

INVESTMENT OUTLOOK

**DIXON, HUBARD, FEINOUR
& BROWN, INC.** *investment
counsel*

- ◆ Stocks flat for the year.
- ◆ Volatility dominates markets.
- ◆ U.S. economy showing steady improvement.

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2011 could have been a big year. It began as a year filled with big risks and big opportunities. It was the year that the

politicians in the U.S. were supposed to come together and chart a course to renewed growth and long-term fiscal responsibility. It was the year that Europe was supposed to deal decisively with the sovereign debt crisis. It was the year before a presidential election, a year when stocks have always gone up. The world watched and waited. Congress and the White House argued and postured. The Europeans fretted and dithered. The markets gyrated. The year ended. A lot happened, but not much changed.

For the year, U.S. equity markets were more or less flat. The large-cap Dow gained a bit, and the small-cap Russell lost a bit. International markets, both developed and emerging, fared poorly and posted significant declines. Gold and, ironically, U.S. Treasury bonds were the big winners. With a strong gain in the fourth quarter, stocks reversed much of the third quarter decline and buoyed hopes that a renewed uptrend may be underway.

Clearly, the investment theme of the past year was

Fourth Quarter 2011 Review and Outlook For 2012

by Whitney Brown

volatility. In a world where political issues, and individual political figures, have become so entwined with the resolution of major economic issues, markets have found it very difficult to anticipate which way to go. Investors have not been able to decide whether they should be anxious and fearful or optimistic and intrepid. The result has been a trendless and very choppy investment climate.

In sum, 2011 served as a reality check. Investors have come to realize that there will be no “grand bargains” or quick fixes to what ails the over-indebted developed world. Frustratingly, the major global concerns that loomed at this time last year remain, seeming no closer to resolution. European policymakers have allowed circumstances to run well ahead of their efforts to stem the debt crisis and made any eventual solution even more difficult, costly and painful. In the U.S., our failure to agree on effective measures for long-term deficit reduction mean that the problem will fester until at least early 2013 when a new Congress and, perhaps, a new president will be forced to take the matter up.

So far, the markets have been very patient with the U.S. deficit situation. Treasury bond yields remain near historic lows despite the credit downgrade last August. For the time being, the U.S. still benefits from having the world’s reserve currency, and our bonds and blue chip stocks are considered safe havens among global investors. If Washington does not make a credible effort to reverse our fiscal imbalances soon after this year’s elections, the market may impose its own form of discipline as it is doing now in Europe.

In a lighter vein, there are some areas of positive development. In the U.S., we have the largest and most diverse economy in the world, and it is proving its resilience. Signs of life in the housing market are emerging, now that prices have corrected from the bubble and the supply of homes for sale is more in line with demand. Labor markets are showing steady improvement with declines in the unemployment rate

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<u>Market Measures</u>	<u>4th Qtr</u>	<u>YTD</u>
S & P 500 (price)	11.1%	0.0%
Dow Jones Industrial Average	11.9%	5.5%
NASDAQ Composite	7.9%	-1.8%
Russell 2000	15.0%	-5.5%
MSCI EAFE	2.86%	-14.8%
Barclays Capital Inter Gov't/Credit Bond Index	0.8%	5.8%
	<u>12/31/11</u>	<u>12/31/10</u>
10-Year Treasury Bond Yield	1.87%	3.29%
Three-month Treasury Bill Yield	0.01%	0.12%

Fourth Quarter 2011 Review and Outlook For 2012 (continued)

(Continued from page 1)

and claims for jobless benefits. Modest GDP growth appears to be sustainable after a double dip recession scare last year.

In the developing world, the major players have had to take measures to slow their economies in order to control inflation. At this time both China and Brazil appear to be having success in damping inflation without killing growth. Going forward, growth should reaccelerate and be reflected in improving stock prices in those markets. The developing economies of China, Brazil, India and others offer a truly compelling long-term growth story, and the period of retrenchment faced by Europe and the U.S. will only serve to increase the role that those countries play as drivers of the global economy.

At this time of year, the financial press is filled with various predictions of how the year ahead will play out. The consensus seems to be that uncertainty is high and nobody has a very clear idea of how the year will go. A nearly unanimous prediction is that the markets will continue to experience a high degree of volatility. That's not a very useful prediction, but it is an easy call to make considering the conflicting goals that policy makers face. They need to stimulate the economy to promote income and job growth

now, yet introduce fiscal austerity to reduce budget deficits in the long run. The Federal Reserve's determination to keep the economy pumped full of easy money that consumers and business are either unwilling or unable to borrow only adds to the potential for market miscues.

2012 will be an interesting year. Time is running out for Europe to come up with an orderly plan for a way forward. Elections in the U.S. may prove pivotal in determining the long-term path we take toward handling our fiscal issues. After the past year's reality check, expectations are low, and there is a tremendous amount of negative news priced into the markets. We would not be surprised to see a little good news go a long way in reviving the stock market. An unexpected breakthrough on the deficit front in the U.S. or the debt crisis in Europe would be especially positive.

