

2012 ECONOMIC OUTLOOK

BEYOND THE HEADLINES: FINDING BRIGHT SPOTS IN THE ECONOMY

Complete Transcript



WELCOME TO THE 2012 ECONOMIC OUTLOOK

TOM JAMES

Chairman, Raymond James Financial

Tom James: I'm Tom James, chairman of Raymond James Financial. It's my great pleasure to welcome you to the *2012 Economic Outlook*. As you might guess, it's always difficult to prognosticate the events of the following year, whether they happen to deal with the stock market or economic conditions. But that makes it even more necessary that one considers both top-down and bottom-up analysis of the world economy, world politics and the economic situations that face most of our industry groups in the United States. Only through that kind of evaluation can you make the best choices for yourself on the investment front.

We obviously today are challenged by all kinds of factors, as we are every year. It just seems like more of them continue to be outside of the control of the individual investor, the individual investment firm, and in fact in some cases, the country itself. So it's always my great pleasure to introduce to you a large number of our experts in various investment fields here at the firm. Many of them are professional analysts who spend all of their time looking at these particular issues that I mentioned. And hopefully, that will create for you the background within which or against which you can establish your plans for the coming year.

Now needless to say, you can't supplant individual reflection with your personal financial advisor. My own view is this is a very customized kind of a process. It requires the integration of all these economic factors, along with personal financial objectives, other personal objectives and a general feeling for what kind of risk you're willing to accept. So I encourage you to use this information as a part of the overall information that's necessary to make decisions.

Investment advisors are well trained in terms of dealing with your individual needs. They do spend many hours every day reviewing all of the economic background, the tax laws, the political situation, which of course will affect 2012, as well as gaining an understanding of the latest alternatives that are available in investment products and investment services. Therefore, I think it's necessary, as I often do every year, to spend some time reflecting on all of these issues to help you lay out a program for the upcoming year. And I encourage you to do that so that you have a total interchange of information with your financial advisor in a personal meeting with that individual.

Please enjoy what follows. I hope it helps you make these decisions during this coming year. Thank you very much for honoring Raymond James & Associates and Raymond James Financial Services with your investment business.

ON THE ECONOMIC FRONT

SCOTT J. BROWN, PH.D.

Chief Economist

PATRICK O'CONNOR, CFA

Senior Vice President, Wealth Management Solutions

Patrick O'Connor: The influence of politics on the economy will surely be a staple in the headlines in this election year, and it is often challenging to cut through all the noise to determine which factors should be taken into account when making personal investment decisions. To shed some light on the economy in 2012 is Chief Economist Scott Brown joining me now. Welcome, Scott.

Scott Brown: Nice to be with you, Patrick.

Patrick O'Connor: Scott, in one of your recent commentaries, you stated that the U.S. economy was running in place. Can you explain that comment?

Scott Brown: Sure. It looks like the economy is growing more or less just enough to absorb the growth in the working age population. The unemployment rate has come down, but part of that is due to people exiting the labor force. If you look at the employment population ratio, it's been trending roughly flat over the last year. So this would be OK growth if we were at full employment, but we're not at full employment. We've got a lot of ground to make up, particularly in the labor market; a lot of ground from the downturn, so we'd like to see growth much, much faster at this point. So it's kind of a good news/bad news: The good news is the economy is growing; the bad news is that it's not especially strong.

Patrick O'Connor: In late summer and early fall there was a lot of talk of increased risk of a recession, and it seems like we avoided that at the moment. Can you give us your sense as to maybe why that was?

Scott Brown: Well, there was a lot of talk about a recession. We saw the consumer spending number slowing down quite a lot in the summer and early fall. Some of that was related to the increase in gasoline prices. We started the year around \$3 a gallon; by early May it was \$4 a gallon, and that really hits the household sector pretty hard. The middle class will spend almost every dollar that they make, and so if you're putting more money to fill up your gasoline tank, there's less money to spend on other things. But as we rolled into the summer, gasoline prices were starting to come down, so there was some momentum being built back up in consumer spending.

On the business side, you're looking at record corporate profits that's helping to fuel business fixed investment. You're seeing enough improvement in the rest of the world, where export growth was pretty good. So there were a lot of concerns particularly about the financial situation in Europe, but again, I think there was enough positive momentum to carry us through.

Patrick O'Connor: Many investors have feared that inflation would rear its head, given all of the easy monetary policy as well as the growing federal deficit. And we did see inflation pick up a little bit in 2011. What's your outlook for 2012? Is that something that investors should keep an eye on?

Scott Brown: Well, I think investors should always be concerned about inflation. I think the Fed has done a pretty good job of keeping inflation low over the long term. We did see an increase in gasoline and in food and energy prices, particularly in the first half of the year, so the inflation numbers picked up. But we had very low inflation numbers in 2010, so some of that was just maybe making up for lost ground. But people should remember that large budget deficits don't necessarily cause higher inflation. We learned that during the Reagan years, where inflation trended lower even though we were running large deficits. The Federal Reserve, I think, is also committed to keeping inflation low over the long term.

But you have to ask, where is inflation going to come from? We have had increases in commodity prices. There's a global growth story there that's going to stay with us for the next 20 years or so. The Federal Reserve has kept rates low, which tends to boost commodity prices. There's a huge speculative element in commodity prices, but in general we know it takes a very big increase in commodity prices to have much of an effect by the time you get to the consumer. Energy and food are probably the exceptions to that, but we're not really seeing a lot of pass-through, maybe a little bit more this year in things like clothing and so on.

In terms of labor, labor is the biggest channel for inflationary pressures, and you're not seeing any wage pressures coming through significantly. And that was a real contrast to what we were seeing with the inflation shocks we had in the '70s

and early '80s, where you had the oil price shocks, and that immediately led to increases in wages, and you had inflation embedded in the labor market. None of that is happening right now, so that's good for the inflation outlook.

And if you look at inflation expectations, market-based measures, if you look at the spread between inflation-adjusted Treasuries and fixed-rate Treasuries, they're telling us that the market certainly doesn't believe that inflation is going to be a long-term problem. So the outlook for inflation is still probably moderate, more or less in the sweet spot we expect for the Fed. One of the things that the Fed really worries about is the threat of deflation, which was the case in 2010 when they did a second round of quantitative easing. If that comes about, we start to fear more about deflation, then the Fed could come in and do a lot more, but I wouldn't expect that to be the case.

Patrick O'Connor: Obviously a lot of attention has been paid to the debt crisis in Europe, and a lot of those headlines have been driving some of the market reactions here in the U.S. What does the impact and the resolution of the European debt crisis mean for the U.S. investor and the U.S. economy?

Scott Brown: Well, the European debt situation is a major risk, not just for the European economy but for the global economy, and there's a couple channels that this could affect the U.S. One is trade. If Europe goes into a recession, U.S. exporters that export into Europe are going to see weaker earnings because of that, so there's that element. The bigger concern may be the financial repercussions. That as you've got Italy, for example, a lot of the French banks own a lot of Italian debt, and if something happens in Italy, then the French banks are going to suffer, and all these global banks are interconnected. In early December we saw the Federal Reserve and other central banks increase the dollar swap facilities, really to sort of grease the wheels in case there is a broader meltdown in Europe.

But at this point, we've been more than a year and a half into the Europe debt crisis. There's been a little bit of a back and forth, but the concerns are still very much there. This gets back, I think, to the construction of the eurozone, and one of the big problems was that there was no fiscal authority for all of Europe. If they get that done, that will be an important step.

And the other is the role of the European Central Bank. The European Central Bank has said that it is not the lender of last resort. That's a contrast to the message we get from the Federal Reserve. And as such, it means that investors, if they doubt Italy, Italian debt, for example, they can pull their money out, so Italy's borrowing costs increase. It adds to the financial

strains and creates more incentive for people to pull money, and you get these self-fulfilling crises. It's essentially like a run on the bank, only it's a run against a country, and there's really nothing to prevent that unless the ECB comes in and takes a bigger role.

So these are going to be very important issues to watch, I think, in 2012. Maybe it's going to be one step forward, one step back with Europe. It's tough to get everybody on the same page. You've got 17 different countries there that all have to agree on things, which makes it really, really tough.

Patrick O'Connor: Something we sometimes get asked as a related question to that is, is the U.S. the next Greece or Italy? What's your response to that kind of question?

Scott Brown: Well, in terms of the problems in Europe, people tend to focus on the debt issues, the government debt issues, sovereign debt issues. These really weren't the catalysts for the crisis in Europe. They're definitely a problem now that you're in a crisis, because then the government's borrowing situation becomes much more tenuous. The initial problem with Europe was largely because at its inception, you had a lot of these countries coming in and suddenly they had much lower borrowing costs, so they had debt increasing, not just government debt but private debt. And then when those capital flows stop and start turning the other direction, then that becomes a problem.

The real issue, as we've seen with financial crises around the world, is it comes from borrowing in currencies that you don't have any control over. And you look at Greece and Italy, well, they don't have any way to devalue their currency. If you look at the United Kingdom versus Spain, the budget problems are much more severe in the U.K., but borrowing costs are a lot lower because the U.K. has a way out. They can devalue the pound and work their way out of it. Spain can't do that. So there are all these strains that really have to be addressed.

