



John M. Longo, MBA, PhD, CFA
*Sr. Vice President,
Investment Strategist*
jlongo@mdegroup.com

Mitchell D. Eichen, J.D., LL.M.
CEO & Chief Wealth Strategist
meichen@mdegroup.com

Glenn A. Myers, J.D.
Chief Operating Officer
gmyers@mdegroup.com

Erman Civelek, CFA, CFP®
*Sr. Vice President
Investment Strategist*
ecivelek@mdegroup.com

A Look Ahead at the Year Ahead: Ten Investment Forecasts and Our Four Strategic Wealth Management Themes

January 2012

While we firmly believe that no one can know the unknowable or predict the unpredictable, we also realize that as wealth management advisors it is a core part of our job to analyze the world around us and to make investment recommendations based upon our best thinking. With this in mind, we would like to share with you our best thinking on some significant events that we believe will unfold in the year ahead.

MDE'S TEN INVESTMENT FORECASTS FOR 2012

1. Economic despair and the enactment of austerity budgets will lead to social unrest throughout a significant part of the world.
2. Greece will default on its debt and trigger a market correction, as an "orderly" restructuring proves disorderly.
3. Election year politics will hold the market hostage – with sideways and volatile movements – until the results of the election become known.
4. A major European bank will fail, requiring a government bailout to avoid a Lehman Brothers type financial meltdown.
5. The U.S. economic rebound turns into a mirage as federal stimulus wears off, weakness in Europe provides an economic headwind, and political polarization results in an inability to pass meaningful economic legislation in 2012.
6. Gold prices will decline as investors realize the "emperor has no clothes."
7. The PIIGS countries of Europe will enter or remain in recession for much of 2012.
8. The Euro crisis will be "solved" with multinational support to enhance the European bailout fund(s), since the true size of the needed bailout is beyond the resources of the ECB.



...we at MDE have termed “the new market realities” – a long-term period of slow growth and heightened volatility, punctuated by periodic financial crises.

9. Unemployment will remain a structural problem and hold above 8% for the entire year.
10. Emerging market growth will slow significantly as the BRICS cannot decouple from recession addled Europe and a weakened U.S. economy captive to election year politics.

MDE’S FOUR INVESTMENT THEMES FOR 2012

These forecasts may manifest themselves in the following four themes designed to protect capital and improve returns.

1. Maintain downside protection to cushion market volatility.
2. Enhance weak returns in a sluggish economic environment without magnifying risk.
3. Capture yield from alternative sources in a low return environment for stocks and a low yield environment for high grade bonds.
4. Obtain further protection, and generate returns from the myriad of risks by holding investments with different risk factors and return drivers.

