MERITAS ADVISORS

Comprehensive Wealth Management

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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 good news is that we are no longer continually bombarded by political ads. The bad news is the market turned into a cat on a hot tin roof when the results came in and we are now bombarded with back and forth over the fiscal cliff that reminds one of the riveting dialogues in teen-after-school TV movie specials. We hope you all ate too much turkey and laughed too hard over the holiday with your family and friends.
Lenore Hawkins, MBA, Principal

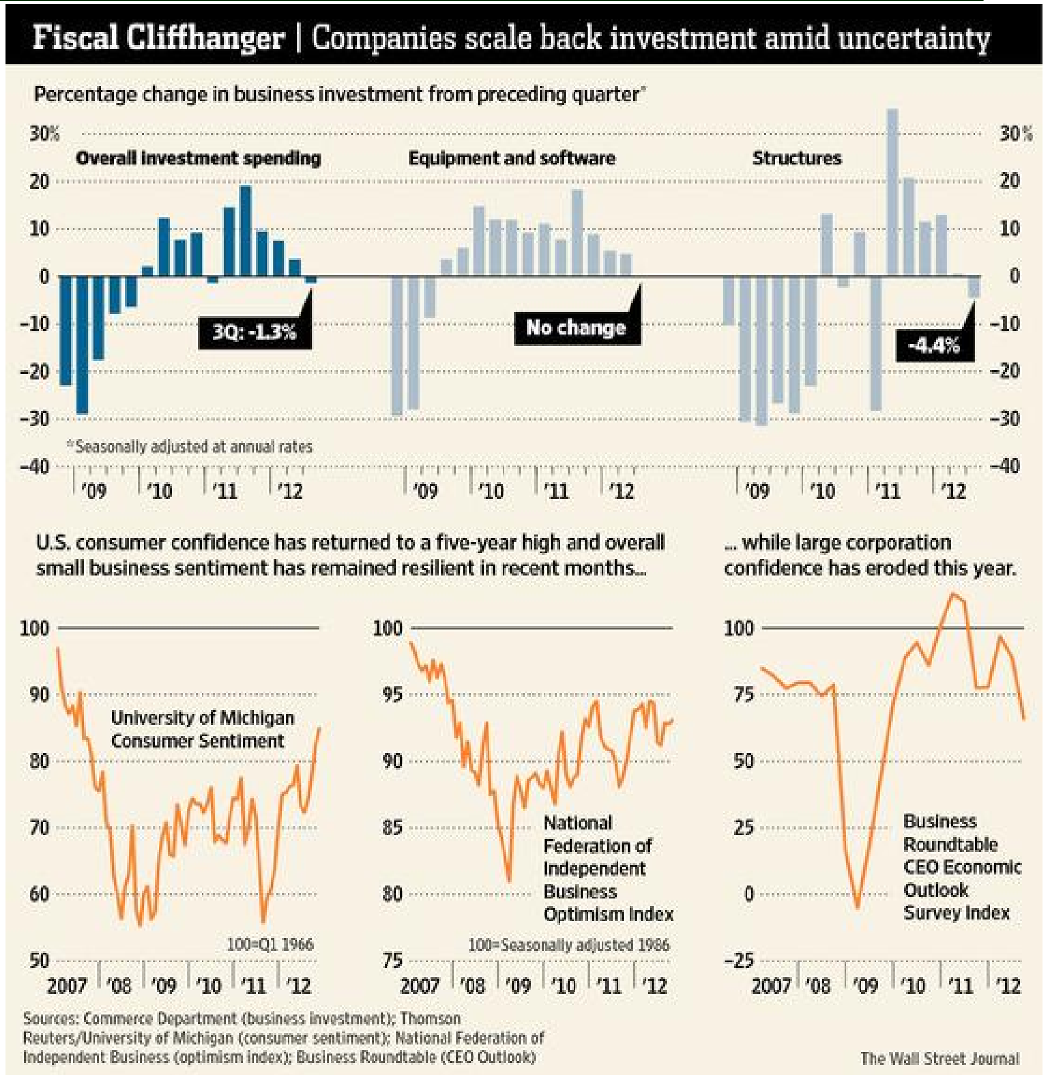
Uncertaintity Rules

"I think there's a one-third probability we'll get a deal, about one-third we'll go over the cliff and be able to reach a deal right afterwards. That'll be OK. But there is that one-third chance we won't and end up in chaos. The markets have felt that no one would be dumb enough to let this happen. Now they can see that it is indeed possible. This could happen."

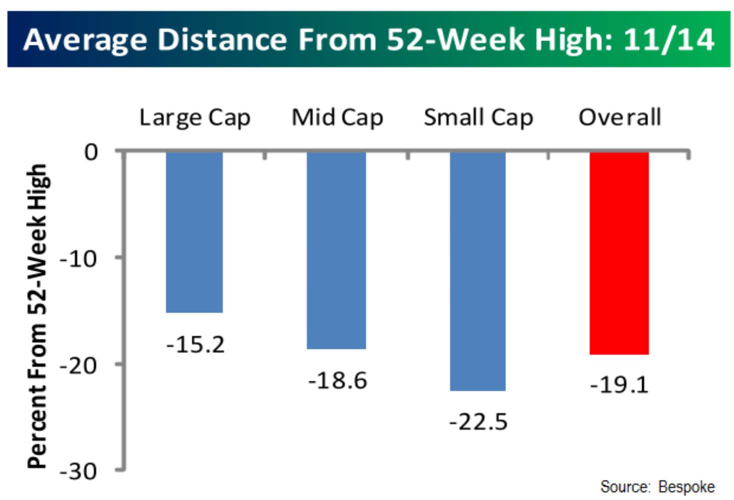
Erskine Bowles, the Democratic co-chair of President Obama's National Commission on Fiscal Responsibility and Reform with Alan Simpson, on Thursday November 15th in a CNBC interview. Those in D.C. continue to keep the U.S. economy in desperate need of some Prozac.

Unfortunately the so-called fiscal cliff isn't the biggest danger. The most significant deadline will arrive in a few months when we once again hit the debt ceiling, like we did in the summer of 2011. Remember that the U.S. Congress sets the legal limit for borrowing by the U.S. government. The last time