we have continued high profitability of companies around the globe. Balance sheets are in better shape as cash profits have only bolstered them more. Banks in North America and Asia significantly improved their capital (over twice the 2007 levels) and moved closer to resolution of the real estate woes of 2008. Even the European banks have strengthened balance sheets with regulatory mandates and government guarantees. Dividends remain high and are seeing increases, in many cases higher than yields on the same company's debt. (And almost universally higher than government debt yields)

We are also seeing significant improvement in the employment levels. Canada remains strong with employment higher than prerecession levels of 2007. The US is also seeing improving trends with unemployment beginning 2011 above 9.5% and ending the year at 8.5%. It's not yet the 6% or lower we would like to see, but the last few months have seen an accelerating trend in the right direction.

In 1859, the year before being elected president, Abraham Lincoln: "And this, too, shall pass away." How much it expresses! How chastening in the hour of pride! How consoling in the depths of affliction!

The fundamentals are in place. Barring any unforeseen news out of Europe or elsewhere, we believe 2012 is setting up perfectly as a very good year for investors.