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INTRODUCTION – Chase Investment Counsel Corporation’s investment process is “bottom up” and driven by our portfolio management methodology. For clients, consultants and financial planners who are interested, we believe these factors influence the current investment outlook.

RISK FACTORS

April marks the end of the seasonally best six months for the DJIA and S&P 500; already Stock Traders Almanac has issued its seasonal (MACD), technical sell signal. Their similar 4/9/10 and 4/13/11 signals proved very timely with the market topping shortly thereafter followed by 16% and 19% declines. Recently Investors Intelligence reported the lowest level of bearish advisors since last July when the market was on the verge of new recovery highs but declined 19% instead.

Richard Koo, who first warned of the U.S. balance sheet recession and Nouriel Roubini, who was one of the first to predict our housing collapse, are both warning of a coming European recession/depression. While Europe is not a big market for U.S. companies, it has a significant psychological affect on U.S. investors and certainly our multinational banks would be affected.

The tone of the market seemed to change after April 3rd when FOMC minutes were released and it appeared that further stimulus (QEIII) was not likely as more evidence of business recovery seemed to change the Fed emphasis. There was even a hint of some foreseeable restraint if inflation increases. Certainly money printing by 4 major Central Banks which has increased their balance sheets by over \$4½ trillion in the last 3½ years has fueled much of the global stock market rallies during the past few years. Last year the Fed purchased a huge 61% of the total net Treasury issuance, in effect subsidizing U.S. Government spending by expansion of its balance sheet and keeping interest rates abnormally low.

As Ian McAvity (Deliberations) opines, “with a host of tax increases scheduled to be effective in 2013 unless the so-called Bush tax-cuts are extended again, it’s hard to imagine that a forward looking market isn’t going to start to worry about them.” Already corporate insider selling has recently been near record levels. Moreover, higher gasoline prices also impact consumer spending much like a tax.

Our balance sheet recession caused by excessive debt and collapsing net worth will take many years of deleveraging restraint on economic growth especially as the savings rate likely rises to more normal levels. Consumer purchasing power remains weak amongst signs of excess inventory build up. Entitlement spending is overwhelming the budget. Health care costs alone are on track to reach \$4.6 trillion by the end of this decade. In very simplistic terms, thanks to the insightful blog “Things That Make You Go Hmmm,” if the U.S. Government was a family, it would be making \$58,000 a year, spending \$75,000 per year and already have \$327,000 in credit card debt. If you add the ‘Social Security lock box’ \$4.7 trillion, the formal guarantees put on the GSEs like Fannie Mae, Freddie Mac, etc. as well as state and local government debt, the total



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of all government debt is estimated at 159% of GDP. Greece was recently at 152%.

We continue to worry that free world equity markets, especially natural resource stocks, are placing so much emphasis on demand from China whose housing market is weakening and export growth stalling. Any significant economic slowing there could trigger substantial declines especially in our commodity oriented markets. The Shanghai Stock market is down almost 25%, from its April 2011 high.

Global markets generally seem to have topped out. With the exception of the USA, virtually every major foreign equity index is significantly below its 2011 high.

POSITIVE FACTORS

Lowry's Research has been on an Intermediate Trend Buy-signal since February 23rd and on balance their studies suggest that both the intermediate and primary uptrends remain healthy. A conventional short-term sell signal was registered on March 29th, but their studies suggest that a near term correction should be modest. They do caution that we are in the 38th month of a bull market, close to the 39 month average length over the past 80 years. Accordingly they would do only selective buying and be alert to any developing characteristics that normally preceded substantial declines such as lagging Advance-Decline lines, a series of 90% down days, weakness in Lowry's Buying Power Index, or strength in their Selling-Pressure Index.

Since 1950 when the S&P 500 was up in January, as it was in 2012, the whole year has been up 88.5% of the time. Moreover full years followed January's direction in 11 of the last 15 Presidential election years with only 2 misses in up Januaries.

The Leuthold valuation figures still seem consistent with holding stocks especially in a low yield low inflation environment. By March 31st the S&P was at a normalized 20.4x P/E, or 9% above the Leuthold Group calculated historical (1957 to date) median "Adjusted EPS" P/E valuation level of 18.6x. Adjusted for periods back to 1926 when the CPI was low (less than +3%), the

S&P 500 would need to rise 2%; while the S&P Industrials would need to decline 10%, to reach that median. For perspective, in secular bear markets like 1973-4 and 2007-9 a decline to the bottom quartile of the normalized median (1957 to date) would involve -30% for the S&P 500. On March 31st its non normalized Operating EPS P/E of 13.8x was well below the 16.5x median. Using a \$105 estimate for S&P 500 operating earnings, a somewhat conservative 14.5x P/E would support a price just over 1500 for 2012.

