MERITAS ADVISORS
Comprehensive Wealth Management

Monthly Investment Outlook

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Strength and Stability in Volatile Times

Our mission is to generate stable real returns, regardless of the direction of the economy, while providing the highest level of service and exceeding expectations in performance, planning and communication.

We seek to generate returns from market movement, rather than being dependent on a particular market direction. We utilize the strongest performing investments across a wide range of sectors and strategies that when combined seek to optimize opportunity, while minimizing downturns.

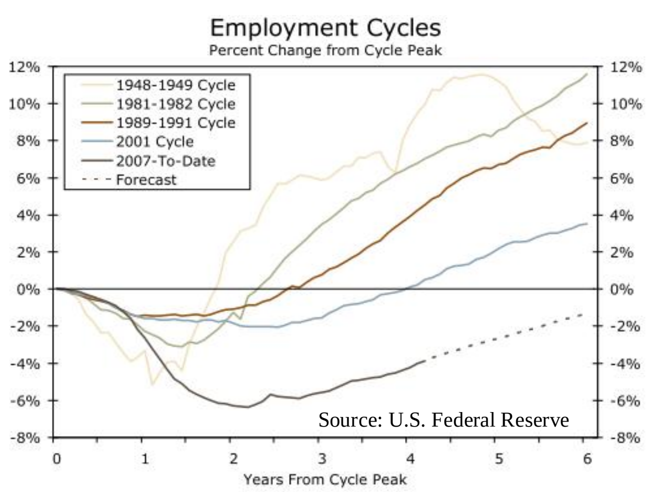
Dear Clients and Friends: The U.S. and European markets just experienced their softest week of 2012 with decliners outpacing advancers approximately 3:1 on the NYSE. European stocks are in their worst losing streak since November. We've had four days of mixed-to-negative U.S. economic data coupled with news of weakening conditions in the Eurozone and China. As our regular readers know, this comes as no surprise. We believe it is likely that the recent rally was induced by the ECB's LTRO2, otherwise known as Europe's version of the Federal Reserve policy of quantitative easing, QE1, QE2, etc. QE2 gave us a 6 month rally starting in the fall of 2010. The following summer wasn't so sunny. *Lenore Hawkins, MBA, Principal*

Domestic Economy

While the U.S. economy is showing some hopeful signs of strength, we are still cautious as the results from Q1 are distorted by the unseasonably warm winter. The loose monetary policies of the Federal Reserve and the other major central banks may also continue to rollercoaster ride the markets in their attempts to get the economy on track due to the "wealth effect" in which a rising stock market induces households to spend more despite an underlying weak economy.

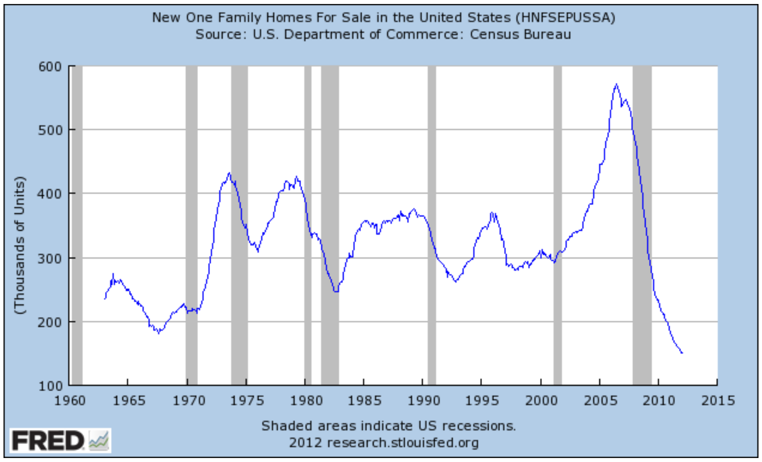
Unemployment: Job openings fell 81k to 3.46 million in January after a 266k pop in December, making it the third decline of the past four months. New hires also fell 30k to 4.16 million in January, the second consecutive decline on top of the 80k drop in December and down three of the past four months. The silver lining is that total layoffs in January amounted to 1.646 million, which is down 39k from December after an 85k decline in that month. Layoffs have dropped, which is great news but so have the level of people voluntarily leaving their job to search for greener pastures, falling 36k in January and down now by 76k since the end of last year's third quarter, indicating falling worker confidence.