we reached the limit, Congress was unable to address the deficit and played a game of chicken, resulting in the first-ever ratings downgrade for the United States. The U.S. Treasury department expects the government will hit its legal borrowing limit by the end of this year, but claims that it can kick that proverbial can until sometime in early 2013 through the use of "extraordinary measures" such as temporarily suspending investment in federal worker pensions. The market's concern that post-election, we still have a group in DC incapable of successfully addressing these problems is reflected in the drop shown below.

The charts at right show just how concerned businesses are with the looming fiscal cliff, thus it is no surprise that by November 16th, the S&P had fallen 7.9% from its closing high reached on September 14th and the NASDAQ had 6 weekly losses in a row. The ratio of negative to positive guidance from companies is at double the average for the past decade. S&P 500 companies have experienced the worst revenue growth rate in three years. Thanksgiving week was the first week the markets closed up, with a gain of just over 3%. This week the risk-off trade returned with the downward trend resuming.



Before last week's brief run up, the S&P 500 was down just shy of 8% from its closing high on September 14th, the average stock was down 19.1% from its 52 week high, while large caps faring better than the average and small caps dropping an average of 22.5%. Despite the recent pullback, 49% of stocks in the S&P are still above their 50-day-moving averages, indicating that this isn't a heavily oversold market.



