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Meritas Advisors
Comprehensive Wealth Management

Monthly Investment Outlook

In This Issue:

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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: We believe the business of wealth management should have a strong focus on *identifying the risks, assessing the risks, pricing the risks and seeking to take advantage of or defend from them*. We are neither bulls nor bears, we simply strive to objectively assess reality and respond accordingly. The risks we've been monitoring for months are starting to be recognized by the market, which we believe is a necessary first step in the process towards a more lasting recovery. *Lenore Hawkins, MBA, Principal*

The Markets

May was the worst month for equities since September 2011 with the Dow Jones Industrial Average down 6.21% for the month, recording only 5 winning sessions versus 18 losers. Signs of a slowing U.S. economy continue to mount. The markets are better appreciating the severity of the European debt crisis with increased volatility. The new season of AMC's **Walking Dead** starts in early July. So there you have three dramas which many are deciding to experience while hiding behind a large pillow:

"Billionaire trader John Arnold, former Morgan Stanley co-president Zoe Cruz, and Duke Buchan III are among managers who have shuttered hedge funds in the past year as Europe's sovereign-debt crisis has roiled global markets. The industry last month posted its biggest loss since September as stocks slumped on concern Greece may exit the euro and the global economy is weakening."

"Fortress Investment Group LLC, based in New York, last month said it will liquidate its $500 million commodities fund run by William Callanan after losing almost 13 percent in the first four months of the year."

"Liquidations in the hedge-fund industry rose to 775 last year, the most since 2009, according to Hedge Fund Research Inc., a Chicago-based research firm."
Bloomberg, June 14th, 2012

From April 1st to last Friday, the S&P is down 5.37% while the Euro Stoxx 50 (Index of 50 European blue-chip stocks from countries in the EMU) is down 11.72% while the VXX ETF (short-term volatility) index is up 10.13% **Bottom Line**: *The next phase of the European drama is upon us with the markets' faith in political solutions weakening.*

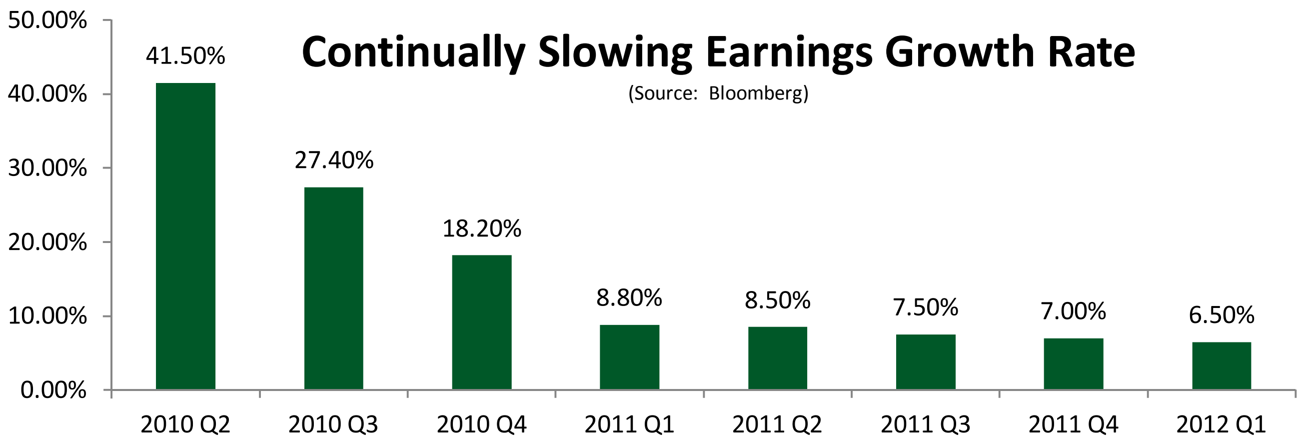
Recent Headlines

Now that we've discussed the reality of the past two and a half months, recall the headlines urging stock purchases from earlier this year.