While we are pleased to see the employment situation appearing to improve, we are very concerned with the decline we are seeing in productivity. Employment is rising, but productivity and GDP growth is falling. Corporate America will not let their productivity rates contract indefinitely, so just as we saw last year, the gains seen in Q1 could be eaten away in Q2. From a historical perspective, every time productivity contracts, company hiring trends slow noticeably. Finally, although we are seeing some indications of positive movement, it is still frustratingly slow relative to historical norms as the chart above illustrates.



We highly recommend the March 12th article from the Financial Times entitled "The U.S. labour market is still a shambles," by Nobel Prize winner Joseph Stiglitz.

Housing: U.S. existing home sales fell by 0.9% in February, surprising the consensus which anticipated a 1.3% month-over-month increase. Overall existing home inventory rose to 2.43 million by the end of the month. However, January total sales saw an upward revision, and February sales were still 8.8% higher year over year. January and February existing-home sales activity also delivered the strongest first two months of a year since 2007.



On the other hand, the chart at left shows that new one family homes for sale in the U.S. don't appear to be in recovery mode yet.

In February, 21 states saw an increase in foreclosures year over year, according to Realty Track. According to data through December 2011, released February 28th for the S&P/Case-Shiller Home Price Indices, the leading measure of U.S. home prices showed that all three headline composites ended 2011 at new index lows. The national composite fell by 3.8% during the fourth quarter of 2011 and was down 4.0% versus the fourth quarter of 2010. Both the 10- and 20-City Composites fell by 1.1% in December over November, and posted annual returns of -3.9% and -4.0% versus December 2010, respectively. These are worse than the -3.8% annual rate reported for November. With these latest data, all three composites are at their lowest levels since the housing crisis began in mid-2006. **Bottom Line**: *The largest asset for most households is not yet in an established recovery which is necessary for sustained improvement in household finances that leads to consumer spending and economic growth.*

Spending: Retail sales in February rose 1.1%. The market got particularly giddy about the upwardly revised 0.6% gain in January (originally reported as +0.4%). Real GDP growth in Q1 may be closer to a 2% annual rate than 1%. Keep in mind that this represents a slowing from 3% in Q4, which appears to be of little import to the bulls.

While the market got giddy, it is important to go deeper. Retail sales represent only 40% of consumer spending. Real consumer spending is barely growing if we add in spending on services, which is the majority of household outlays. Utility spending has dropped dramatically in recent months due to the warmest winter in some 17 years, generating a huge windfall of approximately $40 billion in savings. That money has gone straight into retail purchases, but this is not a sustainable source of savings. **Bottom Line**: *Headlines can be misleading as there is usually more to the story.*

Manufacturing: The New York Empire Index improved in March at 20.21 from February at 19.53. (This index is a regional economic indicator published by the Federal Reserve Bank of New York and released around the middle of the month. It's considered to be an indicator of economic conditions in one of the most populated states in the U.S.) March represents the sixth improvement in a row and the best level since June 2010. The Philadelphia Fed also rose to an 11 month high of 12.5 from 10.2, but there were indications of slippage in the ISM index to a six-month low of 50.3 from 51.2. Unfortunately in both the Philly and Empire orders slipped as did shipments - a 6 month low for Philly. **Bottom Line**: *Reasons for optimism in domestic manufacturing.*

Warning sign! FedEx announced that it will park some aircraft and reduce its work force as the company scaled back its forecasts for global economic growth to 2.3% from a previous forecast of 2.9%.

Headwinds

Gasoline: Prices at the pump continue to rise, so far up $0.60 year to date, which represents an approximately $100 billion drag on households. The fall in heating costs from the weather has sheltered the economy from the full effect of rising fuel prices, but as we move into the travel season, it's likely to have a negative impact.

Taxes: At the end of 2012, the 2003 tax cuts are scheduled to expire, which will likely inhibit economic growth and investments as households will have less disposable income. We once again face a situation on Capitol Hill that will likely keep businesses and individuals guessing until the last minute what taxes will look like after December 31st. The continued uncertainty is a headwind to growth.

Fiscal cuts: We are facing spending cuts at the federal, state and local level as deficit spending inevitably has to be reigned in and the mandatory "cuts" due to the debt ceiling debacle activate in 2013. While these cuts are necessary, in the near term they will have a negative effect on economic growth. We do believe that in the long run, reduced government spending is a tailwind to the economy. *A great historical perspective on this topic is "This Time is Different," by Reinhart and Rogoff.* We could see a 3-4% hit to GDP next year from this fiscal withdrawal and would not be surprised to see a recession in the first year after an election as the new kids on the D.C. block want to get any pain over well before facing reelection.