A GLANCE BACK ON THE YEAR THAT WAS

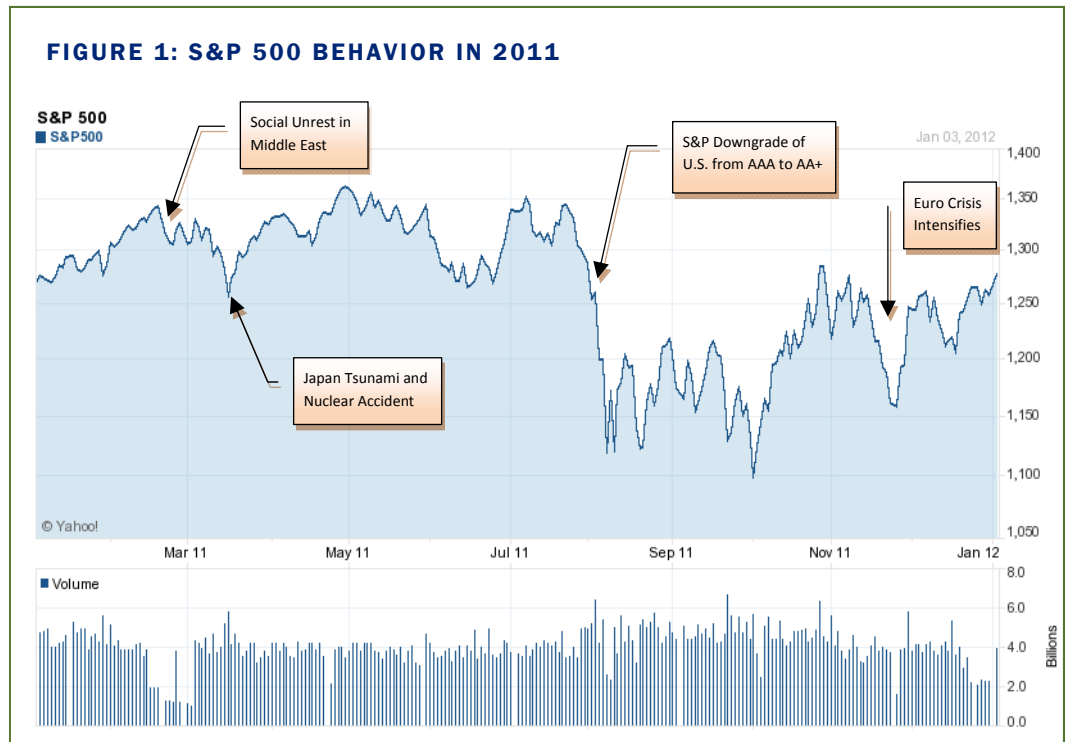
We are fond of the expression, “a long run for a short slide” and it aptly describes market behavior in 2011. Throughout 2011, the S&P 500 shown in **Figure 1** vacillated between minor gains and losses for the year. This meek end of year tally belies the significant volatility experienced intra-year. Indeed, 2011 provided a textbook illustration of what we at MDE have termed “the new market realities” – a long-term period of slow growth and heightened volatility, punctuated by periodic financial crises.

The year began with social unrest that resulted in revolution in the Middle East and North Africa. Once entrenched leaders, such as Muammar Gaddafi and Hosni Mubarak, were either killed or removed from power. A massive earthquake struck Japan and resulted in a tsunami knocking out a nuclear plant of Tokyo Electric and a dramatic leak of deadly radiation. Midyear, S&P stripped the U.S. government of its AAA rating for the first time since 1917. The Euro crisis, long simmering, reached its boiling point, as plan after plan was met with a wave of euphoria then disappointment. Each of these events, and others, has resulted in a market that swung between gains and losses for throughout 2011, with a tepid net result. Bonds benefited from the fear trade and flight to quality movements in capital. Perhaps the biggest disappointment in 2011 was hedge funds,



...it is a core part of our job to analyze the world around us and to make investment recommendations based upon our best thinking.

which failed to deliver the promised “hedge,” with the average fund losing almost double digits, failing to provide their investors with the downside protection that they so often purport to deliver.



MDE'S TEN INVESTMENT FORECASTS FOR 2012

While we firmly believe that no one can know the unknowable or predict the unpredictable, we also realize that as wealth management advisors we are paid to deliver advice. So it is a core part of our job to analyze the world around us and to make investment recommendations based upon our best thinking.

With this in mind, we would like to share with you our thinking on some of the significant events that we believe will play an important role in the year that has just begun. We can state with some confidence that some forecasts we offer for 2012 are likely to be correct, some incorrect, and some partially correct. We can also predict with great confidence that what will ultimately prove to be some of the major events of 2012 are neither on our list, nor on anyone else's. For example, in 2011, the massive earthquake and tsunami in Japan, and related nuclear plant disaster, was unexpected



The welfare state is in the process of being dismantled in Europe, with the stage being set for material reductions in entitlement programs in the U.S., after the 2012 elections.

by most if not all financial prognosticators. With these important facts in mind, we humbly offer you our top ten investment forecasts of 2012.

1. **Economic despair and the enactment of austerity budgets will lead to social unrest throughout a significant part of the world.** We noted above the revolutions that took place in the Middle East and North Africa. Social unrest continued to spread on a smaller scale with the protesting of austerity budgeting enacted in indebted European nations and the “Occupy Wall Street” movement that started in America and spread to many countries around the world. Russia is in the midst of significant political protests, as Vladimir Putin seeks to formally regain power. Indeed, Time named “The Protestor” as its “Person of the Year.”