- *"Bye Gloom, Buy Stocks*," National Post, March 22, 2012.
- *"The Long Good Buy; the Case for Equities*," Goldman Sachs, March 21, 2012.

Thereafter the S&P500 dropped 5.43% from March 23 to June 14. Talk about contrarian indicators! In many cases, newspaper and magazine articles are driven by a mistaken linear outlook rather than a realistic cyclical one that leads them to recommend buying stocks are expensive after a big run-up and selling them when they are cheap after a sell-off.

While earnings are not yet in contraction, there is an obvious trend here and historically, once growth has slowed to 6.5% on a year-over-year basis, earnings have gone into contraction more than 80% of the time. Time to put on my worrywart hat and point out that we haven't yet seen the full impact of the spreading recession in Europe nor the impact of a slowdown in Asia back home in the U.S. We believe it pays to look out farther than one's nose, unlike the headlines these days!



- *"It's 'Risk On' as Investors Dump Treasuries,"* Financial News, March 22, 2012.
- *"Hedge Funds Ditch Treasuries in Droves,"* Reuters, March 19, 2012.

Ten and thirty year yields on U.S. Treasuries reached their lowest ever at 1.4387% and 2.5089% respectively on June 1st as U.S. job growth failed to meet expectations and the European crisis began to heat up again; this after having touched 2012 highs in March at 3.49% for the 30 year and 2.4% for the 10 year.

For all the talk of a bond bubble, Germany's two year note yield fell to below zero for the first time on June 1st, while Switzerland's has been negative since April 24th. Imagine that! Investors are now actually paying these nations to hold their money! When investors are willing to do that, they are really desperate and don't see much hope for growth. Yields on government securities in the U.S., Germany, the U.K., Austria, the Netherlands, Finland and Australia have all tumbled to all-time lows this month as Europe's debt crisis intensified. According to a Bloomberg interview with John Lonski, chief economist at Moody's Capital Markets Group in New York, ñAs far as developed economies are concerned, the credit market is coming to the conclusion that real economic growth will be slower than what weôve become accustomed to since the Second World War.ò

In our February 21st newsletter we wrote:

"The markets can and often do divorce themselves from economic reality. We believe that the current bull market is to be only cautiously 'rented' as it is a rally based on central bank liquidity injections and government interventions, rather than on fundamentals."

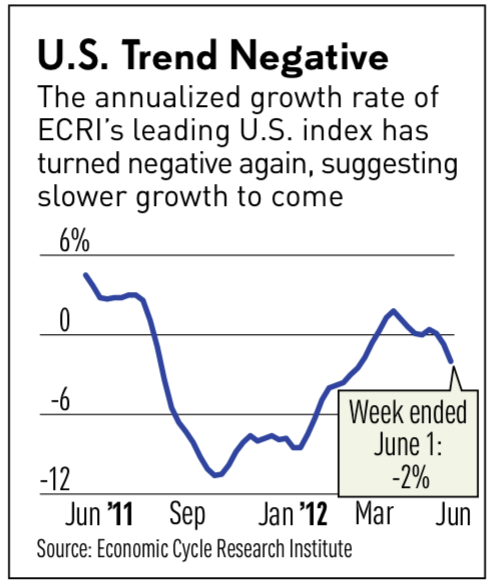
In our March 26th newsletter we wrote:
"We believe it is likely that the recent rally was induced by the ECB's LTRO2, otherwise known as Europe's version of the Federal Reserve policy of quantitative easing, QE1, QE2, etc. QE2 gave us a 6 month rally starting in the fall of 2010. The following summer wasn't so sunny."

Bottom Line: *Those who take their cue from market movement believe the tail wags the dog.*

Domestic Economy

- Retail sales in May dropped 0.2% on top of a 0.2% drop in April for the first back-to-back declines since the double-dip rumblings of May-June 2010. This doesn't give much confidence that Q2 will deliver stronger GDP than the anemic Q1 of 1.9%.
- Consumer prices fell in May the most since December 2008, dropping 0.3%.
- U.S. producer prices fell 1% in May after falling 0.2% in April, giving the first back-to-back declines since May-June of 2010.
- Despite the falling prices, inventories expanded 0.4% in April after a 0.3% gain in March. Rising inventories are not a good sign when accompanied by falling prices.