Global Slowing: With a recession in Europe and slowing Asian economies, U.S. exports are likely to contract, which is a headwind to U.S. GDP growth.

Global Overview

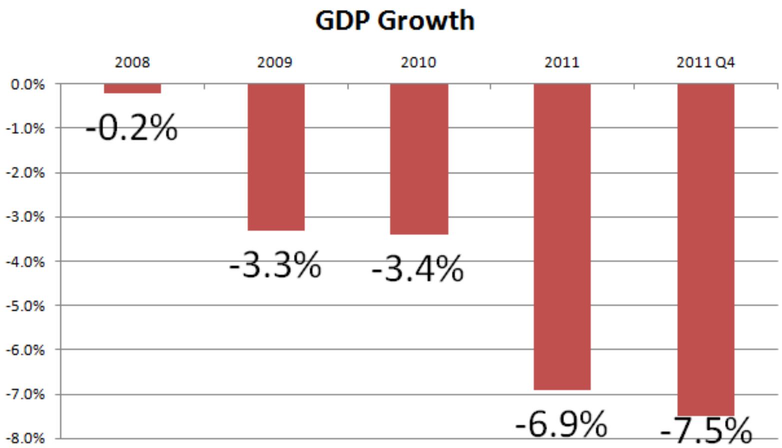
As nations across the globe are attempting to grow out of the quagmire, fiscal stimulus (aka government spending) is being withdrawn, which means the heavy lifting is now being done by the central banks. The central banks have gone from historically being the lender of last resort, to now the lender of first call. The aggregate balance sheets of the OECD monetary authorities now comprise an unprecedented 30% of GDP. It is impossible to predict how we will get out of this in an orderly manner as the world has never experienced such a situation.

The biggest challenge lies in that the increasing manipulation by central bankers all along the yield curve, (meaning manipulating interest rates at various timelines, 1 year, 5 year, 20 year etc.) removes vital economic gauges, pricing and feedback mechanisms upon which policymakers and business people have long relied.

"Stick 'em up. This is a debt swap."

Greece: Earlier this month the latest Greek drama reached a crescendo as the "voluntary" debt swap was completed. As Commerzbank CEO Martin Blessing recently put it, this deal was as "voluntary as a confession during the Spanish Inquisition." Greece finally officially defaulted and is likely to default again as its economy simply cannot grow out of the problem. We'd put the likelihood of future defaults right up there with the likelihood of another contentious round of debt ceiling debates in the U.S. later this year. We also expect that Greece will leave the euro sometime within the next few years, possibly sooner rather than later. While the Eurozone has agreed to give Greece the much needed support post debt restructuring/default, a report from the Troika (name the Troika members) reports that the country is already on course to miss its budget targets in the immediate future. The market is already pricing the "new" debt at default levels. This should surprise no one.

Greeceôs debts are five times those of Argentina when it became the titleholder in 2001 for Largest Sovereign Debt Default and Greek GDP, which stands at US$305 billion, qualifies it for 32nd place on the list of the worldôs biggest countries nestled between Denmark ($310 billion) and the UAE ($302 billion). Greece's economy is in an absolute freefall with unemployment rising to 20%, and 50% for the young who are leaving the country in droves. Losing their youth does not help their economy recover! **Bottom Line:** *The Greek economy has been contracting at an accelerating rate, as shown in the chart at left which makes recovery very difficult.*



Portugal is the PIIG that no one seems to watch despite the fact that its economy is accelerating in reverse! With public debt at 93% of GDP and private debt at a mind-boggling 249% of GDP, it is likely as unsalvageable as Greece. Unemployment is over 14%. GDP fell 1.6% last year and is expected to drop another 3.1% this year. So far Mr. Market has turned a blind eye to this inevitable collapse. Wolfgang Schaeuble, the German finance minister has ruled out another restructuring like Greece, which should have Portugal quite nervous, but then again we heard an awful lot of "never" and "final" from the Eurocrats with respect to Greece that was all reversed when market pressure loomed. **Bottom Line:** *The thing about unsustainable debt levels is that they aren't a problem until one day it suddenly goes exponentially bad and heaven help those who aren't prepared. Remember Lehman!*

Spain is the big problem, with GDP of $1.4 trillion; it is the 12th largest in the world, just behind Russia and Canada. As manageable as Spainôs public debt would appear to be at face value, its private debt is a different story, at a staggering 227% of GDP. According to McKinsey, Spanish corporations hold twice as much debt relative to their output as U.S. companies and in comparison to Germany that number goes up to six times. As Spain attempted to reduce its deficit in accordance with the EUôs Growth & Stability Pact, it has increasingly relied on private debt in order to prolong the enormous construction boom that has been ongoing since the 1970s but which really picked up steam in the 90s and 00s. This resulted in a tripling of average household debt! Then we look at the Spanish unemployment rate skyrocketing toward the 25% mark this year, and standing at twice that for those under 25. **Bottom Line:** *Holy cow we've got serious problems in Sangria-land!*

