Investment Tally & Perspective

Lincoln Capital Corporation

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U.S. markets were primarily influenced by three factors in the first quarter and prior two years – continued stimulus from the Fed, the rate of growth in China, and developments in Europe related to their debt crisis. These events will continue to impact markets in coming months and years. This issue reviews some of the major concerns facing policymakers and investors.

THE ECONOMY

The Recent Past and Short Term Overview

The economic recovery from the 2008-2009 financial crisis/recession is now three years old, yet even with massive amounts of fiscal and monetary stimulus, the pace of recovery is quite weak when compared to prior post-recession periods. Why?

The main issue is that global economies are dealing with a "balance sheet recession". This was derived from decades of encouraging consumers to borrow money to finance consumption and asset purchases, with real estate being the primary target and collateral for borrowed funds (see graph on Page 3). Since the housing boom turned into a housing bust, over indebted households, businesses and governments have been working through the arduous process of rightsizing their budgets and balance sheets. While most businesses are now in solid financial shape and households are making progress, governments at all levels in the U.S., Europe and elsewhere have much, if not most, of the hard work ahead of them. Though necessary and painful, deleveraging (reducing debt) impedes current economic activity.

Business leaders and investors recognize that central bankers and governments have very little experience with these issues, which creates a great deal of uncertainty. The high degree of policy risk, as well as the significant risk of both inflation and deflation, further impedes economic activity as businesses and investors become more uncertain, thereby more cautious in making new investments.

Growth Will Continue

The two main factors that produce increasing economic activity are population growth and increased productivity. World populations have risen throughout time and this trend is expected to continue in coming decades. Growing populations require, and desire, more goods and services, and an increasing number of people producing more goods and services, combined with increased productivity, lead to GDP growth and increased standards of living.

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MAJOR INDUSTRIALIZED COUNTRIES

	2012 Est. GDP	Unemployment	Consumer Prices	Budget Balance	Int. Rate 10-Yr Gov't
Britain	0.5%	8.4%	2.8%	-7.6%	2.25%
Canada	2.1%	7.4%	2.2%	-3.5%	2.19%
France	0.1%	10.0%	2.3%	-4.7%	2.92%
Germany	0.6%	6.7%	2.2%	-1.3%	1.87%
Italy	-1.6%	9.3%	2.8%	-2.2%	5.16%
Japan	1.6%	4.5%	-0.1%	-8.3%	1.04%
Spain	-1.3%	23.6%	1.8%	-6.5%	5.27%
Switzerland	0.7%	3.1%	-0.3%	-0.3%	0.87%
United States	2.1%	8.3%	2.4%	-7.8%	2.28%

Note: Interest rates in bold are Euro currency rates.