And in the U.S., we do have a long-term budget problem. I mean, there's no doubt we were on an unsustainable trajectory. We knew that 10 years ago, 20 years ago, 30 years ago, so this shouldn't really be a surprise to anybody. We have had some increase in the deficit in the last few years related to the recession. The tax revenues are way, way down; some recession-related spending is up. That's going to work itself out over time as the economy recovers. But we know the retirement of the baby boom generation is going to add to strains in Medicare and Social Security, and there has to be a simple solution. I think eventually we'll get there, and it's going to involve some combination of spending cuts and tax increases,

but the two parties are very far apart, and that's where you get a lot of the noise. But I don't think we're going to turn into Greece, so you're certainly not seeing any strains, you're not seeing the markets reflecting any trouble for the U.S. in terms of its ability to borrow. It's not an issue.

Patrick O'Connor: So given that backdrop, what do you expect from the Federal Reserve in 2012? Are we expected to kind of stay in this low interest rate environment that we've been in the last few years?

Scott Brown: Well, the Fed has given this conditional commitment, effectively, to keep short-term rates unusually low through the middle of at least 2013, and it could go longer than that. So the Fed very much committed to sort of getting things going. One of the things that may come earlier rather than later is another round of asset purchases. This would probably be centered in purchases of mortgage backed securities.

One of the big disappointments so far in the recovery has been the weakness in the housing sector. You still have something like 22% of mortgage holders that are under water; half of those maybe are under water by 20% or more. Those people will continue to make payments, but the longer home prices remain low, the more strains you're going to see on households' budgets and their consumer spending. So there may be some efforts from the Fed to help that along, and certainly if they went out and bought more mortgage backed securities, it's not going to be a cure all. It's not going to turn the economy around, the housing sector around sharply overnight, but it's going to help at the margin.

Patrick O'Connor: Scott, your 2% GDP growth call for the second half of 2011 has proven to be pretty accurate. Putting it all together, what do you see for both GDP growth as well as the unemployment rate for all of 2012?

Scott Brown: Well, at this point I think the 2012 outlook is shaping up to be essentially more of the same, moderate growth, GDP growth on the order of around 2%, 2.5%. There's a lot of uncertainty that goes into that. We look at the unemployment rate probably edging down over time. More importantly, I prefer to look at the employment to population ratio, which I think is a better measure of labor utilization, and that probably is edging up, but still far from where we were before the

recession. So very gradual improvement in the labor market, but enough positive momentum. We're still seeing, I think, a good story in terms of corporate profits that's helping to fuel business fixed investment. There's enough job growth, enough wage income growth that consumer spending is going to improve. Bank lending is a critical element; we expect that to continue to improve over time.

There are uncertainties, as I mentioned, in terms of fiscal policy. As we're recording this now, we don't know what's going to happen with the payroll tax reduction. It's set to expire at the end of 2011. There's a good bet that it's going to be extended in 2012; it is an election year, obviously. That's a key insert. There's probably more fiscal policy uncertainty as you look toward the end of next year, because you've got the Bush tax cuts that are still set to expire at the end of 2012.

You have this failure of the Super Committee during the Thanksgiving week that has set up an automatic trigger for cuts and spending in 2013. Congress can still find a way to wiggle out of that, and if the White House approves and they can get around that, I think there's a good bet that they'll wiggle out of that somehow. You're set for another showdown over the debt ceiling after next year's election, so a lot of uncertainty there.

Gasoline prices we know are a major wild card. Gasoline was a major negative for the household sector in the first half of 2011. We could get a break if gasoline prices come down below \$3 a gallon; that would be a big plus for the consumer in 2012. That's something we're going to be watching. Gasoline is just always a major wild card.

And Europe, I think, is obviously the big, big concern. There's still a threat of a more serious meltdown in Europe, and again, most of the worry is through the financial contagion.

Patrick O'Connor: Scott, I think you covered a lot of ground today with us in regards to the various moving pieces that will affect the outcome of the economy in 2012. I think one key takeaway for investors is to maintain awareness of your commentary and insight, which they can access through their financial advisor. Thank you for joining us.

Scott Brown: My pleasure. Best wishes for 2012.

LOOKING FORWARD, NOT BACK

JEFFREY SAUT

Chief Investment Strategist

ART HUPRICH, CMT

Chief Market Technician

PATRICK O'CONNOR, CFA

Senior Vice President, Wealth Management Solutions

Patrick O'Connor: Stock market volatility has been the norm since the financial crisis of 2008, and the second half of 2011 was no exception, where we witnessed not only a 15% decline in the S&P 500 in late July and early August, but also one of the best months in the last 30 years in October. This kind of market volatility often breeds inaction or anxiety among investors when reviewing their portfolio.

Joining us now to discuss market volatility as well as his thoughts for 2012 is Chief Investment Strategist Jeff Saut. Welcome, Jeff.

Jeff Saut: It's a pleasure.

Patrick O'Connor: Jeff, in your commentary, you often talk about buying stampedes or, conversely, selling stampedes that drive a lot of the market activity. Can you explain what a buying stampede or a selling stampede is and what causes it?

Jeff Saut: Well, it's driven by investor psychology, or human psychology, for that matter. Buying and selling stampedes typically last 17 to 25 sessions with only one- to three-session countertrend moves. In a buying stampede, that would be a pause or a pullback. In a selling stampede, that would be a pause or rally attempts, before they exhaust themselves.

And what happens is it usually takes that long for investors to get panicked enough to sell out at the lows or bullish enough to buy at the tops. I've watched it for 41 years in this business, and my day count sequence is something that I've observed over 41 years.

Patrick O'Connor: You know, Jeff, in your 41 years of following the markets, have you seen a period with more buying stampedes and selling stampedes than we saw in calendar year 2011? Walk us through kind of the market activity in this past year.

Jeff Saut: Well, you had the market rally on the upside into the March/April time frame, and then it got hit by a pretty severe selling stampede, which lopped from interday high to interday low about 20% off the markets.

In fact, at the August 8 and August 9 lows, you have to go back to May 13 of 1940 to find a session like August 8 where less than 2% of all the stocks traded on the New York Stock Exchange actually closed in the green that day. And on May 13 of 1940 is when the German army punched a 60-mile-wide hole in the French Maginot line and invaded France, and everybody thought the end of the world was coming.

Patrick O'Connor: Well, speaking of Europe, so to speak, looking back to the past, today Europe faces another crisis in terms of their sovereign debt issues over there. Some would say, well, that's their issue to figure out, but in reality, as global investors today, don't we have to consider what risks that poses to us as investors?

Jeff Saut: Yeah, I think you do. I am of the view that it's not going to vortex and pull the U.S. into a death spiral. I could cite you a lot of innovative ways I think they could get out of the trap, and now you've got the Mario Brothers over there to try and fix things. And they do understand derivatives.

But just a walk-around indicator: The ECB, the European Central Bank, and the bureaucrats surrounding it do not want to lose their power. And, consequently, if the euro fell apart, they would lose their power. So human nature being what it is, I think they're going to find a way in the short run to buy the Club Med countries some more time. So I am not that worried about them spinning us into a double dip recession.

I would also point out that I've seen enough cycles that, when something absolutely, positively had to get fixed, it typically got fixed.

Patrick O'Connor: So you mention that the external forces probably won't cause a double dip recession here in the U.S. What are your thoughts from an internal perspective as to the state of the U.S. economy relative to its impact in 2012?

Jeff Saut: The best walk-around indicator in that space, if you will, that has telegraphed every recession in the past 50 years is the casual dining space. It's the most discretionary thing the American public has. And typically a falloff in the foot traffic

going through the Red Lobsters of the world, the Applebee's of the world foretold a recession four, five, six months in advance. And if you talk to the CEOs and CFOs at the casual dining restaurants, foot traffic's actually improving, not going down. That's a real easy one that anybody can check just by visiting an Applebee's on a Friday night.

You can look at other things, as well. You can look at railcar loadings and intermodal loadings. They have been very strong over the past five and six weeks. Of the 46 states that have reported tax receipts, they have reported them up almost 12% year over year – albeit from a very low base. But these are not the kind of metrics you see going into a recession. I guess we could talk ourselves into a recession if you listen to the negative nabobs on CNBC and places like that. But those folks have missed the whole rally for the past two-and-a-half years with their negativity.

So I think the economy is going to continue to improve – not robustly. I think earnings are going to continue to come in rather surprisingly. This most recent reporting period, the S&P 500 earnings were up roughly 23% year over year. And revenues were up roughly 12% year over year.

So, if you buy the fact that we're not going into a recession, that earnings are going to stay pretty good and then you look at the under-invested portfolio managers out there – and there are a bunch of them, I just got back from New York, in fact the hedge funds I talked to were actually hoping the market would go down because they are under-invested. It just feels to me like stocks are going to trade higher into the first quarter.

Patrick O'Connor: Well, one of the risks, though, to that outlook that you've talked about recently in your commentary has been some of the dysfunction in Washington. What do those risks mean to the investor and to portfolios, perhaps, in 2012? There's a lot on the table.

Jeff Saut: Yeah, but I think you're seeing a change in the constituency of Congress. You have seven lawyers for every MBA in the House and eight lawyers for every MBA in the Senate. And I think that – not that I'm a tea party person – but I think the tea party surfaced what Adam Smith wrote about 150 years ago in *The Wealth of Nations*, where he talked about the political corruption that prevents prosperity. And we have the best Congress money can buy. And if you go look at the people that were elected in the midterm elections, not all of them but most of them had come out of the private sector. They were not professional politicians, and they've actually had to make payrolls. And if you talk to them, they will tell you that they really don't want to be in Washington, D.C., but they think the

country's on the wrong course, and they think it's their patriotic duty to try and put it back on the right course.

So I think you're seeing a change inside the D.C. beltway, and I think it will manifest itself in the 2012 elections.

Patrick O'Connor: Speaking of Washington and the 2012 election, we asked Chief Market Technician Art Huprich to take a look at the history of election cycles as it impacts the markets. Let's take a look at that now.