Ireland slid back into a recession in the fourth quarter of 2011, with GDP falling 0.2% in Q4 after falling 1.1% in Q3. Ireland is now the seventh Eurozone member in a recession, along with Belgium, Greece, Italy, Netherlands, Portugal and Slovenia. The nation is now attempting to persuade its bailout lenders to give it a break on ú31 billion ($40.97 billion) in promissory notes pumped into failed banks. **Bottom Line**: *Caution across Europe.*

Eurozone PMI (Purchasing Managers Index which indicates the health of the manufacturing sector) data has turned quite soft with the combined manufacturing/services index contracting at the most dramatic rate in March to 48.7 from 49.3 in February, moving strongly opposite from consensus that expected a rise to 49.6. **Bottom Line:** *Anything below 50 is indicative of contraction, thus a major force in the global economy is slowing measurably.*

China, which has been the primary engine of global growth post financial crisis, is experiencing a significant slowdown with their weakest retail sales growth since the 2008 downturn, their largest trade deficit in 22 years during January, and their once booming auto sales falling 6% year-over-year. GDP growth is slowing to 7.5%, which is an economy in standstill when viewed in the context of the enormous amount of government spending.

The Chinese manufacturing PMI surprised consensus to the downside in March, coming in at a four-month low of 48.1 from 49.6 in February, silencing the claims that the appearance of a slowdown was only from the Chinese New Year celebrations. Orders were the softest in four months, coming in at 46, which is the second weakest level since March 2009.

Fundamentally, the change in leadership in China later this year will put the premier and president in a tough position as they have to wait a few years to consolidate their power in order to implement the much needed reforms concerning the size of the state-owned enterprise sector, which is now almost 60% of the economy. Domestic private consumption is currently barely 1/3 of GDP, and must be allowed and/or induced to expand in order to prevent a truly "hard landing" in 2013 or 2014. JP Morgan analysts are already declaring that China is in a hard landing. Rumors are currently flying about the country concerning the possibility of various coups, with one rumor concerning a military coup launched by Zhou Yongkang spreading rapidly last Monday.

Bottom Line: *China is the largest exporter in the world, thus its economy slows when falling global GDP hurts demand for China's products. Additionally, across much of the developed world automation is starting to replace cheap labor thanks in part to low interest rates and high energy costs, which makes shipping more expensive. We expect a longer-term trend here of production moving closer to its target selling market.*

> *OVERALL THE GLOBAL ECONOMY IS STRUGGLING. THE ECRI COINCIDENT/LAGGING RATIO, IS OFF ABOUT 2% FROM ITS PEAK AND IS NOW BELOW LEVELS THAT COINCIDE WITH PAST RECESSIONS. WITH CHINA SLOWING, MUCH OF THE EURO-ZONE CONTRACTING AND THE U.S. RECOVERY SO FRAGILE ON TOP OF CONTINUED TENSIONS IN THE MIDDLE EAST, CAUTION IS WARRANTED.*

Market Trends and Investment Flows

China's foreign direct investment fell 0.9% year over year in February, the fourth consecutive monthly drop with ministry spokesman Shen Danyang warning that the outlook for foreign investment in China is "grim." According to a survey last month from the American Chamber of Commerce in Shanghai, U.S. companies are becoming less confident in business prospects in China amid rising costs and difficulties hiring and retaining skilled labor.

Eurozone foreign direct investment fell a whopping 33% last year. *This loss only exacerbates the contracting economy.*

Japan has experienced 10 consecutive weeks of net foreign inflows, around $13.3 billion, which is the most in Asia, but about 1/3 of last year. The seemingly invincible yen has finally been broken, so the vice grip on Japanese exporters has been removed. *This occurred most recently in 2003-2004 and led to a 3-year bull run in the Nikkei of 130%.*

S&P500 experienced the largest weekly drop of the year last week accompanied by the **largest 30 year Treasury yield improvement** of the year and **gold** moved back into the green for 2012. Volume continues to be exceptionally weak, indicating a lack of conviction by investors in the bull run. On the other hand, the low volume makes it easier for the Fed to buoy the markets with their interventions due to the lack of selling pressure. However, corporate insiders donᾰt seem to share this enthusiasm for their own companyᾰs stock. The ratio of insider sellers to buyers has surged from 5:1 in January to 14:1 in February to 35:1 in March! Perhaps they know something that other market participants donᾰt?