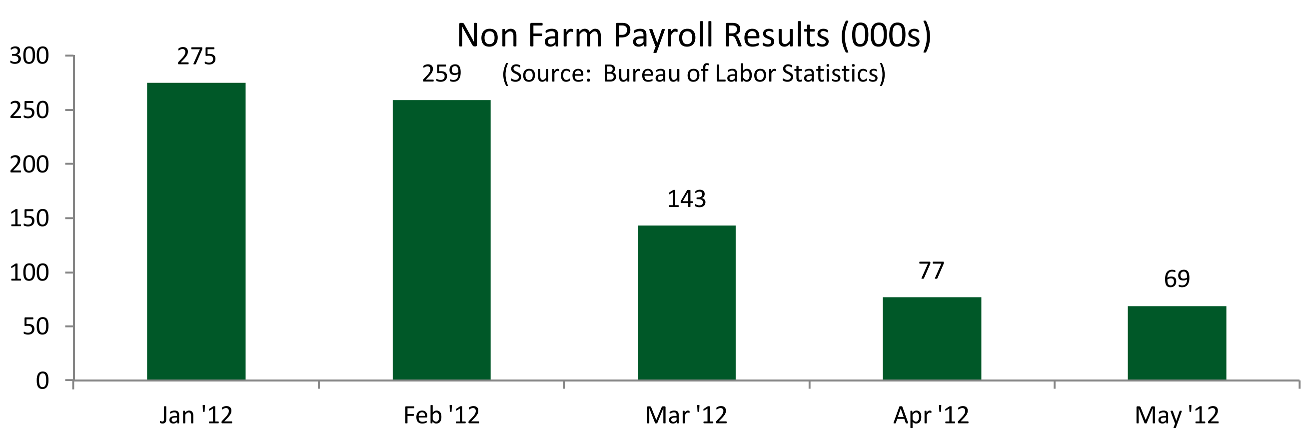
Bottom Line: *The U.S. economy is weakening and we've yet to face the full impact of slowing in Europe and Asia.*