Bottom Line: *The ongoing drama with the fiscal cliff and Europe's continued wrangling over the struggling economies of member nations make any positive market movement tentative. We continue to be in a range-bound cycle in which traditional buy and hold strategies that were successful in prior decades are largely ineffective. The landscape has changed. Historically politicians and policy makers responded to economic conditions.* ***Today the market looks to them to drive economic conditions, which significantly alters investing fundamentals****. Regardless of how much these policy makers may want to solve problems with the stroke of a pen, economic realities persist, thus the range bound nature of the market as we swing from hope to reality and back to hope again.*

Fiscal Cliff

We've been bombarded in the news lately with endless dire warnings over the impending fiscal cliff. So what is it and why does it matter so much? The fiscal cliff refers to approximately 40 different taxes that are due to increase on January 1st as well as large mandatory cuts in defense and non-defense government spending.

The tax increases are a combination of the 2003 tax cuts that were set to expire during the heat of the financial crisis but were temporarily extended, and various stimulus measures such as the 2% payroll tax cut. If nothing is done, the tax burden will rise by approximately $532 billion, a significant drain on an economy dependent on consumer spending. The mandatory government spending cuts amount to approximately $136 billion. The math you'll see in the media adds the two and divides by annual GDP to conclude that this would be over a 4% reduction in GDP, putting the nation into yet another recession. The reality is a bit more complicated, but it is sufficient to say that it would be a noticeable hit to an economy that is still struggling and would likely push the U.S. into a recession (although the Economic Cycle Research Institute would argue that we have already entered a recession). As we mentioned earlier, we will once again hit the debt ceiling, (meaning we max out our national credit card once again) in a few months and Congress will have to vote to either raise the limit again or stop deficit spending. The government spends about 8% of annual GDP in excess of tax revenue, so this is no trivial amount. Recall the tumult of the summer of 2011 for how smoothly this process went last time!

As investors, we need to assess the various ways this could unfold and each scenario's impact on the markets. The situation is constantly in flux, but as of this writing we believe the following to be a reasonable assessment. It is difficult to give specific probabilities since each scenario is dependent on the actions and interactions of hundreds of policy makers, thus rather than try to get specific in our estimates as to likelihood, which can often give a false sense of confidence, we simply look at the three possibilities relative to each other as one of the three will occur.

Scenario	Potential Market Impact	Likelihood
1. (Best Case) We get a comprehensive deal before year-end that addresses spending, taxes and the debt ceiling.	Markets rise moderately, but are likely constrained by recession in the Eurozone, increasing problems in Japan and the rising tensions in the Middle East.	Better than 1/3
2. (Moderate Case) We don't get a deal by year-end and we go over the fiscal cliff but are able to get some resolution before the debt ceiling is breached.	Markets likely take a hit until a resolution is reached on the debt ceiling, which would be sometime in the first quarter of next year. The U.S. would possibly face yet another ratings downgrade and the economy could slide into recession. Overall this would probably be a fairly significant negative for the markets.	Around 1/3
3. (Worst Case) No deal prior to fiscal cliff and no deal prior to the debt ceiling.	The U.S. would most likely go into a substantial recession and face additional downgrade(s) to its debt rating. This outcome would be dire for economies and markets around the world.	Less than 1/3

Bottom Line: *Scenario 2 and 3 are both negative for the markets and we expect the likelihood of one of these two occurring as greater than 50%, thus our investment strategies continue to have a defensive component as we believe the likelihood of a strong market over the next 3-6 months is less than 50%. The situation is constantly evolving, so we continue to refine as new information is available.*

We are in an extended era of financial repression, which means that the Fed's artificial suppression of interest rates materially affects investors' attempts to generate reasonable returns with low levels of risk. Traditional types of investing are relatively ineffective under these conditions. Investors need to focus on preservation of capital in periods of heightened risk and work within range-bound market conditions, which means defensive positioning and an emphasis on income.

Housing

On November 27th, Santa came early for home owners with additional evidence that the housing market is healing. The national Case-Shiller composite was up 3.6% in the third quarter of 2012 versus the third quarter of 2011, and was up 2.2% versus the second quarter of 2012, as the chart at below illustrates.