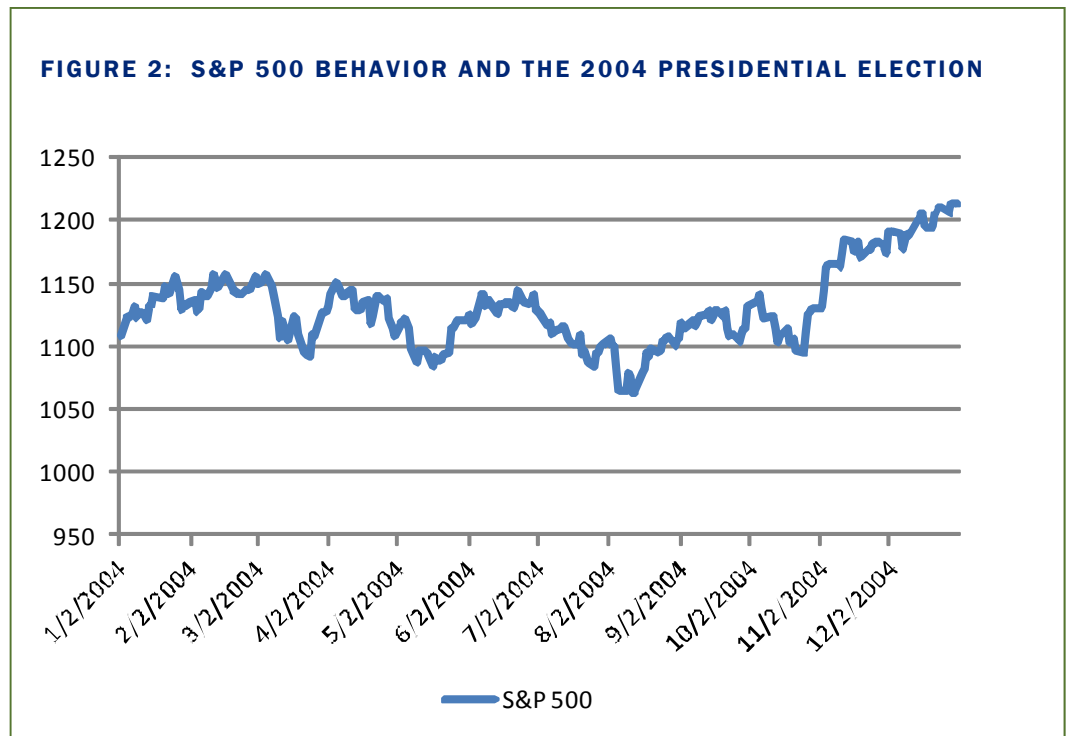
Rather than die out, we believe these protests, and ultimately social unrest, will accelerate throughout the world as the further enactment of austerity programs and continued sluggish economic growth result in increasing economic despair for billions of individuals. The welfare state is in the process of being dismantled in Europe, with the stage being set for material reductions in entitlement programs in the U.S., after the 2012 elections. Asia will be beset with slowing growth, as its largest trading partners (Europe and the U.S.) struggle, and an increasing disparity between rich and poor that will ferment into social and political upheavals.

2. **Greece will default on its debt and trigger a market correction, as an “orderly” restructuring proves disorderly.** Greece will ultimately be required to pay the piper as the IMF and ECB realize the futility in delaying the inevitable. We believe there will be a substantial restructuring or “default” on Greece’s sovereign debt, which sits at an unsustainable Debt/GDP ratio in excess of 150%. Recent talks have discussed the forgiveness of \$130 billion in debt. Of course, most banks holding this debt are highly leveraged, so a loss of this magnitude is analogous to an investor losing trillions. Individuals or institutions suffering losses, often have to sell assets to reduce risk or maintain capital requirements. Hedge funds often smell blood in the water shorting the holdings of those forced to sell assets. This pattern of trading activity, as well as the fear that typically accompanies important negative events, often results in a negative feedback loop, much larger than the initial (\$130 billion) projected loss. Such behavior occurred in past restructurings, such as those that occurred in Argentina and Mexico, and rarely go as well as planned.



Greece will ultimately be required to pay the piper as the IMF and ECB realize the futility in delaying the inevitable.

