



## The PM Who Fell to Earth

By David Hay

### Points of Interest

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*"For tomorrow  
belongs to the  
people who prepare  
for it today."*

-African Proverb

In the investing game, PM is the petite abbreviation for portfolio manager. Much like weather forecasters, individuals in the portfolio management field necessarily need to have opinions about what is likely to happen in the future. And, despite our best efforts and sophisticated tools, we often wind up, much like our local meteorologists, with some egg on our faces—not an entire frittata.

Yet, in a way, this actualized my highest conviction prediction for last year—namely, that 2010 was “likely to be rich in embarrassment and generous helpings of humble pie.” As I also noted at the time, when you play the guru-game you better be satisfied with a 60% to 70% success rate. Otherwise, you will eventually need to be fitted with one of those sport coats that button in the back.

Those of you with exceptional memories might recall that 2009 was my tour de force when it came to ascertaining which way the winds were blowing with a miraculous on-target number of 90%. 2010, alas, contained a cold splash of reality as my accuracy rate plunged to a much more human 65%; in other words, quite a comedown (or, as some less charitably inclined might say, comeuppance).

Therefore, when you consider that I was due for some serious payback, coming in around the realistic average wasn't too shabby, even though it still felt like little more than an exercise in dart throwing.

In the interest of brevity, especially when it comes to looking back, let me just highlight a few of my 2010 predictions (for those of you who want the complete “box score,” please see the summary below):

Forecast #1: Economy: Strong start, no double dip	1/1
Forecast #2: Stocks: Quick start before selling off	0.5/1
Forecast #3: Bonds: Liked 10 years as well as corporate bonds and preferreds	0.5/1
Forecast #4: High Beta investments: Struggle throughout year	0/1
Forecast #5: The Credit crunch: Problems in Europe due to PIGS	1/1
Forecast #6: The Fed: No increase in rates	1/1
Forecast #7: Inflation: No rise in US, inflation risk in Asia.	0.5/1
Forecast #8: Overseas markets: struggles in China and Europe	0.5/1
Forecast #9: The Dollar: Would rise for Euro and Yen	0.5/1
Forecast #10: Politics: GOP landslide and presidential move toward the center	1/1
<b>Total: 6.5/10. 65%</b>	



**The Economy.** My prediction in this regard was pretty much a bull's eye. The year started off strong then decelerated as it progressed. Further, I anticipated that fears of a double dip would flare up, but be proven wrong, and that is essentially how it played out.

**The Credit Crunch.** This was one of my better calls (the kind I like to highlight!). My view was that the tentacles of the great Credit Cataclysm would stretch into 2010 and they did, particularly on the other side of the Atlantic. The best part of my call on this theme was that there was "an untenable situation in Europe where the PIGS (Portugal, Italy, Greece, and Spain) are caught between an overvalued euro and exploding debt levels."

Moreover, I warned about China, where I noted that officials were increasingly alarmed about a potential real estate bubble. In fact, they tightened money in a number of ways, causing the Chinese market to be a stark underperformer.

**Overseas Markets.** Like a number of my 2010 calls, this was another almost spot-on forecast. My view was that the emerging inflation issue in China and measures to rein in the country's property market would lead to underperformance versus the US. In the case of China, this was most definitely true. I doubt most Americans realize the Chinese stock market *fell* 14% in 2010. Additionally, the most venerable of all the international indexes, the Morgan Stanley EAFE (Europe, Asia, Far East) was up just 7.7%, held back, as I speculated, by weakness in the eurozone.

Remarkably, the vaunted BRIC (Brazil, Russia, India, and China) markets returned a mere 6.5% on an equally weighted basis. In reality, however, I believe most investors bet more heavily on the darlings going into 2010, China and Brazil. The latter rose a barely perceptible 1%; therefore, those two booming economies managed to produce a combined return of *minus* 6.5%. In reality, it was the more obscure emerging markets that delivered last year, driving the index up nearly 19%.

Therefore, one could make the case that I pretty much had this one down, but given that the emerging markets in aggre-

gate were up more than the US market, despite the drag from the BRICs, I'm putting it down as a partial score.

### **Now, on to our 2011 predictions...**

**1. Stocks.** Stocks will replay their volatile act from last year, but I suspect the rhythm will be different. However, I do think we could get some surprisingly good news on the budget front that might produce another double-digit year. My range for stock returns: +5% to +10%. But I believe more bad news out of Europe, inflations fears in the emerging world, and rising distress with a few important municipal credits will shake up the complacency, triggering a sharp sell-off early in the year and thereby setting the stage for another up-leg.

**2. Bonds.** In 2011, we see the best gains coming from the battered muni market, followed by mid-single-digit returns on corporate debt and around break-even to slightly negative on Treasuries. Expect plenty of volatility from these normally tranquil investments, however.