Art Huprich: In terms of looking at 2012, I'd like to share with you two distinct and separate calendar studies that are relevant to the stock market. Now, these studies were published by the Hirsch organization, and they were included in the always-insightful 2012 edition of the *Stock Trader's Almanac*.

The first study, the first calendar study, is the presidential election cycle. And as you know, 2012 is an election year. Historically, the presidential election year is the second-strongest year amongst the four years within the presidential election cycle.

Now, if we get a little more specific and break the presidential election year down, going back to 1950, while the first few months of the year are sloppy about 50% of the time, if you look at the last seven months of the presidential election year, in the past 15 presidential elections, 13 years, during 13 of those 15 years, the back seven months of the year produce an upward bias. So, in summary, if we look at 2012 as a presidential election year, while the first few months are going to be a little sloppy or historically have been a little bit sloppy, the back half of the year has had a positive bias.

Now, the second study that I want to look at, the second calendar study, is called the decennial cycle. And what this means is we break down and we look at 10-year periods, and we see how the stock market has done. For instance, for years ending in a zero, how did the stock market do in 2010 or in 2000? Or in 1990, how did the stock market do?

Well, next year's 2012, it clearly ends with a 2. So we ask ourselves, how did the stock market do in the year 2002, in 1992, in 1982? And when you break the market down within these 10-year periods and look at a study of this nature, some very interesting patterns emerge. For instance, years that end in a 5 historically have a positive bias, and years that end in a 7 have a negative bias or a weak bias.

But since 2012 is an election year and it also ends in a 2, let's combine the two studies. There have been three instances since 1932 that were a presidential election year that ended in

a 2 – 1952, 1972 and 1992. And, on average, they produced a gain for the Dow Jones Industrial Average of 9.1%. The smallest gain was 4.2% in 1992 and the largest gain was 14.6% in 1972.

So, in summary, if we can get the issues behind us that are going on over in Europe, and if these historical patterns reassert themselves, 2012 has the propensity for being a positive year, especially in the back half of the year.

Patrick O'Connor: Jeff, given Art's comments and everything we've discussed so far, give us your big picture outlook for 2012.

Jeff Saut: Well, I think that depends a lot on whether we talk ourselves into the recession that everybody's worried about, which I don't think we will. I think that depends a lot on how bad things get in Europe. In my view, they are going to get at the margin better. And, if that's the case, the S&P should earn somewhere around \$105, \$106 a share next year versus this year's \$95 to \$96 a share – provided we don't talk ourselves into a recession.

Patrick O'Connor: Jeff, what are some of your themes that you typically talk about? What do they look like for 2012?

Jeff Saut: I think water is still a very investable theme. I think the weird weather's caused by a building La Niña weather pattern and a shift in the Hadley cell winds because there's more volcanic ash in the atmosphere than anybody can recall, and that means a cold, wet winter again this year. Energy stocks should come into play with that.

I think knowledge is an underpriced asset. Federal Reserve recently wrote a report saying that, in the U.S., U.S.

corporations are accumulating \$1.5 trillion per year in what they term intangible capital. And the way I've explained that in seminars is to say Amazon spent a lot of time and energy in developing the search engine that you use on their site. And yet our accounting system doesn't allow them to list that on their balance sheet as an asset. Icons for Apple is certainly worth something, but it's not on Apple's balance sheet as an asset.

So, if you're not accounting for the accumulation of intangible capital correctly, you're also not accounting for the output the right way, either. So, I think knowledge is an interesting prism to look at a research universe for. We took Raymond James in the U.S., a 900-company research universe, and screened it for companies that were spending a high amount of their revenues on research and development, figuring that's probably a pretty good lens to see if that company is developing intangible capital.

Patrick O'Connor: Jeff, any final thoughts or words of wisdom for investors as we look forward to 2012?

Jeff Saut: Sure. I'll steal a line from *The Intelligent Investor* by Dr. Benjamin Graham that Warren Buffett says is the best book ever written on investing, and in the last chapter, which is titled "The Margin of Safety," Dr. Graham says: "The essence of investment management is the management of risks, not the management of returns. All good portfolio management begins and ends with this tenet."

Patrick O'Connor: Jeff, some great advice heading into this year. Thanks for joining us.

Jeff Saut: My pleasure.

TAX REFORM ON THE RADAR

SUSAN HARTMAN, JD, CFP®

Tax and Estate Planning Consultant, Wealth Management Solutions

PATRICK O'CONNOR, CFA

Senior Vice President, Wealth Management Solutions

Patrick O'Connor: 2012 will be an interesting year, to say the least, with regard to determining the future of our federal tax system, given three important factors. First, the expiration of the Bush era tax cuts on December 31 of 2012. Secondly, the ballooning federal deficits and measures passed by Congress in August of 2011. And, third, lest we forget, all this will be occurring against the backdrop of a presidential election cycle.

Joining us now to sort it all out is Wealth Management Solutions tax and estate planning consultant Susan Hartman. Welcome, Susan.

Susan Hartman: Thank you, Patrick.

Patrick O'Connor: Susan, let's start with what we do know. If Congress doesn't act and the Bush era tax cuts are set to expire on December 31 of this year, what will that mean for investors?

Susan Hartman: If the Bush tax cuts are allowed to expire, individual investors will see an across-the-board income tax rate increase, bringing the maximum marginal rate up from 35% today to 39.6%. Now that doesn't seem like that much on the surface, but when you add to that the additional 3.8% tax that becomes effective January 1, 2013, on excess, unearned income for high income earners, you'll see that their maximum tax jumps up to a total of 43.4%. And that's before we even take into consideration any additional state income tax burden.

Now, in addition to an increase in the marginal income tax rate, we're looking at an increase on the capital gains tax rate up to 20%, and we're also looking at an increase on qualified dividends from 15% to what would equate to ordinary income tax rates. So we're going to be seeing a number of tax increases. What we're also going to be looking for is the fact that Congress has traditionally taken a last-minute approach to a lot of their tax-planning aspects. So, with this inactivity until the last minute – say, November, December, near year-end – what we might actually see happen is that, in effect, this congressional term turns out to be a lame duck session.

Patrick O'Connor: That's a very interesting point. We all know what you just described will happen if nothing changes before December 31 from a congressional perspective. But we know given the election year politics that will be going on, a

lot of ideas are already being thrown out there by candidates, particularly for the presidential election, that would seek to fundamentally change the progressive income tax system that we're under today.

What are some of those proposals that are being thrown out there by candidates and maybe how realistic are they longer term?

Susan Hartman: When you've been around a while, you start to see the same types of proposals coming up again and again in the same types of situations. So it's not unusual at this stage in the election process to see proposals for the flat tax, the value-added tax, a complete overhaul of the taxation system. But the reality is that, while the political process is of a short-term horizon here and political candidates are often said to have a very short-term focus, any sort of significant tax reform is really going to require a long-time horizon, not only for implementation, but also for exploration and design.

And so what we really need to do is not focus on what's going on in the short-term political arena, but let's take the focus and shift it toward something that we can influence, that we can impact in our day-to-day investing and tax-paying lives. And so, for example, what I would do is look to control things such as cash inflows. Maybe arranging cash inflows such that they fall in the lower tax years. We know taxes are going to be going up in the future, maybe we could accelerate cash inflows into the lower tax years.

Additionally, we might want to consider strategic investment portfolio balancing or rebalancing such that we are harvesting gains and losses in the most tax-efficient manner. You know, creating a loss carryforward is not such a bad idea if it fits with the rest of our investment discipline, and if we can use those loss carryforwards in higher tax years.

Patrick O'Connor: Susan, I think that's great advice in terms of focusing on where we are today from a tax perspective and not looking out or speculating too far as to what tax reform may look out well out into the future.

There are some other additional, more shorter-term tactical tax strategies that lawmakers are looking at relative to closing some of the budget deficit that may have more realistic

chances of being passed. What are some of those that we're hearing about right now?

Susan Hartman: Perhaps the most important from a financial planning perspective would be the sacrosanct three: the charitable donation deduction, the home interest expense deduction and the tax-preferred status of the municipal bond.

With respect to the charitable deduction, there's no surprise there. The current administration has previously been very outgoing in pushing forth the message that they'd like to see charitable donations deductions capped at 28% of adjusted gross income. Unfortunately, with the current economic situation, increasing the demand for charitable services and leading toward a reduction in current charitable donations, this could just be one unwelcome stressor on the entire charitable giving environment. We'll have to wait and see how that plays out.

With respect to the home mortgage interest expense deduction, currently taxpayers are allowed to deduct mortgage interest expense on up to \$1 million of mortgages. In the future, we're looking at proposals to either eliminate or reduce the amount eligible for deduction. With the current state of the housing market, it's not foreseeable that they would completely eliminate the deduction. What is more foreseeable is that they would simply reduce the eligible mortgage amount from \$1 million to \$500,000. So, going forward, we look to see a reduction in the ability to deduct home mortgage interest.

Rounding out the trio is the tax-preferred status of municipal bonds. State and local government bonds currently enjoy tax exempt status for all taxpayers. If current proposals are enacted, individuals who are high income earners – which would be those with adjusted gross income of about \$200,000 or more – would find that their municipal bond interest income would be subject to income tax rates of up to 28%.

The impact of this change is that state and local governments could see a significant decrease in the demand for their bonds, which would of course lead to an additional stress on their already-overburdened budgets.