3. Election year politics will hold the market hostage – with sideways and volatile movements – until the results of the election become known. We believe the U.S. stock market will follow the pattern best illustrated by what occurred surrounding the 2004 U.S. Presidential election (Bush vs. Kerry). Namely a volatile, but range bound market that will ultimately exhibit a significant move once the election results become known or widely anticipated. **Figure 2** shows the seesaw movements that occurred throughout much of 2004 until November, when the market broke out to the upside and ultimately delivered low double digit gains. We believe the market will increase post election if the winners (President + Congress) have a substantial, pro growth platform, while it may falter if it becomes clear that a continuation of massive deficit spending policies rule the day.



4. A major European bank will fail, requiring a government bailout to avoid a Lehman Brothers type financial meltdown. In retrospect, letting Lehman Brothers fail was an unmitigated disaster, resulting in losses much larger than the expected political fallout from a government bailout. Politicians in Europe will not make the same mistake as its American counterparts. Arguably, banks are even more



...the market is skittish about bank risk with the U.S. Treasury Eurodollar Spread (“TED Spread”) more than doubling over the past 3 months to 55bps, also roughly doubling its long-term average value of 20-30bps.

important to well being of the economy in Europe relative to the United States, where the capital markets play a larger role in the financing of business activities.

Clearly, the market is skittish about bank risk with the U.S. Treasury Eurodollar Spread (“TED Spread”) more than doubling over the past 3 months to 55bps, also roughly doubling its long-term average value of 20-30bps. This dramatic increase in systemic financial risk can be seen in **Figure 3** below.

FIGURE 3



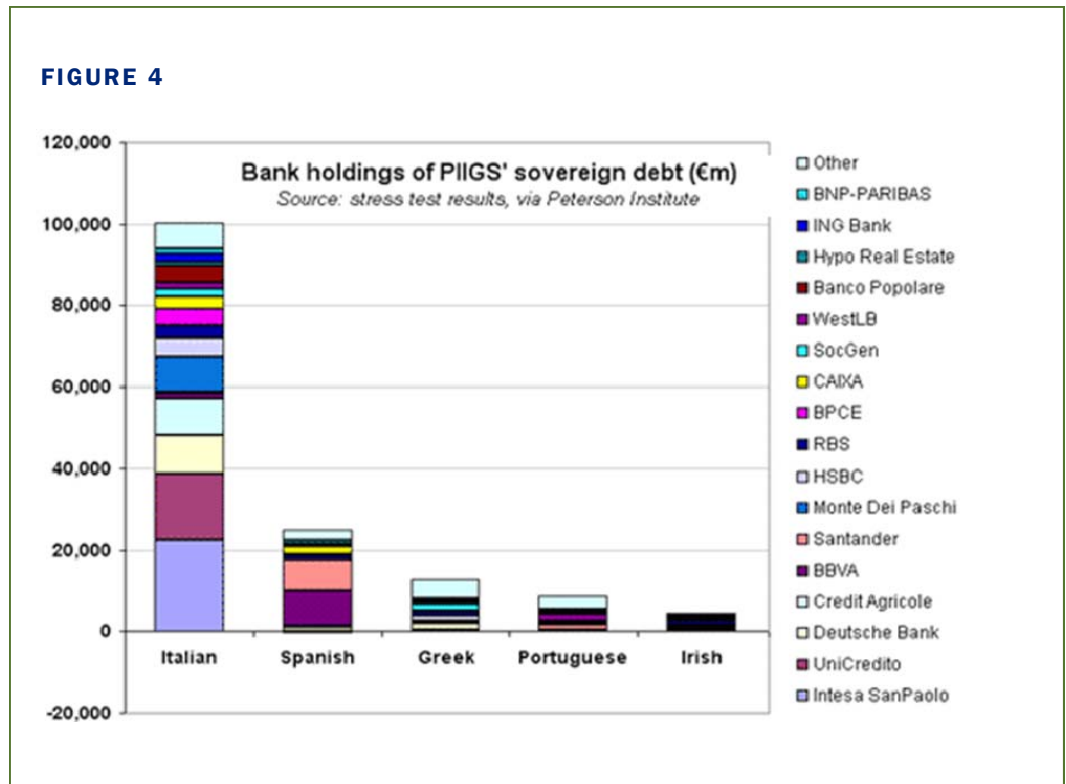
Source: Bloomberg

Which bank will require a bailout? To quote Warren Buffett, “You don’t know who is swimming naked until the tide comes out.” **Figure 4** lists bank exposure to the European sovereign debt of Portugal, Italy, Ireland, Greece, and Spain (PIIGS). If France and Belgium were willing to provide a bailout for the moderately important Benelux bank Dexia, we can only surmise how quickly government leaders would step up to support financial institutions, such as Soc Gen and Commerzbank, the second largest banks in France and Germany, respectively, if their financials rapidly deteriorated. Not only are European banks suffering from an overdose of once ultra