	2012 Q3 Level	2012 Q3/2012 Q2 Change (%)	2012 Q2/2012 Q1 Change (%)	1-Year Change (%)
U.S. National Index	135.67	2.2%	7.1%	3.6%
Metropolitan Area	**September 2012 Level**	**September/August Change (%)**	**August/July Change (%)**	**1-Year Change (%)**
Atlanta	96.06	0.3%	1.8%	0.1%
Boston	157.26	-0.6%	0.7%	1.9%
Charlotte	116.28	-0.3%	0.6%	3.5%
Chicago	116.69	-0.6%	0.7%	-1.5%
Cleveland	102.10	-0.9%	1.0%	1.4%
Dallas	121.57	0.2%	0.1%	4.4%
Denver	134.01	0.4%	0.5%	6.7%
Detroit	79.82	0.7%	2.1%	7.6%
Las Vegas	97.38	1.4%	1.6%	3.8%
Los Angeles	174.80	1.0%	1.3%	4.0%
Miami	150.24	0.1%	1.0%	7.4%
Minneapolis	126.02	1.1%	1.2%	8.8%
New York	166.10	-0.1%	0.6%	-2.3%
Phoenix	120.65	1.1%	1.8%	20.4%
Portland	141.10	0.2%	0.5%	3.7%
San Diego	160.09	1.4%	0.9%	4.1%
San Francisco	143.15	0.5%	0.5%	7.5%
Seattle	142.09	0.3%	-0.1%	4.8%
Tampa	134.90	0.0%	0.4%	5.9%
Washington	192.36	0.0%	0.5%	3.2%
Composite-10	158.93	0.3%	0.8%	2.1%
Composite-20	146.22	0.3%	0.8%	3.0%

Source: S&P Dow Jones Indices and Fiserv
Data through September 2012

Consumer Credit

While there are signs of healthy holiday spending, there is also reason to be cautious about consumer credit. The National Retail Federation reported that 247 million U.S. consumers hit the stores and online retail sites on Black Friday alone, spending a total of $59 billion, or about $423 per shopper, according to the group's figures. Given that the population of the U.S. is estimated to be around 314 million, almost 80% of the country went shopping. With an employment situation that is still struggling, this is concerning. According to the S&P/Experian Consumer Credit Default Indices, most U.S. consumer loan types recorded an increase in defaults for October. That means going into the holidays, before their added spending, Americans are already falling behind on their loan and credit card debt. While the S&P Index chairman insists that consumer credit remains healthy, for the first time in nine months default rates are on the rise for U.S. consumers.

"After three quarters of declining consumer credit default rates, the national composite increased in October," says David M. Blitzer, chairman of the Index Committee for S&P Dow Jones Indices. "Overall consumer credit quality remains healthy. Looking across our 10 headline indices, all are at levels typical of the pre-crisis period of the early 2000s. Only one -- bank card -- shows default rate above 2.5% and even that hit the recent low, which is close to its eight-year historic minimum."

Bottom Line: *As S&P attests, it's not an alarming consumer credit situation at the moment. But as consumers spend more over the holidays, the consumer credit default rate -- which is already rising -- may take a leap in early 2013 which could harm future economic growth since taking on debt trades off future spending for today's largesse.*

