

January 5, 2012

2012: Many Challenges But Opportunity as Well

The new year has come upon us and we must force ourselves to deal with the uncertainty as well as the opportunities that confront us as investors. Our job at FLI is to present the reality that we see coupled with the paramount responsibility of helping you protect your capital. Reality has to take front stage as we live in a world consumed with leaderless developed countries facing huge economic issues. We are living through the agony and frustration of political paralysis in our great nation as well as throughout Europe. Politicians intoxicated by rhetoric and uncompromising inflexibility are thus far failing to address key issues that challenge our social and economic well being.

Meanwhile, many well run businesses have for the most part purged their wasteful ways of the past and become lean economic dynamos. They have accumulated cash and driven operating margins and profits to all time highs. The unintended consequences of this corporate prosperity is a dearth of hiring and a reluctance to constructively use this corporate largesse to more rapidly grow our economy. They have good reason to be reluctant given little visibility on GDP growth, tax policy and new regulations that are paralyzing decision making. While they wait for the political fog to lift, dividends and share buybacks are constructively used by many companies to reward shareholders to keep them in the game (this has really helped our Dividend Growth strategy). Also, a modest amount of strategic and financial acquisitions are taking place. This too represents opportunity for lucky shareholders.

This fog and uncertainty has resulted in a volatile and undervalued stock market in our opinion. At the same time quality bonds offer little return and appear overvalued. Inflation could be a problem if governments print money to bail out huge indebtedness. This is a legitimate worry. At the same time, housing remains depressed resulting from over supply, tight lending, and weak household formations as young unemployed live with their parents. Weak housing means construction workers remain unemployed which in years past represented a meaningful component of overall employment. However, there are small signs of improvement and hope. Couple this with real concerns about our national debt, deficit and impending financial failure of both our Social Security and Medicare systems, and no wonder many Americans are afraid to invest and question the sincerity and effectiveness of our elected officials.

The hope is that while we as a nation struggle to work out these issues, our economy benefits from robust growth in the emerging powerhouse of China and other developing countries. However, can we rely on a country whose human and corporate rights are limited and where its government controls and mandates economic growth? Maybe, but who knows for how long.

So, what do we do as investors? Hiding under our covers is not a good option. Remaining cautious and somewhat optimistic is the preferred way to proceed in our opinion. Don't give up on America because we are a country of resilient people ultimately motivated by a heritage of freedom and an enviable and irrepressible entrepreneurial spirit. Thus we must have a practical wealth strategy that recognizes our many challenges but embraces our history of success irrespective of political knuckleheads on both sides of the aisle.

You have heard of the top ten ideas from a famous late night program. Here we would propose our top twelve ideas for your 2012 wealth management strategy:

1. Have a reasonable goal to achieve an overall investment return that gives you some breathing room above inflation. (We would suggest a net of five percent after taxes with a prudent asset allocation for these times.)
2. Be diversified in your investment selections with strategies that have reduced correlations so that you capture opportunity irrespective of ugly macro and geopolitical circumstances. And be sure to understand the strategies you invest in and require transparency and reasonable liquidity.
3. Take advantage of very favorable current tax laws for individuals before the laws expire. It is most likely that prospective fiscal policy will require give ups from both sides of the aisle including somewhat higher taxes.
4. Be cautious to a larger extent. You are wealthy and you want to stay that way. The world is uncertain and politicians are playing too much of a role as government has become too large. Economic issues relating to deficits, entitlements and the European debt crises need to be dealt with. Now is no time to try and make up for the lean returns of the past ten years.
5. Initiate defensive equity strategies or add to them as they can provide some upside but should reduce downside in bad markets. Our Dividend Growth strategy has provided our clients with real appreciation and has protected capital in market downturns. Consult with us on your current asset allocation.
6. Don't reach for yield in bonds by extending maturities unreasonably or cutting quality and investing in third tier companies or banana republics. Inflation and a slow economy as well as political uncertainty could hurt you. Also, despite fiscal improvement in many states, municipal bond integrity is being litigated as to the full faith and credit that in the past generally assured repayment of bonds. Invest in quality bonds.

7. Rely on a diversified asset allocation to protect you from uncertainty while affording you the opportunity to participate when markets unexpectedly improve. None of us have a crystal ball and equity market upturns happen when least expected. Remember that gains achieved in equity markets typically happen in a small number of big market-moving days. You can't afford to miss them.
8. Review all aspects of your insurance planning. Assess your need for long term care insurance as well as medical evacuation insurance from remote travel locations (American Express offers very little in our opinion). These along with a review of traditional life and property and casualty insurance should be considered periodically. Utilizing the large lifetime gift exclusion as well as low interest cost loans can help fund life insurance policies that could be quite valuable in estate planning. We can help as we are experienced in these areas.
9. Review your annual spending to assess its relationship to your earnings capacity. Personal deficit spending is no better than our country going further into debt without a plan of remediation. Proposed increased taxes and those that are part of Obamacare (higher cap gains taxes) will reduce after tax income and must be considered in how much you can spend without incurring debt or eating into principal. We live longer lives and must have sufficient capital to provide our quality of life as well as keep pace with creeping inflation.
10. Prudent wealth planning and an honest annual assessment of your wealth plan will let you have greater peace of mind leading to sleeping better at night. In addition, you will be better equipped to face whatever challenges we must endure - both those we know about and those we can't project.
11. There are many stresses in the world we live in. Some we can control and others are beyond our influence. In order to endure these, whether they be financial or personal, one's health needs to be constantly attended to. Take the time to do this so you can enjoy life with the best possible quality that is available to you. Although we are not doctors or therapists, we are here to listen and try and help. We do have access to some fine doctors and hospitals should that be needed. And stay in good physical shape as it is one key to living a better quality life.
12. I am sure that we forgot something that you or we should consider. We are there for that as well given all of the unexpected that can occur.

The above twelve points are steps and thoughts we believe each of us must consider. We at First Long Island stand ready to personally help you consider each one of them and assist you in taking whatever actions are required in a well thought out plan. This is incredibly important in today's complex world.

We wish you a most healthy, happy and prosperous New Year and look forward to serving you in your wealth management needs. We appreciate the opportunity to be your wealth managers. Please call upon us.

Best regards,

Robert D. Rosenthal
Chairman and
Chief Executive Officer

*The forecast provided above is based on the reasonable beliefs of First Long Island Investors, LLC and is not a guarantee of future performance. Actual results may differ materially. Past performance statistics may not be indicative of future results.

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