Patrick O'Connor: Susan, I'm sure all three of these issues – mortgage interest, charitable deductions, as well as municipal bond interest – will all be hotly debated in the election cycle in 2012. Let's shift gears to another issue that will have to be decided in this election cycle and subsequent law-making. That is the future of the estate tax. At the end of 2010, we saw provisions put in place by Congress on a temporary two-year period that will expire at the end of this year, in 2012.

They put in place a \$5 million estate tax exemption as well as other features that change the landscape a bit. Where do you see that going forward and where is that debate going to focus in 2012?

Susan Hartman: Well, the 2010 Tax Relief Act gave us two years of a 35% maximum rate on gift, estate and generation-skipping wealth transfers. It also gave us the \$5 million applicable exclusion amount that we see today and we enjoy today.

When they expire at the end of this year, the law's scheduled to revert back to a top rate of 55% and an applicable exclusion amount of \$1 million. Now, in years past, prior to the current administration, it was much easier to look at the way the flags on the top of the Hill were blowing and see which way the winds were shifting. And so we could gauge which way we were going to move with respect to planning. Today, unfortunately, it's not so easy to forecast which way the debate's going to end up, and we've got proposals that are all across the board with respect to future implementation. Now, that doesn't mean that clients shouldn't plan; they should plan. They just need to plan with respect to what the law is today and maintain flexibility.

Patrick O'Connor: Susan, we've covered a lot of ground with regards to potential impacts to our tax system going forward, some proposals that are on the table, as well as those areas that are going to be a critical focus in the election cycle. Let's bring this back to what investors should be focusing on here and now in 2012 with regards to their personal planning. Let's start with a look at maybe those that are in the process of assessing their retirement readiness. What are some planning issues they might want to focus on in 2012?

Susan Hartman: Well, I think a primary importance to those in retirement and those nearing retirement would be their healthcare allocations with respect to their budget going forward. And so one of the things that they're going to want to do is to take a look at the recent healthcare reform packages that have been enacted, take a look at that and see how that's going to impact their planning. But also I need them to be aware that any significant tax reform or budgetary reform is also going to, by necessity, include some sort of Social Security, Medicare, Medicaid reform.

Now, whether that reform is limited to just eliminating or reducing the amount of fraud that we see in the current system or whether there's going to be an overhaul of benefits for individuals who qualify in future years remains to be seen. But one thing we do know is that healthcare allocations, healthcare expenditures in retirement are a significant portion of

budgetary allocations and so it's very important to consider them early in the process and to stay aware of the changes in the programs that are out there.

Patrick O'Connor: Obviously retirement is a big issue that investors will have to keep in mind – Social Security, Medicare. Let's shift to the estate-planning landscape. You kind of talked about what the debate may look like. What should investors focus on in 2012 as it relates to their estate planning?

Susan Hartman: With today's historically low interest rates and the current economic conditions, which suggests that interest rates will stay low for the immediate future, I think I would be focusing on wealth transition techniques and charitable giving techniques that take advantage of this low interest rate environment. Two techniques which come to mind are prime examples. The GRATT, or grantor retained annuity trust technique, which we've spoken of in the past, is a technique that works wonderfully well in a low interest rate environment to reduce the amount of the taxable gift in a transfer of a significant amount of wealth from one generation to the next.

Conversely, the ever-popular charitable remainder annuity trust, or the CRT, is a technique which does not work so well in a low interest rate environment and one which investors who are getting ready to implement any sort of significant charitable planning might want to reconsider. Suitable alternatives in this environment would be the charitable lead annuity trust or the donor-advised fund, or DAF for short.

Patrick O'Connor: And finally, Susan, let's cover investment management decisions. As we look towards the prospect of higher taxes in both capital gains and ordinary income rates, what does that mean for investors making decisions in 2012?

Susan Hartman: In the normal investment process, investors and their advisors will periodically review not only specific investment decisions but also the strategies and techniques that they've implemented within the investors comprehensive financial picture. And, as the tax laws change, the tax efficiencies of some of those investments and strategies is going to change. So everything will periodically need to be reevaluated with respect to the overall performance of the portfolio. One thing to bear in mind is that the tax planning aspect of it should never be allowed to drive all the fundamental portfolio design decisions.

Patrick O'Connor: Clearly, if we expect higher taxes in 2013 and beyond, 2012 will be a great year for investors and their financial advisors to sit down and assess their overall tax planning in the context of their overall goals.

Susan, I really want to thank you for joining us.

Susan Hartman: It's been a pleasure.

DEBT DRAMA

JAMES CAMP, CFA

Managing Director of Fixed Income, Eagle Asset Management

LARRY PUGLIESE

Host

Larry Pugliese: Is Italy too big to fail? Today risk is being repriced and reevaluated in fixed income. Traditionally, investors always look to bonds as the safe portion of their portfolios. Well, that hasn't changed. What has changed is the amount of risk for greater returns. The key to it all is picking the right bonds.

Managing Director of Fixed Income and Eagle Asset Management James Camp joins us now to talk about opportunities ahead and what investors might expect in 2012. Welcome, James.

James Camp: Good morning, Larry.

Larry Pugliese: Nice to have you here.

You know, James, Italy is the third-largest issuer of sovereign debt globally. A crisis there would easily spread to other parts of Europe, wouldn't it?

James Camp: Larry, that's correct. In fact, we are seeing the situation in Italy, their problems now have in fact spilled over to the rest of the eurozone. If we look at yields last August and where they were as we moved into year-end at 2011, they were up across the board for all issuers of sovereign debt in the eurozone. We know about the Greek situation. We know about Portugal. But now places like Italy are issuing 10-year debt 2% higher than they were just months ago. It has actually caused downgrades to the French and the German sovereign debt, which was the safe of the safe havens in the eurozone, is now up in yield. As we know, more expensive debt with the level of debt becomes self-fulfilling in terms of its unaffordability. And, ultimately, we think, the resolution there is not just liquidity measures which can be used in the short term, but ultimately a denigration and write-down of debt across the eurozone, which in fact may have significant impact on sovereign debt and the banking system in Europe.

Larry Pugliese: I guess there's always a lesson to be learned somewhere, James. What did we learn over the last couple of years of the debt crisis?

James Camp: Well, Larry, I appreciate that question. I think the school is still in session, as I like to say. But let's take a

look at a couple of things that I think we should remember over the last three years.

First, it's easier to solve liquidity issues in the near term by policy measures, both at the Federal Reserve, Treasury, central bankers, than it is to solve long-term solvency issues.

Domestically, I think we have to be self-critical about the focus specifically on mortgages and real estate as a policy measure, a central policy planning measure where we had a lot of hands on deck for one unique asset class. We cannot engineer risk out of the financial system. There are not enough ways to model, test and forecast where we can accurately take risky securities and by bundling and diversifying make them riskless. I think the failure on that level is something we need to always remember.

But importantly to me is this notion that our wealth and the consumption that was enjoyed over the last 10 or 15 years was fueled by debt and not real wage growth. I think that plays out globally. So we now have to look at a consumer and a consumption part of the economy that will not be buoyed by debt spending and increasing debt on balance sheets, both individually and collectively.

The couple of other ideas that I think about is the fixed income investor. Liquidity is dear. We have liquidity in the markets that are fluid and changing and, when crises show themselves, because the bond market specifically is an over-the-counter market, it is not traded by specialists, there is no orderly mandate to them, we have seen over the last three years and we're seeing it as we speak, changes in liquidity, changes in bid/ask spreads and, when somebody yells "fire" in the movie theater, the exit doors get very narrow.

Larry Pugliese: Yeah, sure, sure. So, based on investors' outlooks, who expect the economy to get better, what types of fixed income instruments should they consider?

James Camp: Well, we first start with an idea that forecasting is difficult and buying fixed income, and this is perhaps any instrument, away from the financial planning model based on a forecast, can be a difficult proposition. But, if the economy is going to gain traction domestically and folks believe that

we have turned the corner, certainly they want to move away from the Treasury market. That is the most interest sensitive. We have a 2% 10-year. I think it trades in a range for the next 12 months – call it 1.75% to maybe 2.5%. Certainly Treasuries would be most vulnerable.

High yield bonds look reasonably attractive relative to credit quality in the industrial space. Spreads on high yields around 700 basis points, slightly higher than long-term average. We think they get repriced even wider from here, but those are other areas to consider. Keep duration short. Keep floating rate instruments in portfolio that are of good credit quality. And, as I remind people, if the economy really is improving and you're concerned about inflation or yields – which I happen to not be for the near term – cash is a viable investment option.

Larry Pugliese: What about for those who think the economy is going to get worse?

James Camp: That plays more into our theme, Larry, going forward that the economy will struggle or sort of sawtooth through fits and starts over the next couple of years. High grade credit, high grade corporate bonds, intermediate term Treasuries, you don't have to be afraid of the Treasury market at this particular point in time. We are still very productive on the municipal bond market. Credit quality by and large in municipals at the state level is improving. Yield ratios are still very generous. And we think there are tax law changes coming, post-2013 election, which will make the tax deductibility of those assets even more dear. In both of those issues it is important for clients to consult directly with their tax advisors and financial advisors to know what benefits they may enjoy on tax sensitive investing.

Larry Pugliese: Sure, very important. Let's go back a few years, James. In 2008, Treasuries rallied along with the financial crisis. In 2009, the news was bad and they lagged. What can those two periods teach us now?

James Camp: That's a great question, Larry. In 2008, most bond managers performed very poorly. And the reason they performed poorly was not because the Treasury market rallied – that should be a very productive environment for bond investors. We like yields to fall. However, most bond investors were heavy overweight what we call spread product – corporate bonds, mortgage bonds and the like – where those risk premia gapped out significantly.