The most recent U.S. GDP numbers have been strong, with the economy projected to grow at a surprisingly robust 3% clip in the last quarter of 2011.

safe sovereign debt holdings, but also from inflated real estate loans, as well as the expected rise in defaults that normally accompanies a weak economy.



5. The U.S. economic rebound turns into a mirage as federal stimulus wears off, weakness in Europe provides an economic headwind, and political polarization results in an inability to pass meaningful economic legislation in 2012. The most recent U.S. GDP numbers have been strong, with the economy projected to grow at a surprisingly robust 3% clip in the last quarter of 2011. Unemployment fell a noticeable 0.4% in November to 8.6%, although we shall see that there may be more to these numbers than meets the eye.

We question the sustainability of GDP growth in the 3% range, since it was partially driven by a reduced savings rate, a rebound in auto sales (which recovered from the Japanese supply chain disruption earlier in the year), and consumption of the affluent. Additionally, it is difficult to see GDP increasing at a healthy 3% rate in light of problems in Europe (18% of S&P 500 profits) and lessening U.S. federal



Gold has been one of the few asset classes in a secular bull market, capitalizing on the fear trade and the rampant printing of money by many indebted nations.

stimulus. We do not foresee any dramatic new economic program passed in the 2012 election year, given that voting along party lines is near an all-time high of 90%. A further extension of unemployment benefits and the payroll tax is in the works, but this merely keeps the status quo and will likely not result in net new growth.

- 6. Gold prices will decline as investors realize the “emperor has no clothes.”** Gold has been one of the few asset classes in a secular bull market, capitalizing on the fear trade and the rampant printing of money by many indebted nations. **Figure 5** below shows the rise in the gold ETF (GLD) over the past five years and the performance of the S&P 500. GLD has increased roughly 150% over this 5-year period, while the S&P 500 is approximately unchanged. All of the gold that has ever been mined can fit into roughly a 67 foot cube. Gold has value precisely

FIGURE 5: RISE IN THE GOLD ETF (GLD) OVER THE PAST FIVE YEARS





Although we remain concerned about inflation over the intermediate to long term, we do not foresee dramatic inflation risk in 2012 due to a sluggish global economy.

because of its scarcity and store of value, but there has to be a limit to its value.

Gold prices valued at \$1,600 per ounce equates to a value of approximately \$8.6 trillion. To put this enormous figure in context, a 67 foot cube of metal is valued at more than half the value of the entire U.S. stock market. Or as Warren Buffett, aptly stated, “For what that’s worth at current gold prices, you could buy all — not some — of the farmland in the United States. Plus, you could buy 10 Exxon Mobils, plus have \$1 trillion of walking-around money. Or you could have a big cube of metal. Which would you take? Which is going to produce more value?” Gold has increased 22% in value since Buffett’s remarks in October 2010.

What will push gold down in 2012 given its upward historical trajectory? In our view, there are several reasons, in addition to its apparent overvaluation on a fundamental basis. First, many hedge fund managers, such as John Paulson, have piled into gold. Hedge funds have had a disappointing year in 2011, resulting in many redemption requests. Therefore, we expect to see hedge funds selling gold at the margin. Although we remain concerned about inflation over the intermediate to long term, we do not foresee dramatic inflation risk in 2012 due to a sluggish global economy. Lastly, the U.S. Dollar is poised to increase v. the Euro and other major currencies, as it appears to be the best house in a bad neighborhood. In sum, we see gold falling from its lofty perch in 2012.