The most promising areas for investment should include U.S. and emerging markets stocks as well as corporate and municipal bonds. U.S. government bonds offer subpar returns, and longer dated maturities could be very volatile if interest rates rise unexpectedly. In this uncertain climate it will be best to stick with good quality assets, remain flexible and expect to be surprised.

A Resolution for the New Year: Update Your IRA Beneficiaries by Ted Feinour



At the beginning of each year, people often make a list of resolutions that they want to follow in the coming months. Reviewing important records can become a useful recurring event as one of your New Year's resolutions, thereby making sure that your financial records are timely and that legal documents accurately reflect your intentions. With ever increasing governmental regulations, we are also required to keep important financial records and information for clients of our firm.

One form that often is overlooked when reviewing documents is the Individual Retirement Account Beneficiary Designation Form. If our firm manages your IRA or Rollover IRA, we should have this IRA Beneficiary Designation on file. If circumstances have changed and the primary beneficiary designation is no longer applicable (e.g. death of the beneficiary), new forms reflecting updated beneficiaries should be completed. If you named your children as beneficiaries and over time their names have changed (e.g. due to marriage), those changes should be noted on a new beneficiary designation. In many cases, people only name a primary beneficiary and no contingent beneficiaries, creating a potential problem if the primary

beneficiary has predeceased the account holder. It is also a good time to review the percentages awarded to primary and contingent beneficiaries to ensure they remain appropriate and applicable.

You may change your IRA beneficiary designation at any time and as often as you wish. Such designations must be in writing. We will gladly help you review the beneficiary designation that we have on file for your IRA to ensure that all of the information is still applicable and accurate.

On another note, as of this writing no decision has been made to extend the ability to make charitable donations from IRAs as part of one's required minimum distribution (RMD). Once regulations have been decided, we will give you an update. Would-be IRA donors should be aware that a similar lapse in 2010 led to many missed opportunities to use charitable donations to satisfy the RMD. Since Congress waited until December of that year to reinstate the provision, many IRA owners had already taken their distributions. The general advice for 2012 is to wait as long as possible before taking your RMD in case Congress belatedly restores the provision.

Is the Gold Bull Market Still Intact? by Stebbins Hubard



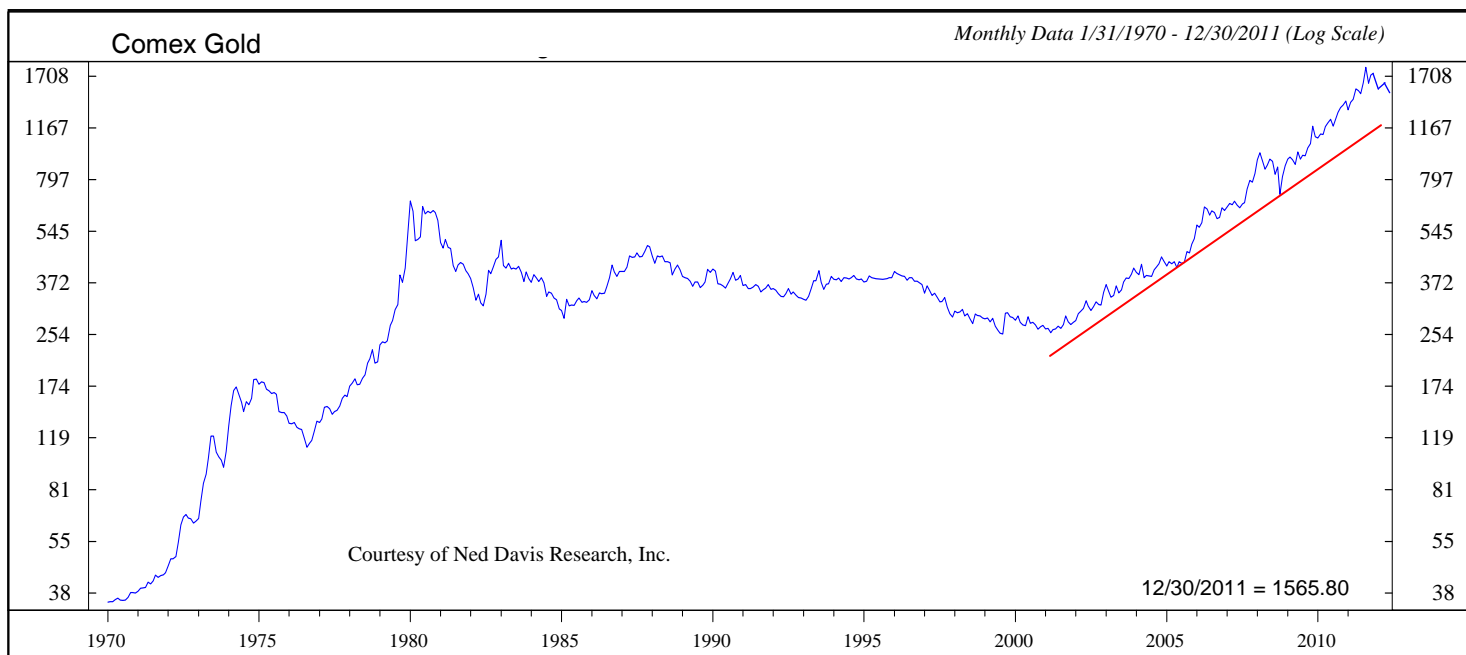
While some headlines are predicting the end of the bull market for gold, many analysts remain bullish on the yellow metal. However, all agree that more volatility should be expected. Does the recent sharp fall in gold prices mark a massive buying opportunity or signal the end of the decade long bull run - as many would suggest? Gold adheres to relationships with other assets such as the dollar, equities and oil. It also reflects the balance of supply/demand fundamentals, and it echoes sentiment about the broader global economic outlook.