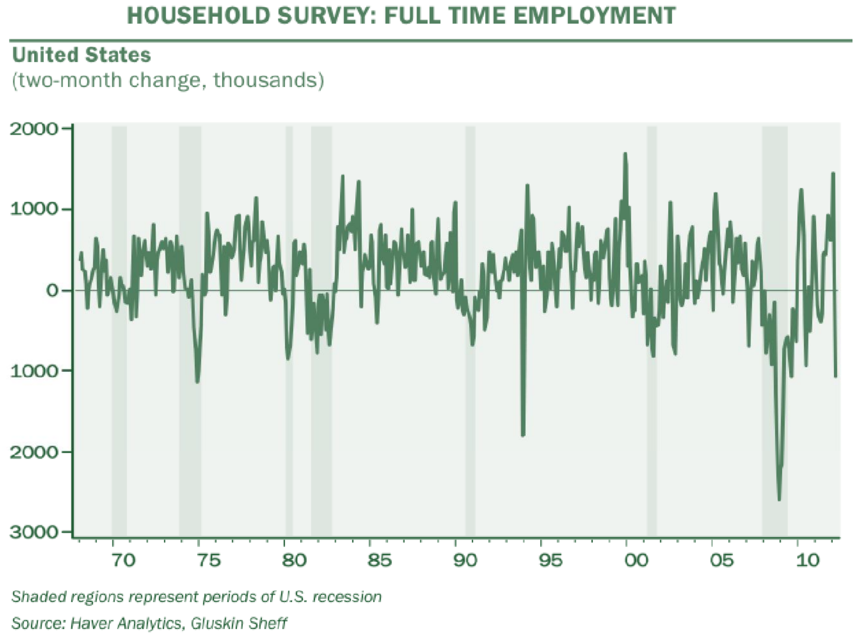
Employment

- U.S. payrolls for May added only 69,000 new jobs for the month versus expectations of 150,000.
- On June 14th we learned that jobless claims rose 6,000 in the week ended June 9th, versus an expectation of a 5,000 drop.
- Job openings in April dropped to 3.4 million for 3.7 million in March.
- The jobless rate has risen to 8.2%, while those employed as a percent of the population is still only 0.4% above the nearly three decade low of 58.2% reached in December 2009.
- The share of long-term unemployment is 42%, the highest level since the Great Depression.
- 45 million Americans, (one in seven) are on food stamps.
- 47% of Americans are on some form of government assistance. Ponder that one for a moment. Almost half of America is dependent on some form of support, provided by the other half. Meanwhile, households are continuing to try and pay down their debt. Not a recipe for a rapidly growing economy.

Notice the trend in the chart below. This degree of deceleration of new job creation is often a precursor to a recession. To have payrolls slowing four months in a row has only happened 2% of the time. We aren't pessimists, we just respond to the reality of the data.

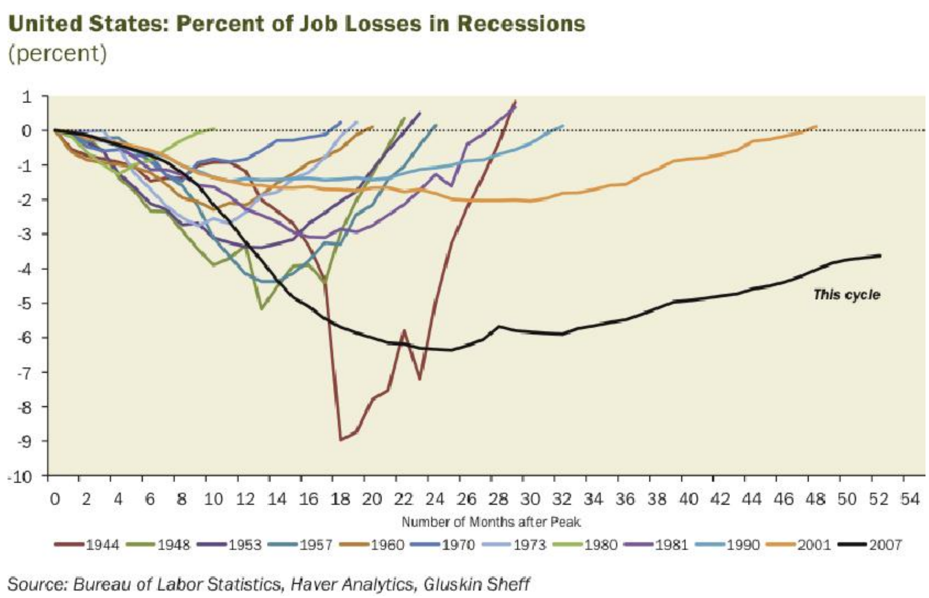


Even more startling is the household survey on full time employment which shows that full-time jobs have declined by more than one million in the past two months. This level of decline has only occurred once (in 1994) without a resulting recession, (see chart at right where recessions are the shaded regions).



Lastly, the chart below shows how the employment recovery has yet to gain any traction relative to every other recession in history. This chart shows job losses in each recession from pre-recession highs. This isn't the most severe, as the 1944 recession takes that title, but the duration is unlike anything our nation has experienced.

Bottom Line: *Housing and overall economic growth are closely tied to the lack of recovery in the job market. Until businesses have sufficient confidence to expand hiring, the economy will continue to struggle.*



Europe

The big news from the weekend is that **Greece's** conservative New Democracy Party claimed victory in the recent elections with sufficient votes to form a coalition government. At a minimum, an immediate Greek exit from the Euro currency has been avoided, but the underlying problems remain unchanged. The new government is weak, facing formidable challenges and is quickly running out of time. Meanwhile the situation in **Spain** has the markets as neurotic as a cat with scotch-taped paws, as Spanish bond yields crossing the dreaded 7% mark again today. The European debt crisis has been going on for over 2 1/2 years now and yet the "solutions" continue to be only more summits, more prattle about austerity and more fist pounding diatribes from the pulpit on political will. At some point the markets will no longer have faith in political verbiage and things will start to get really interesting.