- 7. The PIIGS countries of Europe will enter or remain in recession for much of 2012.** Greece and Portugal are in recession, while the other PIIGS nations remain on the brink. As the screws of austerity budgets begin to tighten, as mandated by the IMF and ECB as condition for bailout funds, the PIIGS economies will continue to falter. The latest Greece bailout involved a new austerity package that was approved by the Greek government on December 7. Its details provide a good illustration of how difficult it is for an economy to grow under the grip of austerity. Greece is required to cut pensions by 15% and government wages by a slightly higher amount. The Greek government must cut its budget by 5 billion Euros (3% of GDP) and raise an additional 3.6 billion Euros (2% of GDP) in taxes.

The expected austerity budgets of other PIIGS nations are not quite as severe, but are likely to materially impact the biggest contributors of GDP, consumption and government spending. Since the PIIGS nations do not control their own currencies, they cannot devalue in order to spur the net export component of GDP. Hence, to



...the November jobs report showed that the unemployment rate fell from 9.0% to 8.6%...half of the reduction in the unemployment rate came from new job creation...the other half from people dropping out of the workforce.

our mind, the question is not if the PIIGS nations will be in recession, but rather, “How bad will the recession(s) be?”

8. **The Euro crisis will be “solved” with multinational support to enhance the European bailout fund(s), since the true size of the needed bailout is beyond the resources of the IMF and ECB.** The IMF is the primary quasi governmental agency responsible for bailout packages in Europe. According to The Globe and Mail the entire resources of the IMF amount to 290 billion Euros, a figure that equals the financing needs for Italy in 2012 alone. The main European bailout fund set up by EU nations, The European Financial Stability Facility (EFSF), has 250 billion Euros or 750 billion Euros in leveraged capital. The true size of the needed European bailout has been estimated to be in excess of \$1.4 trillion. An amount of this magnitude is beyond the resources of the EU.

In our view, the crisis will be “solved” with additional “investments” to the bailout fund(s) by nations outside the EU. By “solved” we mean that a financial meltdown or run on the global financial system will be averted, but we will still remain mired in the “new market realities.” A clue to what may emerge occurred about a month ago with the multinational swap facility set up between the ECB and the Federal Reserve, Bank of England, Bank of Japan, Bank of Canada and Swiss National Bank. The swap facility helps avoid a liquidity crisis, but does not involve a capital contribution that would be needed to help weak sovereign nations finance their deficits, nor does it aid in the recapitalization of multinational banks that are “too big to fail.” Given the scope of the problem, we believe that China, with its \$3 trillion in foreign exchange reserves, will also play a role in the solution to the EU debt crisis.

9. **Unemployment will remain a structural problem and hold above 8% for the entire year.** As noted above, the November jobs report showed that the unemployment rate fell from 9.0% to 8.6%. Approximately half of the reduction in the unemployment rate came from net new job creation, while the other half came from people dropping out of the workforce. It is this latter issue that gives us confidence that unemployment will remain above 8% for all of 2012. We lost 8.8 million jobs during The Great Recession and have regained roughly a third of them, as shown in **Figure 6**. This “shadow inventory” of individuals that have dropped out of the workforce will keep the formal unemployment rate high, since more