In 2008, intermediate-term bonds, well-run and diversified, returned north of 6%. Now, if we scroll the clock forward to

2009, the winds shifted. The Treasury markets sold off. Yields went up on the 10-year Treasury. However, the period of 2008 created dislocations in non-Treasury bonds. And those managers or individuals who bought non-Treasury-based assets, despite the increase in yields in 2009, performed very well. What it tells us is the bond market is not all about interest rates. It's about risk pricing, relative value and, in our opinion, active management.

Larry Pugliese: And, of course, for our listeners, we are purposely talking about a few years back. And, James, we know past performance is no indication of the future. But what you're saying now, that actually exceeds the 2008 plan of 24.4% during the worst financial crisis since the Great Depression. I think you've called them "low absolute moves." Why is that important?

James Camp: The Treasury performance in 2011 probably surprised a lot of people. The reason I think it's important to look back at 2011 with a very good Treasury rally is a couple of things. One is, nobody would have predicted, the average person on the street, in fall of 2010, after Quantitative Easing 2 was announced, yields moved up temporarily. That began the conversation, "Here we go. Yields are going higher. I need to get away from bonds and Treasuries." Lo and behold, the events of the day last year in 2011, the flight to quality trade began in earnest. The fact that growth rolled over and the eurozone crisis shown itself, the dollar and the U.S. Treasury market as safe haven stood tall yet again.

And, as you mentioned, when you have a low-yield environment, smaller moves make bigger differences in terms of total return. So though the 10-year Treasury or 30-year Treasury started last year at a reasonably low yield, the moves downward had a very big impact on total rates of return.

Larry Pugliese: The bond market indicator, the Treasury yield curve, has predicted every U.S. recession since 1970. What do you think it's telling us today?

James Camp: I think first and foremost we have to look at the Treasury yield curve as being an anomaly right now. Because of the Fed policy, because of their two-year-plus explicit call that short-term rates will be at zero, we have anchored the short end of the curve at zero. So we can't get normal yield curve movements, at least on the short end.

However, the longer end of the curve, the 10-year and 30-year, has rallied significantly – meaning, fallen in yields in 2011. That tells us slow growth, inflation expectations are muted

and the store of value in the safe haven of U.S. Treasuries is overruling any concern about our domestic deficit situation.

Typically, when we see a recession forthcoming, the Treasury market will invert. Meaning, short-term rates will move up higher and long-term rates will fall. We've gotten half of that equation here. Long-term rates have fallen significantly. We can't get the other half because the Fed has pegged the rate, because of other issues.

Another part of the markets that we have to look at is the credit markets versus the stock market.

Larry Pugliese: Yeah.

James Camp: Credit spreads have widened significantly over the last two or three months in the summer of 2011 going into the fourth quarter of 2011. Credit spreads widened while stocks recovered somewhat. There's been another period recently where the spreads on credit, meaning the risk pricing on credit, has diverged significantly from the levels of stocks. That was 2008. We're in a period now where the bond market for non-Treasury instruments is telling you to be wary of risk while the stock market seems less interested. That is a data series that we look at very carefully, because one of the markets right now, in our opinion, is mispricing risk.

Larry Pugliese: With somewhere near \$2 trillion in cash out there right now and at some time heading toward stocks rather than bonds, is this what the media calls the worst time to be in bonds?

James Camp: I go back to your previous question, Larry. I suggest that they would have said it was the worst time to be in bonds 12 months ago. And I remind folks that the evergreen forecast for Wall Street economists is interest rates are going up and bonds are going to struggle. That has been a losing proposition, as we know, over the last handful of decades.

I think it is ever more important to talk to your advisor about the type of fixed income instruments that you own. Importantly, the behavior of those instruments in different economic cycles and the behavior of those instruments relative to your other assets – I certainly would not advocate moving away from long-term growth strategies, dividend-paying stocks, balanced portfolios. But to suggest that an asset class should not be invested in because of a forecast is unlikely to be a successful long-term strategy.

Larry Pugliese: And, finally, James, I want to ask you – as you know, President Obama wants to curb the amount of interest

from munis that top earners can actually exclude from their income. What are your thoughts about that and do you think this could actually pass?

James Camp: I actually think, Larry, in 2013 we're going to see a decided policy move one way or the other. We'll have an election. We'll begin to decide how we're going to treat the tax code, how we're going to treat entitlement spending and the like. Nothing will happen before then.

I do think it is a more likely scenario if the Obama campaign is successful and he is reelected, that there would be some tweaking to tax deductibility of certain instruments. Having said that, putting more pressure on bond yields for municipalities at this time, state and local governments, seems to me to be a nonproductive strategy fraught with political risk in its own right. We have seen this come up many, many times; it has been defeated many times. However, for us, even if municipal bond tax deductibility were limited in some fashion, which we don't believe ultimately will happen, the attractiveness of the asset class still stands.

Larry Pugliese: And, finally, James, Fitch lowered its rating on U.S. debt after the Super Committee failed to agree on how to reduce the deficit. It kept its AAA rating for long-term Treasuries, but revised its outlook on U.S. debt to negative. What are the implications there?

James Camp: Well, interestingly, Larry, we did have an actual downgrade in 2011 by one of the rating agencies. The long-term outlook is difficult if the fiscal policies and the entitlement programs and the tax codes are not modified. We know in 2013 there will be a sea change early on, at least in my opinion, in how revenues are generated through the tax code and spending is dealt with.

If that is not dealt with directly, long term we will have a difficult time sustaining our debt levels. The Fitch outlook to negative is to me as much about process as it is about economics. And right now the process in Washington, as evidenced by the debt Super Committee's inability to come to a conclusion, is flawed and there's a lack of confidence in policymakers' ability to deal directly with long-term budget deficits. If that persists, downgrades and trouble in the U.S. in the form of higher interest rates, higher debt costs, will happen, as it is happening in Europe as we speak.

Larry Pugliese: All right, sir, always a pleasure. James Camp, thank you.

James Camp: Larry, pleasure to be with you.

HOT AND COLD ON ENERGY

MARSHALL ADKINS

Director of Energy Research

PAVEL MOLCHANOV

Alternative Energy Analyst

LARRY PUGLIESE

Host

Larry Pugliese: What are energy analysts forecasting for this pivotal political year? Director of Energy Research Marshall Adkins joins us now from Houston. Welcome.

Marshall Adkins: Good to be back.

Larry Pugliese: Always good to have you, Marshall.

You know, in last January's economic outlook, you were bullish on the oily shale business and not the natural gas shale business, and the companies that provide services and drilling. Are you still?

Marshall Adkins: Yes. Application of horizontal drilling technology in U.S. for both the oil and the natural gas shales has completely changed the game. We call a lot of these areas we're going into "shales." The reality is we're now applying this technology across the board in the U.S. and beginning to do so internationally to dramatically reduce the cost of extracting both oil and natural gas. This has opened up a whole new set of reservoirs that were previously uneconomical.

Larry Pugliese: Our top foreign supplier of oil, natural gas and uranium to the United States is Canada. The Keystone Gulf Coast Expansion Pipeline project in Canada's Alberta Oil Sands region, also known as Keystone XL, it is being delayed, last I checked. Once all four phases are complete, how much crude could conceivably be delivered to the U.S. each day?

Marshall Adkins: The numbers tend to move around, but certainly coming out of Canada, if all the pipeline extensions and whatnot are accomplished, it's a half million a day and could be meaningfully higher.

Larry Pugliese: And how many jobs, do you think?

Marshall Adkins: Oh, tens of thousands of jobs, certainly on the construction side of things.

Larry Pugliese: You know, another big producer we're hearing about is Williston, North Dakota. Not only are jobs plentiful there – in fact, one trucking company, last I heard, needed 500 drivers – the economy is booming there. So do you think we'll see more boom towns like that, Marshall?

Marshall Adkins: Oh, no question. You're seeing it across the country, certainly up in North Dakota, there's an acute shortage of labor because it's not a real populated area. But you're seeing the same type of jobs being created in Appalachia, in the Marcellus Shale. You cannot get a hotel room in the Permian Basin in Texas, because things are blowing and going out there. Really, the only area in the oil patch where you haven't seen this incredible tightness is the Gulf of Mexico activity, and that's because we decided to shut it down.

Larry Pugliese: That's true.

Marshall Adkins: There's a lot of different types of jobs created. There's a lot of money that's being created. The emergence of these oily plays here in the U.S. also means that's a lot fewer dollars overseas to import oil.

Larry Pugliese: You know, 10 years I've been talking to you about your energy outlook, and I guess I've never asked you this question. I know several factors actually shape your outlook. Which factor is the most important?

Marshall Adkins: Well, it changes from time to time, but pretty consistently for the last decade-plus, on the oil side it's been the Hubbert's Peak theme. And what that theme basically entails is oil prices moving higher over time because of a lack of ability to bring on new supply. In shorter term, we've been concerned about natural gas because of just how good we've gotten at getting natural gas out of the ground. Anyone that uses natural gas in the U.S. – the petrochemical industry or other industrial consumers – that gives the U.S. a huge competitive advantage.

What's interesting about the oil shales is we have, for the last four decades, U.S. oil supply has been trending lower. And just in the last few years, for the first time in almost a half-century, you're actually growing oil supply here in the U.S. because of the application of these technologies. So things have changed considerably over the last five years.

Larry Pugliese: And there are concerns, even in the alternative energy space, as some critics say, of why the government should not try to fund renewable energy companies, they can

sometimes go belly up. Pavel Molchanov covers alternative energy and integrated majors for Raymond James. He joins us now.

Pavel, do the Energy Department's loan programs have a future or will they just come to an end?