Data from The Economist, April 7, 2012

EQUITY INDEX RETURNS

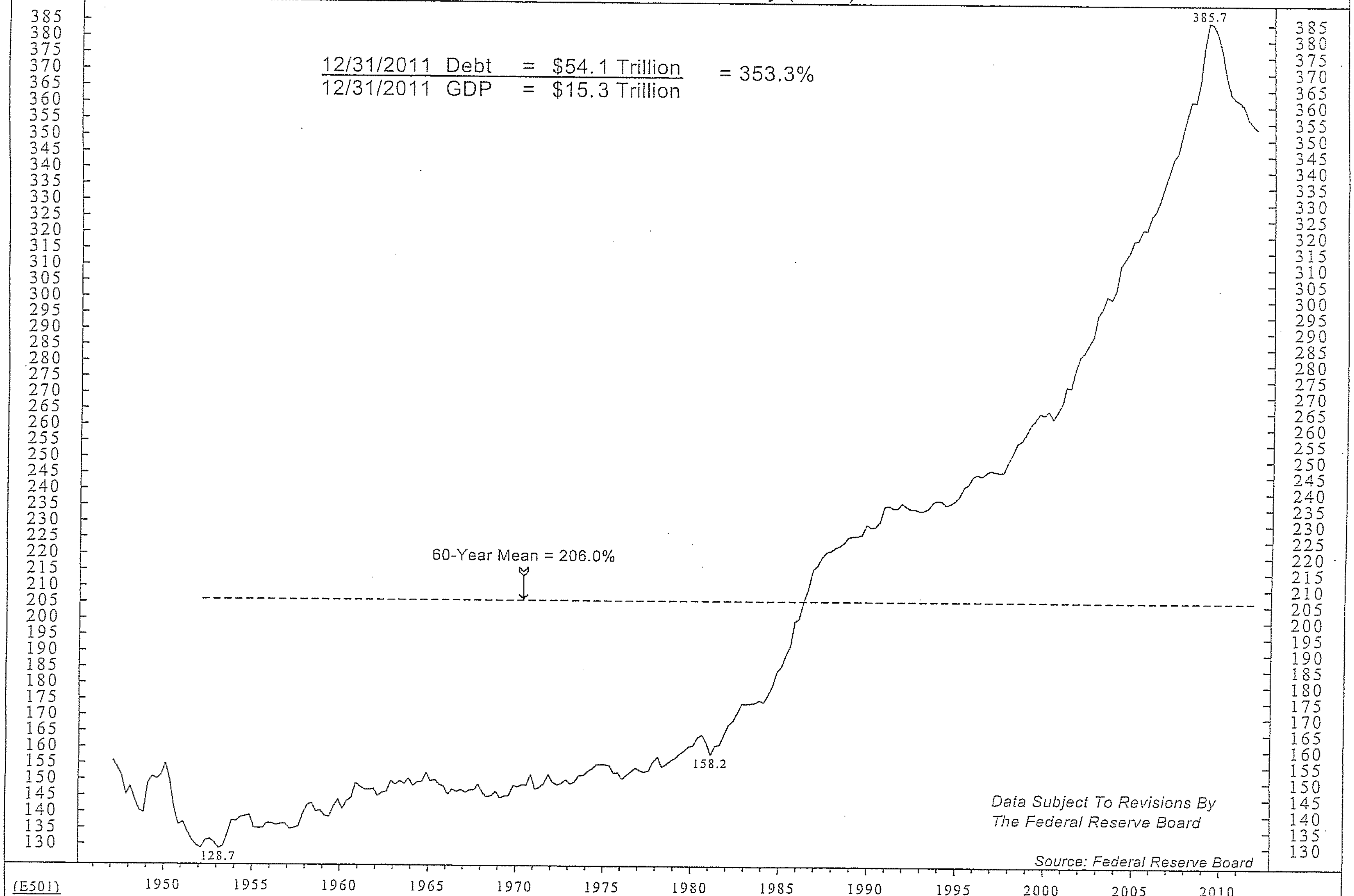
Period Ending March 31, 2012

				Average Annual Returns		
	First Qtr 2012	03/31/11 - 03/31/12	2011	3 Year	5 Year	10 Year
S&P 500	12.66%	8.70%	2.14%	23.38%	1.97%	4.10%
NASDAQ Composite	18.67%	11.16%	-1.80%	26.52%	5.01%	5.31%
Dow Jones Ind. Average	8.91%	10.17%	8.35%	23.55%	4.17%	5.04%
Russell 2000	12.06%	-1.57%	-5.45%	25.28%	0.73%	5.08%
MS World Stock	10.62%	-1.72%	-7.34%	17.71%	-2.83%	2.70%

Data from Interactive Data Corp.

Total Credit Market Debt (All Sectors) as a % of the Economy (GDP)

Quarterly Data 3/31/1946 - 12/31/2011



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Yet, strong sustainable economic growth is rare these days, as many countries have relied on rapid credit growth to push activity to artificially high levels. Now, most major developed economies are facing a long period of mediocre growth against a background of private sector caution and fiscal restraint. This will change over time as governments and citizens are forced to make necessary adjustments. Meanwhile, the emerging world still has the potential to achieve strong productivity growth, as underemployed people move from agriculture to industrial jobs, and large infrastructure projects are undertaken.

Together, continued growth in the emerging countries combined with structural changes in the developed world will lead to increased productivity and populations, and higher living standards in the years ahead.

OUR VIEW OF THE MARKETS

The recent stock market rally was mainly fueled by central bank liquidity and rate suppression, forcing investors to take more risk. Numerous technical measures of market activity were indicating internal market weakness, or warning signs of trouble ahead. An optimistic long term view on equity prices, which we have, will require companies to invest more in growth and governments to restore order to their finances. While changes will not be easy and without setbacks, we do expect coming months will bring transformations leading us to become more aggressive.

Positive developments in the following areas would support a more bullish investment strategy.

- Consumers and businesses do not know what lies ahead in vital areas such as tax policy and healthcare. This uncertainty will diminish after the Supreme Court healthcare ruling and the elections, and markets may anticipate the outcomes beforehand.
- Fiscal actions that address structural imbalances in federal budgets, debt levels, unfunded liabilities (Medicare, Social Security) and resolve the "Fiscal Cliff".
- European Debt Crisis – With much of the continent in recession, resolving their debt crisis will take a long time, yet markets would applaud credible actions that address budget and debt levels.
- China is a major economic force, and fears of their economy suffering a hard landing are widespread with global repercussions. While their data is filtered and the risk of policy errors are significant, signs of continued growth would support higher activity levels worldwide and be a positive for markets.
- The Fed – It is clear that past periods of low interest rates engineered by the Fed were prime contributors to asset bubbles (tech, housing) which ended badly. Fed actions since the financial crisis may have been necessary to prevent a depression, yet there is no clear plan to unwind their extraordinary actions. Credible information on Fed plans to return policy to near normal would greatly reduce fears of businesses and investors.

In closing, the correction we have been anticipating now appears to be underway. As time and events march on, we expect more clarity on the uncertainties noted above. As the skies clear, investment opportunities will become more visible and patience will be rewarded.