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Market Recap

Index Levels	Close 03/23/12	Year End 12/30/11	Year Ago 03/23/11
Dow Jones 30	13,081	12,218	12,086
S&P 500	1,397	1,258	1,298
Nasdaq	3,068	2,605	2,698
Russell 2000	830	741	811

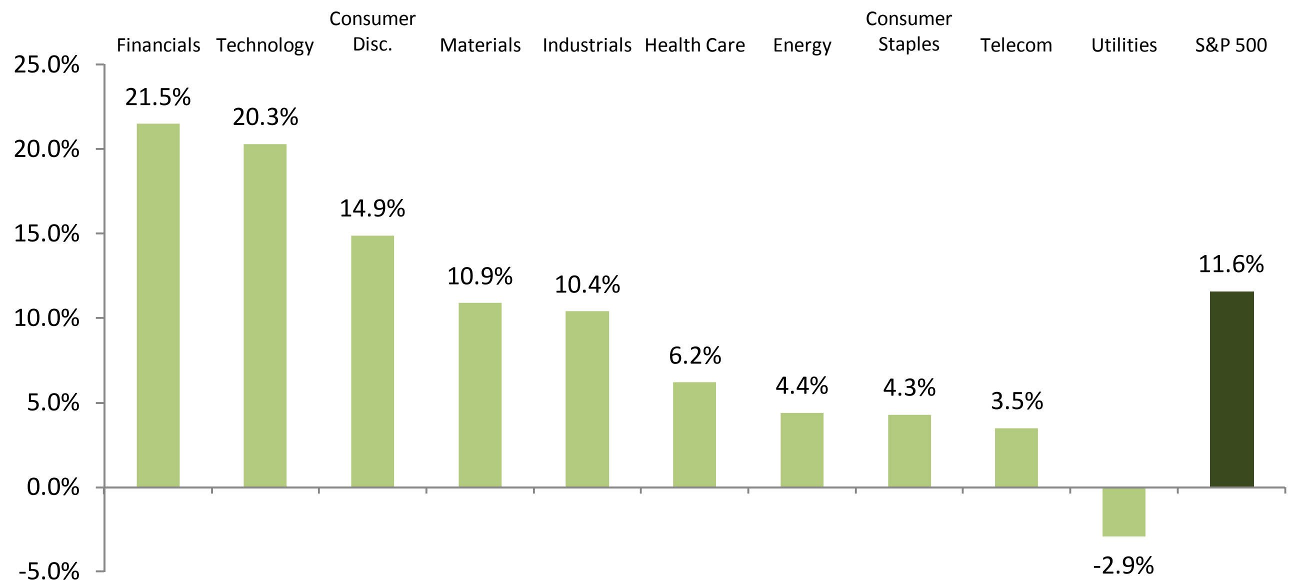
Commodities	Close 03/23/12	Year End 12/30/11	Year Ago 03/23/11
Gold	1,664.00	1,531.00	1439.50
Crude Oil	106.87	98.83	105.25
Gasoline	3.87	3.26	3.56

Bond Rates			
Fed Funds Target	0.25	0.25	0.25
2 Year Treasury	0.36	0.24	0.66
10 Year Treasury	2.24	1.87	3.35
10 Year Municipal	2.53	2.45	3.66
High Yield	7.24	8.36	7.04

Index Characteristics	P/E Forward	P/E Trailing	Dividend Yield
S&P 500	13.21	15.85	2.06%
Russell 1000 Value	12.09	14.90	2.51%
Russell 1000 Growth	14.97	17.36	1.51%
Russell 2000	18.92	23.79	1.39%

Year-to-Date Returns by Sector

(As of 03/23/12 - Source: JP Morgan)



Wrap Up: From a technical standpoint the equity markets continue to be heavily overbought with the reality of continued economic struggles finally receiving appropriate level of attention. On the other hand, U.S. corporations are in spectacular shape, with 77.6% of total nonfinancial corporate debt now long-term vs. 65.8% a decade ago and companies enjoying the highest liquidity ratio since the third quarter of 1955. This means that default rates are likely to stay exceptionally low and if we do have a recession, U.S. corporations are poised to weather the storm better than at any other time in recent history. As always, we are honored by your continued trust in us and continue to diligently shepherd the funds you entrust with us through these tumultuous times.

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