Pavel Molchanov: Well, I have no doubt that loan guarantees for renewable will continue, but certainly there will be even greater scrutiny along the way. These programs have already had very strict due diligence, which is why over 95% of the loan guarantee recipients remain in good shape. Certainly, Solyndra and Beacon Power are two high-profile examples that, as you said, went belly up, but those are really the exceptions that prove the rule.

In one sense, it's a bit like the Gulf of Mexico after last year's oil spill. The media will always focus on the one time that there is a major incident, even though the overwhelming majority of wells drilled out there, of course, are entirely safe.

Larry Pugliese: Yes, yes, good point. You know, coal and nuclear power, as we know, have existed for years with their infrastructures already in place, while some of the newer forms of energy production still need to be built from the ground up. Now, barring the time factor and even the cost factor, the outcome as we know, Pavel, is greener, cleaner, renewable energy. How does this actually resonate with investors?

Pavel Molchanov: Today coal provides almost half the electricity in the United States, and in some countries, like China and Australia, it's even more than that. Coal is not going away. Even nuclear power, as controversial as it may be after the Fukushima disaster, is not going away, either. But as we think about the incremental electric supply that the world will need, it's increasingly going to come from low carbon sources. Natural gas is going to be important, both domestically and especially in Asia, in the form of LNG. And renewable will play a role, too. Wind, for example. It's only about 2% of electric generation in the United States, but in some countries like Denmark and Spain, it's over 10%. So we know there's a lot of running room.

The biggest hurdle to adoption of wind and solar on a large scale is the fact that power storage is difficult and expensive. Once the storage issue gets resolved, which will take time, I think adoption can really take off.

Larry Pugliese: So what trends are you seeing in solar energy, let's say, for 2012? And which ones do you like at this time?

Pavel Molchanov: Well, solar specifically is an industry really in transition now. The major demand drivers used to be in Europe – it was 80% of the market last year – but now it's shifted to North America and Asia Pacific. And supply of solar panels is also becoming dominated by China as opposed to Western countries, which helps explain why the industry has really become commoditized and panel prices have fallen very quickly. In 2008, you could buy a crystalline solar panel at \$4 a watt. Today it's close to \$1 a watt. And this is great for consumers, of course, but if you're a manufacturer, clearly not a good thing.

For 2012, what I am more excited about is the advanced biofuels and renewable chemical space. This is the next generation beyond ethanol. And it's an early-stage industry. There is a lot of execution risk. But it is scaling up and making good traction. Conceptually what I like about the advanced biofuel arena is three things. Number one, unlike many areas of alternative energy, no dependence on subsidies. Number two, you have direct leverage to the upcycle of the oil market, which remains in very good shape. And, number three, there is really no competition from China to speak of.

Larry Pugliese: Excellent points. Pavel Molchanov, thanks so much.

Pavel Molchanov: Thank you.

Larry Pugliese: Marshall, oil man T. Boone Pickens says the first logical step toward ending U.S. energy dependence on foreign oil is natural gas. He's probably right. With these pipelines, shale development, deep water, new drilling technology, everything we've talked about to acquire vast reserves like Canada and North Dakota, the United States is decreasing its dependence on foreign oil. Is it sustainable and how long will it take?

Marshall Adkins: There's no question that over the intermediate term and the short term we can maintain it. We've found a lot of new gas reserves here in the U.S. It will take us many years to develop these. Is it forever? No, of course not. But could we see lower natural gas prices for a decade? Absolutely. And that certainly buys you time to develop other types of energy sources and become more efficient. It helps us become less dependent on the OPEC nations, one of whom is Iran. We're now putting in new sanctions, we're worried about them getting nuclear weapons. To the extent that we're importing less and less crude, it helps on all these fronts.

Larry Pugliese: But that crude is going through the Strait of Hormuz, right?

Marshall Adkins: And that's one of the themes we've tried to bring investors' attention to recently is, our oil model does look very bullish, we're not really growing supply and demand is, continues to be strong enough to drive prices higher. What very few people are plugging into models is the shutting of production from Iran or through the Strait of Hormuz. Almost a quarter of all global oil supply flows through this area in the Middle East that borders Iran, and to the extent they could block off the Strait of Hormuz, you're talking about a major

global shock. Investors need to put Iran on their radar screen. We're not saying anything happens tomorrow. But certainly it is a risk element that would drive oil prices meaningfully higher and negatively impact the global economy.

Larry Pugliese: All right. Always a pleasure to talk to you, my friend. Marshall Adkins, thanks so much.

Marshall Adkins: Thank you.

WHAT'S CONSUMING CONSUMERS

DAVE HENWOOD, CFA

Chief Investment Officer

SAMANTHA PANELLA

Softline Retail Analyst

LARRY PUGLIESE

Host

DAN WEWER, CFA

Hardline Retail Analyst

SHYAM PATIL

Communications Software Analyst

Larry Pugliese: Consumer borrowing in the United States rose in October to the highest level in two years by over \$7.5 billion to almost \$2.5 trillion. The most since October 2009, Federal Reserve figures showed. They charged less to their credit cards for three consecutive months to pay down debt, too. Motor vehicle sales rose to \$13.6 billion in November, the best month since August 2009, according to Auto Data Corporation. The small business optimism index rose to 90.2 in October, up from 88.9 in September, as well. The Commerce Department called it the largest gains in seven months.

Of course, as journalists are quicker to point out, consumer spending is not where it should be. Dave Henwood joins us now, shares his thoughts about the headlines and today's consumer. Welcome, Dave.

Dave Henwood: Pleasure to be with you again.

Larry Pugliese: Always a pleasure to have you.

Dave, the National Retail Federation reported total spending over Thanksgiving and Black Friday weekend reached a record \$52.4 billion. That's up 16% from \$45 billion last year, thanks to a record 226 million consumers between that Thursday and Sunday. Even a casual observer, Dave, might wonder if the doom and gloom is over, at least subsided. What are your thoughts?

Dave Henwood: I think the combination of less apparent risk of a recession in the near term, expectations for stronger monthly employment growth across corporate America, given strong and growing U.S. corporate profitability, is driving elevated positive feelings by most consumers.

U.S. citizens are still struggling with too much debt. While 9% are unemployed – approximately 9%, actually it dipped in October – 16% are underemployed and approximately 25% of U.S. citizens are 65 or older, with most no longer employed. Nearly 50% of adults may be viewed as financially challenged now.

The recovery in world financial markets since the lows of March of 2009 has also helped the willingness of those benefiting from equity investments to spend more during the 2011 holidays. The critical question here is this a sea change in spending that will produce stronger than expected consumer spending in 2012, or an unsustainable holiday spending binge?

Larry Pugliese: Isn't what we're seeing possibly pent-up consumer demand pushing these sales, Dave?

Dave Henwood: I think pent-up demand is part of it. Also wages and salary increases have been growing at a slightly faster rate in 2011 than in recent years, and there are indications that people in the upper income brackets were spending a lot more than was true in recent years on cars, computers,

handheld devices and other high-end merchandise. Consumer savings rates have been higher in 2011, but I expect that many felt the spirit of Christmas and spent more than they did a year ago when they were predicting the probability of a recession at 40% or higher. The probability of a recession in the next 12 months is probably down to 20% or less today. Thus, I do feel pent-up demand and greater willingness to spend was a large part of the 2011 holiday spending equation.

Larry Pugliese: And I agree with that. Let's get additional perspective on this by taking a look at a few key consumer sectors. Raymond James hardline retail analyst Dan Wewer joins us now from Atlanta. Welcome, Dan.

Dan Wewer: Thank you for having me.

Larry Pugliese: Thank you, I appreciate it. What were the most popular items on people's wish lists?

Dan Wewer: Right now, it's all about tablets and e-readers. Today those are the number one sellers within the consumer electronic category, followed by smartphone sales, which are currently tracking up about 35%. And then the strength in smartphone sales is leading to a strong growth in accessories, such as headphones and cases.

Larry Pugliese: Do you see an exciting consumer electronics year ahead?

Dan Wewer: I think that the entire industry will be relatively flat or up slightly. For example, the television category is going to probably decline for the second consecutive year. On the other hand, there are categories such as gaming software, smartphones, tablets, e-readers, even appliance sales are beginning to show some evidence of a pickup.

Larry Pugliese: Since the debut of the Apple iPhone 4S in October and all the positive reviews about its speech recognition technology, Siri, the voice-controlled personal assistant, the voice-recognition computing revolution is under way. To tell us more, communications software analyst Shyam Patil joins us now from Atlanta.

Shyam, if I'm correct, when you ask Siri to do something – and Siri is a “she,” we understand – of course it sends the audio to Apple servers, which uses the voice recognition system from Nuance to turn speech into text. Does any other smartphone do this and, if so, do they do it as well?

Shyam Patil: You're correct. This is probably the most sophisticated mobile speech deployment that we've ever seen, and both Nuance and Apple invested heavily in it. The functionality includes command and control, dictation of emails and SMSs

and voice search. It's actually quite remarkable. The T-Mobile 4G Slide probably has the most sophisticated speech functionality after the 4S, so it's probably second to the iPhone, but it's definitely a distant second.

Larry Pugliese: Okay, so there's definitely momentum building for these systems in other applications, right?

Shyam Patil: Yeah, momentum is growing for speech recognition technology, whether it's in healthcare, enterprise or mobile. If you look specifically at mobile, we're seeing interest in automobiles in the U.S. and Europe and also newer areas, such as entertainment, for example, the living room. Nuance recently announced a deal with LG, for example, to add its technology to its television, which is, I think, a quite interesting opportunity going forward.