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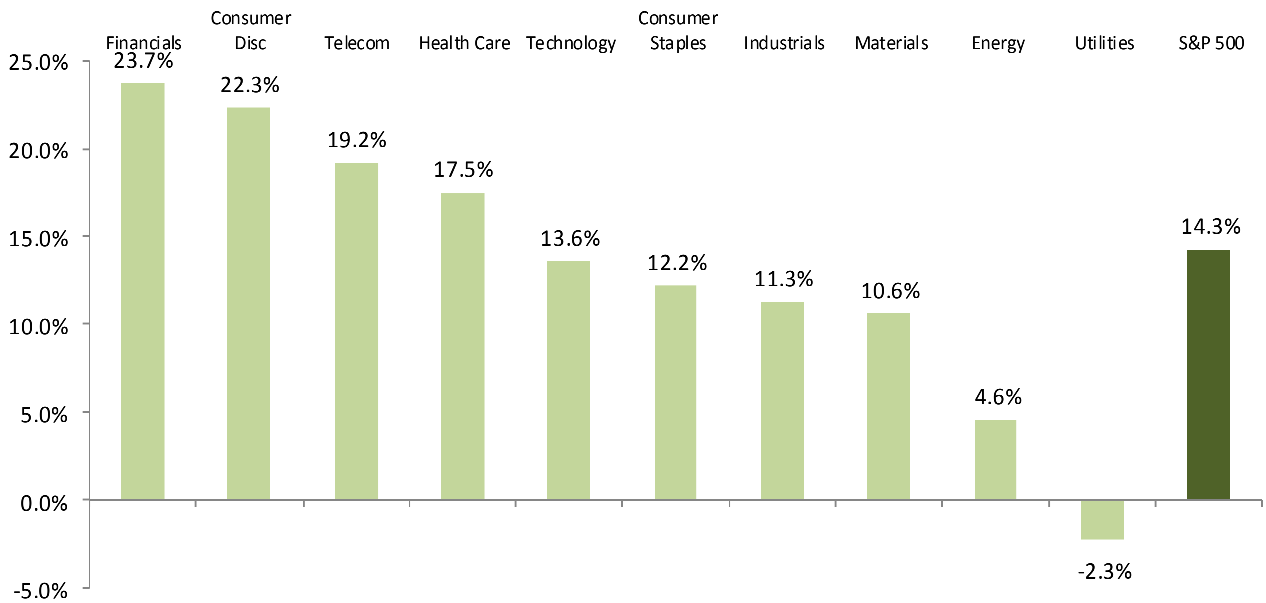
Market Recap

Index Levels	Close 11/26/12	Year End 12/30/11	Year Ago 10/23/11	Commodities	Close 11/26/12	Year End 12/30/11	Year Ago 10/23/11
Dow Jones 30	13,010	12,218	12,258	Gold	1,734.5	1,531.00	1,681
S&P 500	1,409	1,360	1,162	Crude Oil	88.28	98.83	96.17
Nasdaq	2,967	2,605	2,460	Gasoline	3.43	3.26	3.37
Russell 2000	807	741	674				
Bond Rates				**Index Characteristics**	**P/E Forward**	**P/E Trailing**	**Dividend Yield**
Fed Funds Target	0.25	0.25	0.25	S&P 500	12.82	15.82	2.29%
2 Year Treasury	0.27	0.24	0.27	Russell 1000 Value	11.64	14.15	2.53%
10 Year Treasury	1.69	1.87	1.88	Russell 1000 Growth	14.98	18.34	1.81%
10 Year Municipal	1.80	2.45	2.83	Russell 2000	17.32	23.56	1.46%
High Yield	6.67	8.36	9.04				

Year-to-Date Returns by Sector

(As of 11/26/12 - Source: JP Morgan)



Wrap Up: As of November 27th, the Greek can has once again been kicked with an extension of the deadline on the terms of its bailout. The markets are wary of this can kicking and watch as Congress and the President square off. We believe it foolish to think one can accurately predict how this will all pan out, but it seems evident that the dysfunctional nature of many governments around the world is yet another headwind to the struggling global economy. In our view, we are likely to continue experiencing range-bound markets which are constrained on the upside by substantial macroeconomic problems and on the downside by central banks around the world that will use any and every tool at their disposal to prevent asset prices from falling far. Our strategy is to maintain flexibility while facing this dynamic. As always, we are humbled by and seek to continually earn your trust.

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