**3. The Economy.** With stocks having recovered and likely to stay in a jagged upward trend, the surprisingly strong holiday spending we just saw at the end of 2010 might portend more of the same for this year. Moreover, the biggest positive I see bubbling up throughout 2011 is a steady increase in confidence. In my opinion, businesses will also get caught up in this better karma, leading them to at long last go on a hiring binge, further uplifting consumer spirits and, therefore, causing yet stronger activity and more job growth.

**4. Junk Bonds and Risky Investments.** It continues to be my view that the better junk (forgive the oxymoron) will produce decent returns while at some point during 2011 the weakest slices are likely to get seriously lacerated. Eventually, I also foresee overly popular small cap stocks and commodities experiencing a major day of reckoning after extreme upward moves. Dislocations in China due to its various excesses, notably in real estate, could cause things like copper to come a cropper. It just might not happen in 2011 given a generally improving economic backdrop.



**5. The Fed.** My view is that Ben Bernanke will need to halt or reverse QEII at some point during the year as it becomes clear that job growth is resuming, confidence is returning, and the all-important velocity of money accelerates. However, it's improbable the Fed will actually raise rates, though I think that's somewhat of a possibility late in the year.

**6. Inflation.** Fears of its eruption are likely to be greatly exaggerated. While the Fed's bag of tricks is getting pretty light when it comes to fighting deflation, it has ample weapons to nip any budding inflationary forces. In my view, the Fed will begin selling a portion of its \$2 trillion government debt hoard well before it contemplates any actual fed funds rate increases.

**7. Overseas Markets.** Put me down as mixed in this regard. My belief is that Europe will face a moment of truth in the near future and be forced to solve some of the core problems that it has been sweeping under the antique rugs in Brussels ever since the European Union was formed. Thus, a serious sell-off impacting global markets is a distinct possibility. As far as everybody's favorite foreign investment, emerging markets, I believe we'll see pretty much a replay of 2010—some up a lot, some hit hard, many in the middle, but overall you should make as much through blue chip US stocks with a lot less heartburn.

**8. Currencies.** This is an area where I think there is good money to be made and we have been positioning accordingly for our clients via securities that appreciate should the yen and euro decline. Further weakness in the euro is highly probable as it's an absolutely essential element in preventing the weaker Continental countries from devolving into chaos.

**9. The Budget Deficit.** States do it, cities do it, even European elites do it, let's fall in love—with spending cuts, that is. At the federal level, the president's upcoming

budget proposal might be surprising in its fiscal toughness, possibly embracing key elements of the Simpson-Bowles plan that can realistically bend the otherwise terrifying budgetary cost curve. A convincing bipartisan effort to rekindle the fiscal magic of the 1990s would definitely take a lot of folks by surprise, giving the stock market rally further impetus.

**10. Unemployment.** There are already signs a major turn is at hand but various forces have inhibited the normal employment cycle. Recently, however, the closely followed ADP payroll survey revealed almost 300,000 new jobs, the biggest increase in its 10-year history. Additional olive branches from the Obama administration to the business community—such as providing firms with reduced taxation on repatriating overseas cash or, most importantly, a major Tax Code revision lowering the corporate tax rate—could really juice hiring.

In conclusion, we expect 2011 to be less lucrative for our clients' portfolios than 2010. Nevertheless, we anticipate one or two outstanding opportunities as less committed investors panic due to scary headlines that are almost certain to occur from time to time. If so, others' pain will turn out to be our clients' gain.

—David Hay, Chief Investment Officer, Evergreen Capital Mgmt, LLC

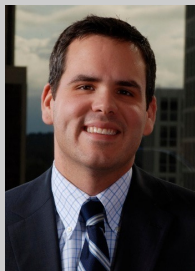
#### ***Evergreen is Ever-growing...***

- ◆ ***Our new office in Portland is now open!*** We are very excited at ECM to announce the expansion of our firm and the opening of our new office in Portland, Oregon.
- ◆ ***Welcome David Meyer!*** We are very happy to announce a new client relationship manager. David will be working out of Portland, Oregon office and will have a major role in expanding our client base.

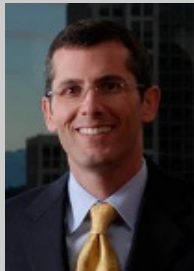
*Important Disclosure: Past performance is not indicative of future results. Evergreen Capital Management's performance returns are calculated net of fees and includes the performance of money market, equity such as ETFs, individual equities, fixed income and other liquid marketable securities. Evergreen's performance reflects the reinvestment of dividends. Investments have the possibility of loss including principal.*



*It Takes A Team...  
Your Evergreen Team*



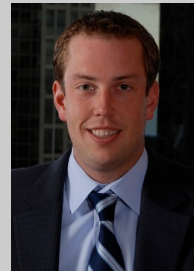
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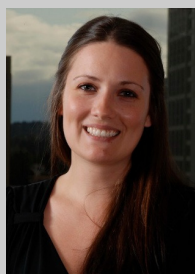
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