Larry Pugliese: I would say. Shyam Patil, it's been a pleasure to talk with you, thank you.

Shyam Patil: Thank you.

Larry Pugliese: What happened to the downtrodden consumer, Dan?

Dan Wewer: The downtrodden consumer is willing to spend if they perceive exceptional value in a device.

Larry Pugliese: There you go.

Dan Wewer: For example, if you look at the golf category, the consumer isn't necessarily finding a lot of value in another \$400 driver. On the other hand, that same customer is lined up all day long, spending \$400 or \$500 on a tablet because they do perceive that's a device that can truly change their day-to-day life.

Larry Pugliese: Yeah, that's an excellent point. You also cover some sporting goods retailers, as well; now that you mention golf, that's got me thinking. What do you see ahead for that sector this year?

Dan Wewer: This is a tremendous product cycle for athletic footwear and apparel. We haven't seen a product cycle this compelling in sporting goods in 10 years, even though this is a category that's a luxury, it's a “want,” not a “need,” it's just been amazing the type of sales growth that leading retailers are achieving.

Larry Pugliese: Now, your value retailers, which you cover, are also known for needs, but they do sell wants.

Dan Wewer: We've been bullish on the value retailers because of their focus on lower-priced items. They do sell wants, they

do sell giftable items to low-income families. They're really in the right place at the right time for this kind of economy.

Larry Pugliese: All right, let's switch gears here for just a second, because I know this is another area which you cover – maybe you see growth. Is it in the automotive retailers or in auto parts?

Dan Wewer: We don't see growth with the automotive retailers. Where we do see growth is in the sale of auto parts in the aftermarket. In the U.S., amazing statistic: The average vehicle today is 11 years of age. And what happens when cars get older? They need more repairs. And therefore the demand for the type of parts that they sell is growing.

Larry Pugliese: All right, sir. Dan Wewer, a pleasure. Thank you for joining us.

Dan Wewer: Thank you, Larry.

Larry Pugliese: Samantha Panella covers softline retail for Raymond James and joins us now from New York. Welcome.

Samantha Panella: Thank you.

Larry Pugliese: Having the American stores that you have under coverage, Sam, who deal internationally, have they been affected by the European financial crisis?

Samantha Panella: Yes, they are experiencing challenges with their European business. However, some of it is partially due to their own internal issues with a poor merchandise assortment. But it is challenging in Europe and it certainly is having an effect on their business. And the other part that has taken place over the past year is, with the strength of the foreign currencies, many of these retailers benefited from foreign currency translation with their revenue in 2011 and, as the dollar strengthens, certainly that benefit starts to go away.

Throughout the whole world, this group of retailers focusing on apparel, not only do they have to worry about the consumer confidence level, what's going on in the macro backdrop, be it gasoline prices or political issues, they also need to focus on the fashion. This is going to continue to be an issue for them in 2012, as well as 2020.

When we focus on the U.S., until we see the unemployment numbers come down, I think it's going to still be a very challenging environment for them. It doesn't mean that they can't grow their revenue and grow their business, but it still will be challenging.

Larry Pugliese: And now, challenging doesn't necessarily mean stores dropping off.

Samantha Panella: Retailers are looking at their store base. Certainly they are closing those stores more willingly now than maybe they would have done, you know, before the financial crisis took hold.

Larry Pugliese: Sure.

Samantha Panella: The bigger picture in 2012 and beyond is the growth of the Internet and shopping online, and many retailers are very focused on growing their market share online as well as at the stores.

Larry Pugliese: Is general merchandise that are shipped to these stores, are they going up in price this year?

Samantha Panella: I think in 2012, we could actually see prices come down, and that's primarily because cotton prices have come down from peak levels in March of 2011. We could actually see some retailers passing that savings along to their customer, although we would think that some will try to maintain that margin benefit.

Larry Pugliese: Sam Panella, thanks very much.

Samantha Panella: Thank you.

Larry Pugliese: So, Dave, we've been getting better than expected economic news. Are you more optimistic?

Dave Henwood: Larry, I am becoming somewhat more optimistic about corporate America's ability and willingness to sustain capital expenditure outlays while increasing their hiring rates for new employees in 2012. I'm also more optimistic on the ability of the U.S. economy to sustain a moderate growth and avoid a recession in 2012. I'm not more optimistic about the U.S. budget deficit outlook, the control of excess growth and the \$15 trillion national debt, since Congress cannot agree on an action plan to deal with it and it appears politically gridlocked on the subject.

Also, the problem in Europe dealing with its worsening sovereign debt issues, I expect 2012 U.S. economic growth to be fairly constrained, because I expect consumer spending to be fairly muted growth throughout 2012, while business spending should be up about 5%, and U.S. government and municipal governments will continue to operate under budgetary limitations that continue to constrain spending. I therefore expect GDP growth in 2012 in the 2-3% range.

Larry Pugliese: It's always a pleasure, Dave Henwood. Thank you.

Dave Henwood: Thank you, Larry.

PAUL PURYEAR

Director of Real Estate Research

BUCK HORNE, CFA

Housing and REITs Analyst

LARRY PUGLIESE

Host

Larry Pugliese: Stocks look cheap, fixed income looks expensive and cash is earning nothing. So where can investors go? The life insurance industry underwrote \$15.7 billion in new commercial mortgages in second quarter 2011, the largest volume on record since the American Council of Life Insurers began tracking the number in 1965, representing a doubling of the volume of mortgages underwritten in the first quarter and a nearly 26% increase over the second-highest number on record, \$12.5 billion, reached in fourth quarter 2005. So, seeing an upcycle in commercial real estate and equity REITs, Director of Real Estate Research Paul Puryear watches fundamentals improve. Or at least stabilize. He joins us now with more. Welcome, Paul.

Paul Puryear: Thanks, Larry.

Larry Pugliese: Thanks for being here.

Paul, residential REITs, apartments, as we know, are providing a steady stream of income for investors with, what, 94, 95% occupancy? Is it certainly a sign of the times?

Paul Puryear: It is a sign of the times. We unfortunately put too many Americans into owner-occupied houses during the housing bubble. We underbuilt apartments during that period; very few people realize that. But we built rental stock well below trend, starting in 2004, all the way through 2006 and 7. And it's still well below trend.

So now the shift is we need to take the homeownership rate back to where it was historically, which is 64% and we're thinking maybe it's going to go to 62. We're at 66. Each 100 basis points there represents about a million households. So it looks like very much a sign of the times.

Larry Pugliese: Didn't we hear not too long ago how commercial real estate was the next shoe to drop?

Paul Puryear: It was on the front page. It was a top story for a lot of the media. We wrote about it and talked about it that we just didn't see it as the next shoe to drop. It wasn't that commercial real estate was not going to get worse. It was destined to get worse. But it's a \$5 trillion sector relative to, rough estimate, a \$20 trillion sector for housing. So some collapse in commercial real estate was not going to have near the economic impact that a collapse in housing was having.

Not to mention the fact that we had a very normal correction in the commercial real estate cycle in 2001. We didn't have a correction in housing, that's the cause of all these problems. Consequently, we weren't as over-built. We weren't as over-levered. We just didn't have the issues in commercial real estate. We felt like we saw that. We didn't think it would be as bad as a lot of the prognosticators were saying. And, in fact, it wasn't.

Larry Pugliese: Some folks have no place to go but apartments. You have alluded to that. Rents are not cheap, but fair in most cases, aren't they? Are they actually correlated to GDP, Paul?

Paul Puryear: In some ways they're correlated to GDP in that rents are driven by income levels. Right now, in the U.S., rough estimates, it's hard to get these numbers, we feel like that rental rates as a percentage of income is running at about 17, maybe 18%. Very comfortably, we think the U.S. can move up to 20, 21%, it's been there before. And of course it's very different market to market. So, affordability dictates what happens in housing, period. Whether you're an owner, you're a renter, it's how much can you afford. But it looks like there is room to go with rental rates as a percentage of income, and that of course is part of the call that we've been making for the apartment stocks.

Larry Pugliese: Consumers are slowly chipping away at that huge inventory of homes. Sales of existing homes rose at least 1.4% in October – you probably have more up-to-date figures than I. Are critics correct, Paul, when they say the administration has taken too long and, as a result, home prices are heading for the first triple dip since the 1990s?

Paul Puryear: New home prices are flat. We track both the median existing home price and the median new home prices. New home prices, the home builders are feeling the pressure of cost to push. The cost to build, inflation in materials, it's very tough. They're not making money at these levels. So we don't see the new home price coming down much from here.

There is still pressure on the existing home price from the 4.6 million housing units that are in the foreclosure pipeline. And that's the big issue there. It's going to take some time to clear that. That's what we're all waiting for here, is to clear

that inventory. So, yes, they're probably going to drift a little bit lower into 2012, but we're bouncing on the bottom.

Larry Pugliese: And we're going to hear from Buck Horne with the outlook for the home builders in just a minute.

Yale economist Robert Shiller, co-founder of the Case-Shiller index, said that rather than a recovery in home prices, the best hope would be for stability. Is that what we need?

Paul Puryear: Well, stability is going to precede strength in the housing sector. That's true in any real estate cycle. And stability is defined as what takes place when the excess inventory is absorbed. Whether it's houses or whether it's hotels or office buildings or shopping centers. When you get overbuilt, the first phase of the recovery is filling up. And once you fill up, the landlord has pricing power. And then he can go back to making a margin again. That's where we are in the housing space right now. We still have, by our estimates, 2.6 million – too many empty housing units that we need to fill up. But it's not going to happen in 2012 and probably not going to happen in 2013.