A poll in the Economist last week showed that just over 50% of Europeans believe the EU can solve its problems, down from 65% three months ago and 80% three years ago. The dull light of reality is becoming brighter.

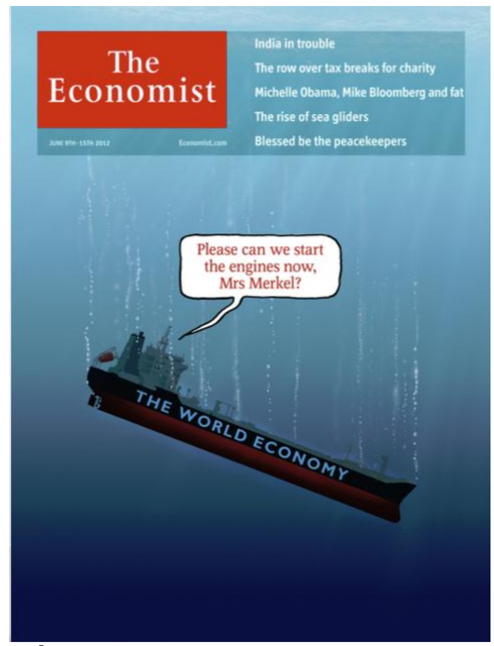
As we expected, repeated rounds of central bank bailouts are having less and less of an impact on the markets. This is analogous to the way a drug addict gets less and less of a high from their drug of choice. After Spain requested ú100 billion to recapitalize its banks, becoming the fourth euro member to need a rescue since the start of the regionôs debt crisis, concerns have grown that **Italy** may follow. This time the bailout dealt with Spain's financial sector directly, rather than the nation's sovereign debt, so Madrid has not faced the kind of political demands that were placed on countries like Greece and Ireland. The relief rally after the aid request was short-lived, with Spanish bond yields rising the most since the euro was created in 1999. Spainôs 10 year yield reached a euro-era record 6.974% on June 14th, pushing up Italian borrowing costs in the process. The graphic below gives an idea of the magnitude so far of the various so-called bailouts. *You know things have gone into the realm of truly absurd when you notice that Italy is on the hook for over 20% of the Spanish bailout, around €22 billion. Italy is running a deficit, so they have to borrow the money to give to Spain and Italy's 10 year rates have been hovering around 6%! Italy has €2 Trillion of public debt. Talk about the broke bailing out the destitute.* (Before getting too high on our U.S. horse, remember that the U.S. will borrow over $1.3 trillion this year, giving away significant amounts to countries all around the world, so this crazy logic isn't exactly unprecedented on the global stage.)

Italy's economy contracted 0.8% in the first quarter compared with 0.7% in the fourth quarter of 2011. The country is mired in its fourth recession since 2001, with growth lagging the EU average for over ten years. Concern over the nation's ability to reduce its debt has contributed to an exodus of foreign investors, with foreign ownership of Italian debt falling to 32% from 50% in 2008, leaving Italian banks to pick up much of the slack. Italian bank ownership of government bonds rose to ú295 billion at the end of April, an increase of over 30% since November 2011, according to a Bank of Italy report on June 8th. This increase in exposure to its sovereign bonds has slammed the stocks of Italian banks, with UniCredit SpA, Italy's biggest bank, falling 12% in the three trading days since the Spanish bailout, for a year-to-date drop of 43%. Intesa Sanpaolo SpA dropped almost 10% this week and has lost nearly 25% year-to-date.