During its recent price decline, gold failed to uphold its role as a safe haven asset. Gold should have reflected the deepening world economic crisis. However, gold upholds other—equally strong—relationships. The U.S. dollar is one in particular. The dollar index had been very oversold. It fell to a strong technical support level and then rallied back, promoting a corresponding fall in gold prices. The dollar strength may reflect a deepening liquidity crisis (and the need for cash), something that many banks and businesses will struggle with. The current financial crisis in Europe has shades of the 2008 Lehman crisis about it in terms of dollar versus gold price action, where there was a scramble for liquidity (and gold fell) followed by a flight to safety (and gold rallied).

The dollar strength may be warranted on a

fundamental basis. There are modest grounds for economic optimism given that United States growth rose from sub 1% in the first half of 2011 to 2% in the third quarter and a hoped for 3% in the fourth quarter. Unemployment has eased from 9% to 8.5%. Granted that the growth has been driven by stimulus that may roll off at the end of the year, it remains to be seen how well the United States can wean itself off those growth enhancers. With Asia beginning to falter it may fall to the United States to again provide the engine for growth.

On balance, the fundamental factors which have been driving gold onwards and upwards for the past several years all still seem to be in place, and on those grounds the current fall could well prove to be just a major correction with the price having overshot in August/September. It probably is wrong to assume the secular gold bull run is over - between 1963 and 1978 gold saw two 20% corrections and a 40% fall before it went exponential in 1977. Then from early 1980 until mid 1983 gold experienced a 50% correction leading into a sideways market for 18 years. Starting in 2001 gold has been in an uptrend, taking the price up over 500%. From the chart below it is obvious that gold has undergone a significant pre-Christmas selloff, however the ten-year uptrend has not been broken. This may very well be a good opportunity to get in before gold continues its upward trend.



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Update on U.S. Gas Drilling by Watt Dixon



The same drilling technologies that have unlocked large amounts of crude and natural gas from shale formations across the U.S. are now producing large amounts of gas liquids. Ethane, propane and butane are known as natural gas liquids. Ethane, in particular, is used heavily in the making of plastics. The manufacturing of plastic packaging and grocery bags relies heavily on ethane for production. “If chemical companies were bakeries, ethane would be the flour”, said Cal Dooley the president of the American Chemical Council.

This new found supply of gas liquids has resuscitated the U.S. petrochemical industry. Just a few years ago, this industry was struggling due to the high cost of raw materials. Processing ethane into useful chemicals is 50% cheaper than using crude oil derived naphtha. Demand for ethane has grown to about 933,000 barrels a day during the first half of 2011, up from 812,000 barrels a day in 2009. An inadequate supply of pipelines that carry ethane drove the price to 95 cents per gallon up from 60 cents at the start of this year. However, even with the price spike, chemical companies prefer ethane over other chemicals for the production of certain plastics.

The boom has turned into a potential profit center for oil and gas producers, as well as for the pipeline companies that transport the fuel. Ethane is hard to transport. Therefore,

ethane plants, known as “Ethane Crackers” may need to be built near these reserves of ethane. Crackers are part of the chain of manufacturing plants that break byproducts of drilling into their constituent parts for further processing. Drilling for natural gas is well under way in the Marcellus Shale region. This region comprises large parts of Pennsylvania, West Virginia, and Ohio. With each ethane cracker representing about \$1 to \$2 billion of investment, and hundreds of construction jobs created, all three states are scrambling to get an ethane cracker built in their respective state.

As with drilling for natural gas, drilling for ethane involves the new environmentally controversial technique known as fracking. In its simplest form, fracking occurs when water, sand and chemicals are shot at very high speeds into potential natural gas and gas liquid reserves. The force is intended to break up rock formations, thus releasing the gas or gas liquid reserves. The run off of these chemicals is what concerns people. Another concern is that the waste water from fracking is not being properly treated in water treatment plants and is making its way into drinking water. Despite precautions taken by drilling companies, ground water contamination has occurred in Wyoming due to fracking.

There are a number of companies, such as pipeline suppliers or drillers, that may profit from these gas and gas liquids reserves. But at present, there are some environmental questions that could limit production in the coming years.