Larry Pugliese: Maybe homeowners will get some help from programs like HARP? If a homeowner is up-to-date on payments, they could get a little help. Do you think that's something that will help us this year?

Paul Puryear: Anything like that helps. But you've got a situation where you need some kind of support here. Is it the best medicine in the long run? We think the government needs to step aside in housing, to some extent. There's been so much involvement. It's created a great standard of living for a lot of people. Affordability, subsidized mortgage rates, interest rates in the 4s. I mean, those are subsidized mortgage rates at the moment. So we have to get back to a free market system. I think if we do that, we can avoid the bubbles in the future.

Larry Pugliese: Wow. OK.

New homes represent approximately 6% of the housing market. Each home built creates an average of three jobs for one year and generates about \$90,000 in taxes, according to the National Association of Home Builders. With his outlook for the home builders ahead, here's Buck Horne joining us. Welcome.

Buck Horne: Thanks, Larry. That's down from a historical rate of about 14 or 15%. So, new homes have really fallen off a cliff and have yet to really recover.

Larry Pugliese: A-ha. OK.

Buck Horne: Larry, you asked Paul about the Shiller index and how the cost of homes would compare to historical rates of inflation or historical levels of income. And what we found actually is that a lot of existing homes out there are trading well below their historical level of replacement cost. If you actually compare the rates of inflation in the commodity cost, called the sticks and the bricks that go into building a single-family house, the producer price index for building a single-family house is up roughly 7%, year on year, and is continuing to accelerate.

So, what we're seeing here is the cost spread – and you can actually see this in two different trends – between the cost of buying a new home versus buying an existing home, the spread between those two prices are as wide as they've ever been historically. In fact, they're now about a 25, 26% discount, if you're buying an existing home relative to paying for a new home.

One thing we think is going to happen that maybe Shiller is missing is that, when we do reach a normalized level of supply and demand and we do have some normalized level of job growth, we expect probably a larger-than-expected snap-back in the price of existing homes as they start to reflect that rising rate of inflation in the core commodity costs and that replacement cost discount narrows. But that's maybe a couple of years off.

Larry Pugliese: Yeah, interesting. How about the outlook for the home builders ahead? What do you see?

Buck Horne: The intermediate term outlook and, really, the near-term outlook, I think fundamentally is basically more of the same. We continue to see a number of headwinds and issues in 2012 for the home builders, mainly related to the mortgage market – that's our number one concern right now, and I think is the largest impediment to getting a real housing recovery off the ground right now. And that relates to the continued tightening of credit standards. You've got lower GSE loan limits, and you also have what we're seeing now is a higher cancellation rate among a lot of realtors with their customers really reaching record levels. The second issue beyond that, of course, is we simply still have too many houses out there.

Larry Pugliese: Of course everyone looks forward to the spring selling season. Any bit of optimism there, Buck?

Buck Horne: Well, there's always optimism around the spring selling season, and we've seen that for a number of years in a row. And the home builders themselves are perpetually an

optimistic crowd. And investors always seem to be willing to take a fresh look anew anytime you reach the turn of the calendar and especially around cyclical sectors, and particularly this is the one cyclical sector that hasn't seen any sign of a real recovery since the beginning of the collapse, call it, in 2006.

If you do have investors or clients that think that 2012 legitimately could be the start of a recovery, we would tell you to stick with the home builders that are larger cap in nature, a little bit more liquid, and also well-run and have a chance of being profitable in 2012.

Larry Pugliese: All right, we'll leave it. Buck Horne, thank you.

Buck Horne: Thank you, Larry.

Larry Pugliese: So I would say a general outlook coming from Paul Puryear is maybe partly cloudy instead of mostly sunny?

Paul Puryear: We're getting there. We believe that the

excesses that were part of the economy from the consumer using his house as an ATM, buying TVs, second, third cars – that's all gone. We're back to the basics. We've really not been in the camp of a double dip because we felt like a lot of the excesses have been stripped out of the economy.

So we feel like we're at some sort of a baseline, economically speaking, for the consumer, barring a shock from Europe. So, we've not been in the double-dip camp. We're in the New Normal camp. These are the reasons why – we just don't have the same push from the housing industry that we've had in past recoveries, and unfortunately we're just not going to get it.

Larry Pugliese: And certainly we don't need any more shocks. As always, a pleasure. Paul Puryear, thank you.

Paul Puryear: Thank you.

BANKING BLUES

ANTHONY POLINI

Banking Analyst

LARRY PUGLIESE

Host

Larry Pugliese: You've heard about the grim new reality for U.S. banks. Slow economic growth, slow loan demand, low interest rates that pressure investment returns, volatile markets that inhibit risk-taking. And tight regulation adding to bulging costs. Standard & Poor's rating services has lowered its credit ratings for many of the world's largest financial institutions, including the biggest banks in the U.S. And recently, you heard the Federal Deposit Insurance Corporation say the nation's 7,436 banks and thrifts posted third-quarter net income of \$35.3 billion. That's up from \$23.8 billion just a year ago, with overall lending activity increasing only slightly.

Raymond James banking analyst Anthony Polini shares his insights and observations with us now.

Anthony Polini: Good morning.

Larry Pugliese: Thank you for joining us.

You know, Anthony, once global fears lessen, do you expect bank stocks to perform well in this slow-growth environment?

Anthony Polini: Yes, we do. In fact, bank stocks tend to outperform better in a slow-growth economy, marked by improved credit quality, accelerating loan growth and discounted valuations.

Larry Pugliese: International Monetary Fund chief Christine Lagarde said on "60 Minutes" regarding increased regulation, was hinting towards arrogance from banks who think they can continue to operate on their terms. Is that a shared sentiment across the pond, Anthony?

Anthony Polini: Well, the anti-banking sentiment is certainly building. The European counterparts are clearly behind the curve compared to the U.S. banks, particularly as regards balance sheet cleanup and fortification. We've raised equity, we've discounted the problem assets. The road ahead is much tougher for these European banks than it is for the U.S. banks, for sure. Keep in mind that each country in Europe typically has five or less banks. So they've always had this grandiose position in their national economic system.

Larry Pugliese: This anti-bank sentiment really just kind of rose up like a behemoth, didn't it?

Anthony Polini: Yes, it did and it's unfortunate. You know, in the U.S., we still try to villainize the big banks, like Bank of America. And these banks were arguably the heroes of the past recession, not the cause. B of A bought Merrill. They tried not to buy Merrill, but U.S. regulators insisted that they close the deal. They bailed out Countrywide. They provided more than \$100 billion every quarter in new credit throughout the recession. Yet we villainize them, and we look at them more as a root cause of the recession, as opposed to one of the cures of the recession.

Larry Pugliese: OK, good points there. How much pressure is on the banks today due to expected minimal capital levels and capital distributions from the 2012 Comprehensive Capital Analysis and Review? Maybe some are not familiar with that, the CCAR program.

Anthony Polini: The CCAR, as you say, is really what is commonly referred to as the stress test. And it's really the third stress for the large U.S. banks. The first one began at the bottom of the past recession, and at that point we were stressing banks to see if their balance sheets were strong enough, how much capital they needed. Now we're testing banks or stress-testing banks to see really who can return excess capital sooner rather than later.

Larry Pugliese: If the banks open up their tight fists for consumers this year, would the outlook for banks be more positive?

Anthony Polini: Well, we think the missing ingredient for a more robust economy and job market has really been a lack of confidence in our national leaders to promote a pro-business environment. And this is no more evident than when you look at line utilization rates for commercial customers. Commercial America, those commercial customers have never been more efficient or more profitable. They're just afraid to expand, hire the incremental employee, because they don't know what government interference or what new policy changes will bear upon the costs of their business. There are plenty of loans available to creditworthy customers, and these big banks are still lending more than \$100 billion a quarter in new credit.

Larry Pugliese: Yeah, now that you say that, it does nothing for the bank if they can't turn lending deposits out at a higher interest rate. No loan growth, as Scott Brown says, no economic growth. Although, as you mention now, commercial lending has been active, hasn't it?

Anthony Polini: Yeah, particularly the commercial real estate. Some markets have been stronger than others. Right now, we certainly have excess deposits.

Larry Pugliese: Yeah.

Anthony Polini: Commercial loan activity in general moved up to a 10% annualized rate. So we're starting to see four, five quarters in a row of increased activity, but it's still low to where it typically would be two years into a recovery.

Larry Pugliese: I guess it's important to also mention Bank of America lost some customers and even dropped one notch in the S&P ratings when it triggered the public outrage and online outcry because of their plan to charge customers the \$5 debit card fees. Now they're under more scrutiny. Just as a result of a huge public relations misstep, Anthony, or is there something else?

Anthony Polini: That's one way to look at it. I think the timing of this \$5 charge was not advisable, given the heated regulatory and political backdrop. But, in essence, we changed the rules of the game midstream, and the banks are just trying to recapture some of the lost revenue.

Larry Pugliese: You know, Alan Greenspan said about the banks, if they're too big to fail, they're too big. Would you add anything to that?

Anthony Polini: No, I'd have to agree with that. And, really, I don't think we have a bank that's too big to fail in the U.S. I think the problem is more international and more on a global perspective. One thing we haven't really tested have been these swaps and derivatives and the counterparty risk. We did test it to some extent with Lehman, and the market moved without a hiccup. But if we were to lose a big French or German bank, you get the uncomfortable feeling that, even if your net exposure is limited, that you may only be as strong as your weakest, largest counterparty. That's something that is still certainly a big question mark.

Larry Pugliese: All right. Anthony Polini, always a pleasure. Thanks very much.

Anthony Polini: Thank you.

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