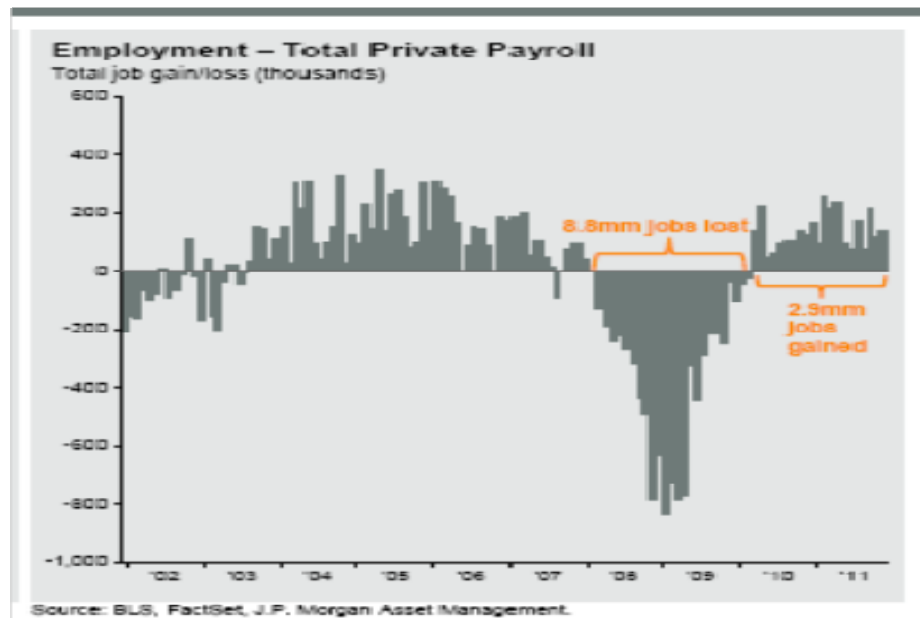


The strengthening U.S. dollar will likely limit any substantial gains in exports.

individuals will look for work at any signs of economic improvement. In other words, if the number of American's actively looking for work were the same as the figure in 2007, the current unemployment rate would be 11%.

Robust hiring requires a strong economy and favorable regulatory environment. We believe neither will materialize in 2012 with the economy held hostage to election year politics. The strengthening U.S. dollar will likely limit any substantial gains in

FIGURE 6



Source: JP Morgan

exports. Lastly, the hiring boom instituted by the U.S. federal government over the past three years is likely to come to a halt and possibly reverse, as incremental steps towards fiscal sanity are instituted.

- 10. Emerging market growth will slow significantly as the BRICS cannot decouple from recession added Europe and a weakened U.S. economy captive to election year politics.** We heard much about the decoupling thesis during The Great Recession. Namely, that the emerging markets, and especially the BRICS nations, would be unaffected by the problems in the United States and



...MDE continues to focus on strong risk adjusted returns with downside protection, liquidity, and transparency as the core investment principles of MDE.

Europe. Decoupling did not occur in 2008 and we do not believe it will occur in 2012. For example, the two largest trading partners of China are Europe and the United States at 16.4% and 13.9% of total imports and exports, respectively. Not only do the BRICS have strong economic ties to Europe and the U.S, but they are also dealing with their own problems at home. For example, most of the BRICS are grappling with inflation and overbuilding problems that will ultimately crimp domestic growth, in addition to the trade headwinds emanating from the U.S. and Europe.

MDE'S FOUR STRATEGIC WEALTH MANAGEMENT THEMES FOR 2012

Investment forecasts in and of themselves are interesting, but of little direct value. They must be actionable if they are to be valuable for our clients. Therefore, coupled with our Ten Investment Forecasts, we would like to offer Four Strategic Wealth Management Themes for 2012, along with specific investments to implement them.

One commonality among nearly all of our 2012 investment themes is that they should add value in an economy beset by the "new market realities" of slow growth, heightened volatility, and periodic financial crisis. MDE continues to focus on strong risk adjusted returns with downside protection, liquidity, and transparency as our core investment principles. Without further delay, we list our four strategic investment themes for 2012 and specific investments to capitalize on them.

1. **Maintain downside protection to cushion market volatility.** We believe allocations to Planned Return Strategy[®], alternative investments, short-term/high-grade bonds, and cash provide substantial downside protection. Planned Return Strategy protects its investors fully from the first 12% of price losses on the S&P 500 and doubles the price returns of the S&P 500 up to a cap, which has historically averaged about 10%. Using this investment as the core of a portfolio in lieu of long only investments substantially mitigates volatility while preserving reasonable upside in this current slow growth environment. The alternative investments favored by MDE (Titan, TFS Market Neutral, JP Morgan Strategic Income, etc.) tend to be market neutral in orientation, which by definition, are not materially exposed to market direction. Although short-term bonds and cash are not a long-term return enhancement technique, in the current fixed income environment they may serve to smooth volatility and ultimately be redeployed when greater investment opportunities present themselves.



Planned Return Strategy[®] protects its investors fully from the first 12% of price losses on the S&P 500 and doubles the price returns of the S&P 500 up to a cap, which has historically averaged 10%.