Recent economic and sentiment indicators suggest at least moderate growth. The Conference Board Index of Leading Economic Indicators (LEI) increased 0.7% in February. That is its fifth consecutive monthly increase and puts it up 3% y-o-y which is above its historical average of 2.5%. The Philadelphia Fed Index on the economy for February was +2.3%. It is usually in the range of +10 to -10 although it collapsed to -30.7% last August. The University of Michigan Consumer Sentiment Index rose to 76.2 in March.

Despite low yields, on 3/31/12 Money Market funds were at \$2.6 trillion, about 15.9% of NDR Total Stock Market Values. Some of that cash may be invested in equities by investors seeking higher yields, since 39.1% of S&P 500 stocks have annual dividend yields greater than 10-year Treasuries, or trying to hedge against dollar devaluation and inflation. In fact, since mid 2008, there has been an inverse correlation between the U.S. Dollar and the S&P 500.

Although manufacturing employment has declined, U.S. manufacturing output has risen substantially reflecting the dramatic rise in productivity. Our GDP of around \$47,000 per capita (IMF 2008) was still #1 exceeding #2 Hong Kong by about \$3,000 and #3 Canada by about \$8,000. By comparison, China was only about \$6,000 per capita in 2008, maybe \$8,500 now, which accounts for why its able to develop so rapidly.

CONCLUSION

In view of the overall economic uncertainties investors seem overly complacent; The VIX (CBOE



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Market Volatility Index) at 15 was recently near a multiyear low. Certainly that doesn't reflect the risk of at least a moderate correction.

Corporate profits are expected to continue to improve although at reduced rates. Investor psychology will be a major determinant bolstered by the Presidential Cycle which projects good equity gains in an election year.

Nadeem Walayat (The Market Oracle Newsletter) emphasizes long term investors recognize that equity indexes reflect the inflationary growth spiral of corporate revenues and earnings reflecting rising commodity and consumer prices fueled by perpetual currency debasement and enhanced by increasing worker productivity. Many investors will want to gradually accumulate strong companies and our domestic economy seems better than most.

We frequently remind clients of a 35-year (420 month) study that found if you were out of the market just 5% of the time and missed the best 22 months, your 35-year gain would have been only 14% as much as the return on the S&P 500, even less than just holding T-bills. Another very long term study found that if you could avoid just the 10 worst days, the gain on the Dow tripled. For equity accounts which require us to remain fully invested, we believe emphasizing attractively priced, good quality stocks of growing companies is the

soundest approach.

Our separate equity account composite which on average is comprised of A rated stocks did well to keep up with the Russell 1000[®] Growth Index during the first quarter when low quality stocks and cyclical sectors outperformed. The performance of the B of A Merrill Lynch U.S. Equity (1600 stocks) index broken down by quality shows that C & D rated stocks rose about 22% during the quarter, more than twice as much as A+, A, A-, and B+. We remained risk averse. At an average beta (volatility) of 0.96 our large cap stocks were below their benchmark's 1.00 as were our midcap stocks at 1.05 versus its benchmark of 1.20.

In our balanced accounts we remain conservatively invested and most of our individual portfolios are hedging against inflation/devaluation with a modest investment in gold.

Our investment process combines fundamental, technical, and quantitative analysis to control risk and build portfolios which give us a good balance between making money and preserving capital. The high quality, more stable growth stocks we own are relatively cheap, and in a good position to continue their earnings growth in a slower growing economy. The large cap equities we held on March 31, 2012 had earnings growth of about 24% in 2011; our midcaps 32%.

A handwritten signature in blue ink, reading "Derwood S. Chase, Jr.".

Derwood S. Chase, Jr., CIC, Chairman & CEO

Chase Investment Counsel Corporation manages equity and balanced portfolios for institutional and high net worth individuals in 17 states. We also manage two mutual funds which serve approximately 5,400 investors nationwide. The opinions expressed herein reflect those of Chase Investment Counsel Corporation and are subject to change without notice. Past performance does not guarantee future results. For further information please contact us at (434) 293-9104 or (800) 293-9104.