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- The Slow Comeback Has Accelerated
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Important Reminders:

- We Will Be Closed January 16 as the Markets Honor MLK Day

Tax Forms and Dates:

- February 15, 1099s
- 1099s Now Contain Detailed Year-End Gain/Loss Report
- No Separate G/L Report
- April 17 IRA Contribution Deadline

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Greetings From The Northwest.

So far, the letter that accompanies our December reports has turned out to be the most enjoyable to write. Not that the preceding years were all that satisfying or rewarding for investors, but there is a bit of a rejuvenation and freshening as we slide from the old to the new year. Since we opened Cairn Investment Group, some years have certainly felt the pain of nerve-testing declines, and other years the satisfaction of ending a year with more appreciated value than when we began. But 2011 has been the corker for volatile wild swings. The Dow Jones Industrial Average (DJIA) ranged between 10,655 and 12,810, Gold between \$1,310 and \$1,887. And the big swinger, Oil, gyrated between \$75 and \$113 a barrel. None of the three, DJIA, Gold or Oil, finished the year at the top of its range, yet they all finished the year at loftier valuations than where they began a year ago. Why? The economy is strengthening. The great recession of 2008-09 was the worst that I have lived through, and the recovery is now two plus years in the making, the slowest I've known, to the point of almost being undetectable.

The overly simple profile of who won in 2011 includes investors who stuck close to home and mostly owned large U.S. based stocks that paid dividends. The further one strayed from that path, the more elusive the modest gains of 2011 became, with the most frustrating declines coming from foreign developing markets that didn't develop. Cairn's managed equity mutual fund portfolios held, and still hold, modest amounts of these frustrating foreign developing market investments. I believe that their future looks bright, and it is appropriate to invest with a global view.

Things, plans, and businesses that weren't working out right got worse. Kodak down 88%; Research In Motion down 75%; and three of the six reactors at Tepco's Fukushima Nuclear Plant melted. Don't ever forget the concept of expansion of failure. I try to avoid this. Many things were quite positive: Precision Castparts up 18%, Portland General Electric up 16%, real estate prices firming, a growing number of sales closing, and mortgage interest rates at low lows. Gold contin-



Crooked River Cairn

Photo by: Tim Mosier

ues to be of interest, but nowhere more than in Thailand, where it is now all the rage to have a gold facial! \$200.00 is a bargain if you don't count in the airfare.

As business cycles come and go, company CEOs and boards love to demonstrate how they are increasing shareholder value, either by acquiring new business or splitting up a current company. We appear to be in a splitting up or spinning off phase, as can be seen in recent announcements to spin & split by Motorola, Abbott Labs, Conoco-Phillips, Northrop Grumman and others.

In June, I wrote that I wouldn't continue with the Quarterly Earnings Comparison chart in our letter. So I won't, but it is fascinating to watch companies continue to right size themselves so that their earnings continue to surprise on the upside. 75% of the companies that we watch beat or matched analysts' earnings expectations for the fourth quarter of 2011.

The national home building companies are seeing an increase in sales, which has been a long time in coming.

Additional data suggest that fewer Americans are filing for jobless benefits in recent weeks. I've heard people refer to the U.S. recovery as fragile, but I don't think that is correct. It's durable, just not robust.

A January 5, 2012 editorial in the *Wall Street Journal* by Burton Malkiel made this wise observation about 2011-2012: "U.S. stocks stayed flat, Europe and Japan declined by double digits, and emerging markets suffered even greater losses. Last year again demonstrated that it is virtually impossible to make accurate short-term predictions of asset returns. But it is possible to make reasonable long-term forecasts. Let's start with the bond market. If an investor buys a 10-year U.S. Treasury bond and holds it to maturity, he will make exactly 2%, the current yield to maturity. Even if the inflation rate is only 2%, the informal target of the Federal Reserve, investors will have earned a zero rate of return after inflation.

"With a higher inflation rate, U.S. Treasuries will be a sure loser. Other high-quality U.S. bonds will fare little better... Bonds, where long-run returns are easy to forecast, are unattractive in the U.S. and Japan, as well as in Europe, where defaults and debt restructurings are likely.

"Long-run equity return forecasts are more difficult, but they can be estimated under certain assumptions. If valuation metrics (such as price-earnings ratios) are constant, long-run equity returns can be estimated by adding the anticipated 2012 dividend yield for the stock market to the long-run growth rate of earnings and dividends. The dividend yield of the U.S. market is about 2%. Over the long run, earnings and dividends have grown at 5% per year.

"Thus, with no change in valuation, U.S. stocks should produce returns of about 7%, five points higher than the yield on safe bonds. Moreover, price earnings multiples in the low double digits, based on my estimate of the earning power of U.S. corporations, are unusually attractive today."

Switching focus to some light housekeeping, here are a few notable items:

- Some of you are anxious to do your taxes; please remember 1099 information will not be in your mail box until mid-February.
- The Year-End Gain/Loss Report (GLR) you may have been receiving from your custodian is being retired. The Form 1099 Composite has been updated to include a Year-End Summary section that replaces the GLR. The Year-End Summary should display all the gain/loss information you need for tax purposes.

- For those of you who are taking RMDs from your IRA, we will be in contact with you soon regarding this year's distribution plan.
- For those who are building your IRAs, contribution deadline is April 17, 2012. The maximum contribution for the under age 50 bunch is still at \$5,000 and for the over age 50 crowd at \$6,000.
- Please help us help you by contacting our office for help with address, bank account or phone number changes. From time to time our investors have tried to interact with their custodian directly and have occasionally been frustrated.

As we go forward along the path of investing, I am convinced that we will benefit from owning creative, well managed enterprises that meet the world's unpredictable demands of constant newness.

Happy Trails,



Jim Parr, Principal
Cairn Investment Group, Inc



Cairnites on a
Holiday Tree Tour -

Jim, Kris, Mike, Lara and Tim