- 2. Enhance weak returns in a sluggish economic environment without magnifying risk.** Tough economic sledding generally results in muted returns, at best, for most financial markets. Planned Return Strategy and Accelerated Return Strategy[™] double the price returns of the S&P 500 up to a cap. The cap for Accelerated Return Strategy historically averages about twice the amount of the previously noted historical cap for Planned Return Strategy, or approximately 20%. And it does so with the same downside risk in terms of price movement as a regular investment in the S&P 500. Most investors would gladly accept a double digit return in 2012 if they could get it, given the tremendous uncertainties that continue to exist across the financial landscape, and by doubling the returns of the S&P 500, up to a cap, we are more likely to achieve this target.

Blending Planned Return Strategy and Accelerated Return Strategy together in, for example, a three to one ratio as the core of a portfolio, serves to substantially mitigate risk while allowing for the potential to achieve double digit gains at twice the rate of the market. Although we do believe that emerging markets may not be able to decouple from the troubles in the western world, they are still likely to experience better relative growth. Hence, we continue to maintain exposure to emerging markets through the PIMCO Eqs Emerging Markets Fund and attempt to control its risk by holding a modest 5% weight in most client portfolios.

- 3. Capture yield from alternative sources in a low return environment for stocks and a low yield environment for high grade bonds.** With short-term Treasuries and money market funds providing close to zero yields, we have had to search elsewhere for income generating investments. In our view, we have a range of quality offerings for our clients with the SteelPath MLP Alpha (6.5% yield), Loomis Sayles Strategic Income (5.9% yield), and Nuveen High Yield Municipal Bond (7.3% yield) funds. Some clients also hold the Schafer Cullen High Dividend Fund (2.6% yield).
- 4. Obtain further protection, and generate returns from the myriad of risks by holding investments with different risk factors and return drivers.** Return drivers may include equity movements (Risk 3.0[™] and other equity strategies), commodity prices (Parametric Commodity Strategy Fund), interest rate changes (Breckenridge and PIMCO Total Return), economic activity (SteelPath MLP Alpha) as well as volatility (market neutral hedge funds). In



Although we do believe that emerging markets may not be able to decouple from the troubles in the western world, they are still likely to experience better relative growth.

addition, we hold several balanced funds (Permanent Portfolio and FPA Crescent) that maintain holdings across a range of asset classes in an attempt to mitigate volatility.

CONCLUSION

We at MDE look forward to the opportunity to discuss our Ten Investment Forecasts with you, as well as the ways in which our Four Strategic Wealth Management Themes can be custom tailored for your personal situation. As always, we close by thanking you for your loyalty and support. We at MDE consider our relationship with our clients a symbiotic partnership. We realize our sole mission as a firm is to add value to our clients in any way we can. It is with the fulfillment of this mission in mind that each of us at MDE is focused on individual and collective improvements each day.

Legal disclaimer

Information contained in this communication does not constitute personalized investment advice. Information contained in this communication does not constitute an offer to sell or solicitation to buy securities. Any offer to sell The Alternative Fund, LLC or any other non-registered security will be made only to qualified investors pursuant to a confidential offering memorandum. All information contained in this communication has been gathered from sources which The MDE Group, Inc. deems to be accurate. However, inadvertent errors may occur. Investing involves risks which may lead to losses. Different types of investments involve varying degrees of risk and there can be no assurance that any specific investment will be profitable. The MDE Group, Inc. does not make any representation that any of its investments on behalf of clients, including but not limited to any investments in Risk 3.0, Planned Return Strategy, Accelerated Return Strategy, Third Rail Strategy, the Alternative Fund, LLC or any other investments will or are likely to achieve returns similar to those shown in the performance results presented. Past performance is not a predictor of future results. It should not be assumed that any information discussed herein will prove to be profitable or that decisions in the future will be profitable or provide similar results. Calculation methodologies are available from The MDE Group, Inc. upon request. Any discussion of tax matters contained within this communication should not be used for the purpose of avoiding U.S. tax related penalties or promoting, marketing, or recommending to another party any transaction or matter addressed herein. The MDE Group, Inc. disclaims liability for any expense incurred or any damage or loss sustained which may be attributable, directly or indirectly to the use of or reliance upon any information provided.

The MDE Group, Inc.
465 South Street
Morristown, NJ 07960

New York
630 5th Avenue, 20th FL
New York, NY 10111

Tel: (973) 206-7100
Fax: (973) 206-7101
www.mdegroupp.com
info@mdegroupp.com