Italy is also facing pressure from the international markets. After the Spanish bank bailout failed to bring the expected relief to markets, Prime Minister Mario Monti, as well as German and French officials, quickly declared that Italy did not require a bailout. Italy has been relatively successful at reducing its deficit, but the country still holds Europe's second-largest debt-to-GDP ratio at 120%, surpassed only by Greece, and has been struggling with high bond yields for most of 2012.

Spain's economy contracted 0.3% in the first quarter and Moody's cut the nation's debt rating three steps to Baa3, just one level above junk, on June 12th, and gave the nation a negative outlook.

As is to be expected in a crisis of this magnitude, tensions among European leaders are breaking into the open as bond investors reject their fixes for a debt crisis that threatens to overwhelm the euro regionĝs financial firewalls. Germany's Finance minister Wolfgage Schaeuble is grousing at Greek yacht owners. Spain's Prime Minister Mariano Rajoy is raging at the European Central Bank while telling Finland to stuff it over advice on how to use the ú100 billion bank bailout funds. Meanwhile Italy's Mario Monti took aim at Austrian Finance Minister Maria Fekter for claiming that Italy would be next in line for a bailout saying that the suggestion by Fekter was "totally inappropriate" and that the markets and financial observers should "not be governed by clichés or prejudices." France's President Francois Hollande is thumbing his nose at Angela Merkel over austerity measures while she strikes back with mumblings over the lack of French competitiveness. Global politics or scenes from the high-school TV show **90210**?



The European Commission President Jose Manual Barroso delivered an impressive, "there, there you mental midgets" when he claimed that the Eurozone crisis may not be fully understood by some governments and greater integration is the solution to the crisis. He also said that this is a defining moment for European integration and that the European Union has a systemic problem. Talk about hubris while stating the obvious.

Angela Merkel is under increasing pressure to continue bailing out the various weaker nations, as is evidenced by the cover of the Economist earlier this month. Keep in mind that Germany has provided about 1/3 of all the bailout funding, representing 25% of the nation's GDP. That doesn't exactly sound miserly to us. According to the New York Times, the top-selling book in Germany is "Europe Doesn't Need the Euro," by Thilo Sarrazin. The daily newspaper *Die Welt* had two full pages on Sunday discussing a possible return of the Deutsche Mark and Germany's exit from the EMU (European Monetary Union).

Bottom Line: Ultimately politicians have to face their voters, or get the boot. Without support from the German public, the EMU will likely not survive as it is heavily dependent on the strength of the German economy. Evidence is mounting that German sentiment is wearing thin.

Global Roundup

- In early June, **Japan's** Topic Index plunged to its lowest level since 1983 and entered into a bear market after a disappointing U.S. jobs report and data on China services provided additional evidence of a slowing global economy.
- June 12th, S&P published a report warning that **India** is in danger of losing its investment-grade rating if it continues on its current economic course, making India the second of the BRIC countries to be formally identified as troubled.
- On June 7th, **China's** central bank announced that is was lowering benchmark interest rates by 25 basis points, signaling that Beijing is turning towards more simulative policies and away from inflation control.
- On June 10th, **Bolivia** nationalized all deposits in the Colquiri tin and zinc mine, following **Argentina's** lead as the trend to nationalize resources during troubled times grows. Both nations now face enormous difficulty attracting foreign capital.
- The U.S. Navy dispatched four Avenger-class mine countermeasures ships to the Persian Gulf, putting the U.S. in a better position to respond if **Iran** were to mine the Strait of Hormuz. This comes as the U.S. envoy to the International Atomic Energy Agency reported lack of any progress with Iran, and stated that it believes Iran is clearing incriminating evidence from the Parchin military complex.

Market Recap

Index Levels	Close 06/15/12	Year End 12/30/11	Year Ago 06/15/11
Dow Jones 30	12,767	12,218	11,897
S&P 500	1,343	1,258	1,265
Nasdaq	2,873	2,605	2,631
Russell 2000	771	741	779

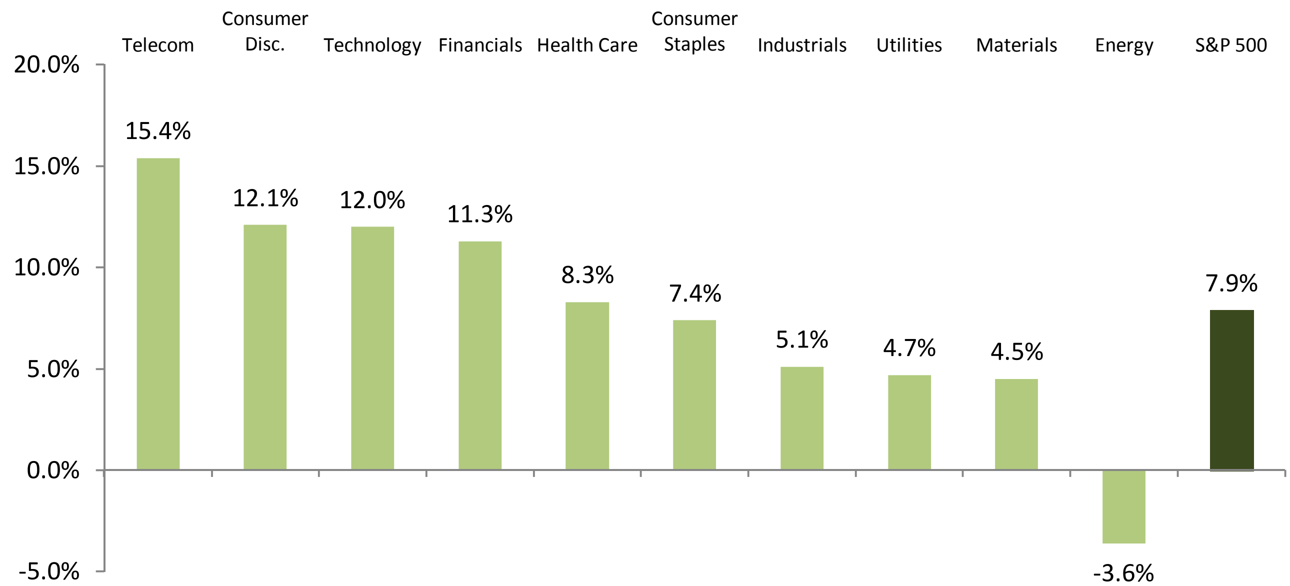
Commodities	Close 06/15/12	Year End 12/30/11	Year Ago 06/15/11
Gold	1,627.25	1,531.00	1529.75
Crude Oil	84.03	98.83	94.81
Gasoline	3.57	3.26	3.71

Bond Rates	Close 06/15/12	Year End 12/30/11	Year Ago 06/15/11
Fed Funds Target	0.25	0.25	0.25
2 Year Treasury	0.28	0.24	0.38
10 Year Treasury	1.59	2.97	3.16
10 Year Municipal	2.26	2.45	3.29
High Yield	7.82	8.36	7.27

Index Characteristics	P/E Forward	P/E Trailing	Dividend Yield
S&P 500	12.43	15.24	2.24%
Russell 1000 Value	11.38	14.08	2.77%
Russell 1000 Growth	13.84	16.31	1.66%
Russell 2000	16.54	22.20	1.58%

Year-to-Date Returns by Sector

(As of 06/15/12 - Source: JP Morgan)



Wrap Up: Never before in history have financial markets been so dependent on policy stimulus. In the past two weeks, the hope of additional support from the Federal Reserve and European Central Bank has added around $1.5 trillion to equity markets. The markets react violently to rumor and innuendo, a dangerous place to be without a high level of awareness and some protective gear. We believe that now, more than ever, patience and sufficient dry powder on hand are critical to longer-term success. Those who watch the markets day-to-day and think the movements are meaningful are missing the bigger picture and as such, are likely to drown in the oncoming storms. As always, we are humbled by our clients' trust and continue to work diligently to warrant your faith.

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