



Few would disagree with the adage that investing with one's head is preferable to investing with one's heart. Too often, emotions rather than logic are in play when it comes time to make informed investment decisions. Ultimately, hoping and wishing are poor proxies when it comes time to do the homework, assess the facts and make the proper choices.

The purpose of this report is to provide a better understanding of the macro economic landscape and in so doing provide my personal perspective in helping investors invest more intelligently, with their heads and not their hearts!

Secular Markets

"Buy and hold" has long been a mainstay of the stock market. Buying and holding equities under the premise they will eventually recover from declines may have worked well during secular bull markets but not so well in secular bear markets.

A secular market is one whose component assets move in the same direction -- up or down -- for an extended period.

Benchmark indexes continue to rise to new and higher levels over an extended period of time during a secular bull market despite corrections. Similarly, during a secular bear market, index levels decline or remain flat despite sharp rallies over an extended period of time.

Secular markets tend to move in cycles, so that a secular bull market is followed by a secular bear market, which is followed by a secular bull market, and so on.

For the most part, 'buy and hold' investing in stocks can be a successful strategy in secular bull-, not bear markets.

The secular bear market that ended in 1982 was followed by the biggest bull market in history, lasting 18 years. From its December 31, 1981 close of only 875, the Dow Jones

Industrial Average climbed to 11,497 on December 31, 1999! Never before in the history of the stock market has the Dow made such a large move over that period of time.

There is, I believe, a very good reason why many investors embrace a buy and hold approach for stocks. The secular bull market that spanned the 17 years from 1982 to 1999 was so strong and lasted so long, many investors failed (or were not old enough) to remember how stocks made little or no progress in the prior 32 years!

Although we've experienced only three prior secular bear markets (in the 20th century), they've each managed to last 16 to 21 years, with an average annual return of only around 1.5%. (See the table below.)

Secular Bear Market Duration Average Yearly Return*

Markets	(Years)	(Dow)
1906-1921	16	1.58%
1929-1949	21	1.69%
1966-1982	17	1.59%
2000	?	?

Source: Amateur-Investor.Net

The year 2000 marked the beginning of our most recent (and ongoing) secular bear market. Over the past 11 years, from December 31, 1999 through December 31, 2011, the Dow had a total return of 6.2% (11,497 vs. 12,717) for an annualized 11 year return of less than 1% (.57%).

The S&P closed at 1469 in December 1999. It closed on December 31, 2011 at 1258. That's a cumulative loss of 14.3% and an annualized loss of 1.3% over 11 years.

*Past performance is no guarantee of future performance.

What we've witnessed over the past 11 years in the stock market is the epitome of a classic secular bear, where the major indices have made major up—and down—moves over a lengthy period of time with little or no progress.

How Much Longer Will the Secular Bear Market Last?

Eleven years is a long time for a market to go virtually nowhere. Nonetheless, I believe we're in for no less than five more (if not 10 additional) years immersed in the same

"directionless, roller coaster-like" markets that we've been accustomed to over the past 11 years.

Why? The fundamental underpinnings of a market determine long-term direction. Our economy, unfortunately, has the unpleasant distinction of having some of the worst economic fundamentals since the Great Depression: high unemployment, mountainous sovereign debt and a virtually imploded housing market—all of which is deep-seated and, in my opinion, offers no quick fixes!

And one last fact: The average length of secular bear markets over the past 100 years is 18 years. To believe this current secular bear market will end soon might just be letting wishful thinking replace intelligent investing.

Are We Headed for Recession?

The consensus among economists is that we will avoid a recession. However, economists generally have a spotty record forecasting recessions and financial crises. For example, a vast majority of economists, including those at the Fed and in the White House, failed to foresee some of the most crucial developments of recent years, including the severity of the subprime mortgage crisis, the decline in the housing market, the onset of the financial crisis and the Great Recession and the weakness of the subsequent recovery. Where we stand now!

The Economic Cycle Research Institute (ECRI) is an exception. According to an October 10, 2011 Wall Street Journal article, *An Ugly Forecast That's Been Right Before*, ECRI offers up a record of prescience (and perfection) when it comes to forecasting every recession over the past 15 years—and with no false alarms!

The following are excerpts from the article. The quotes are from the Institute's Chief Operating Officer:

*As bad as the economy has been its about to get worse....the United States, which is struggling to recover from the last downturn, is lurching into a new one. "If the U.S. isn't already in a recession now it's about to enter one"....more pain is coming....the institute made its recession call only after an array of economic indicators showed a "pronounced, pervasive and persistent", downturn consistent with a recession... The pattern is clear...a host of leading and coincident indexes --those that suggest activity down the road, and those that measure current movements---are all pointing strongly toward recession"...**taken as a whole, these indicators are quite clear. "We've entered a vicious cycle, and it's too late to be averted".***

Reacting to other economists' more favorable forecasts on the economy, Lakshman Achuthan, Chief Operating Officer of ECRI made the following comments on December 9, 2011:

Forward looking data since two months ago has remained weak, it's getting weaker, it's not turning up. So, to my fellow forecasters out there, I'd say they're roughly in two camps. There are those who say that the economy is firming and will continue to firm into next year. We reject that. There's nothing there that suggests that at all. I think there's a larger camp that says we're going to muddle through; we're going to get this kind of slow growth, 'I'm not terribly optimistic, but we're going to muddle through.' I would point out that that's never happened. We never muddle through. A market economy does not want to have a static state. It either accelerates or it decelerates, and these forward looking indicators say decelerate.

In a follow-up December 18, 2011, The New York Times article, *In the Forecasting Fog, It's Wise to Slow Down*, the ECRI's Chief Operating Officer was questioned concerning his forecast of a recession in light of a pickup in economic activity towards year end. His opinion about not being able to avert a recession has not changed. He stated:

"The institutes leading indicators-which incorporate data on purchases, inventories, credit, business and consumer confidence, housing, real estate, global trade and profitability-unfortunately continue to signal recession."

Bear in mind the stock market has historically declined an average of 40% leading into a recession. Past performance is not necessarily indicative of future results.

Sovereign Debt Crisis

With U.S. and European economies interconnected the U.S. has exposure to European debt problems. Greece, Italy, Spain Portugal, Ireland are already in or on the verge of recession, while France and other European countries very close. I believe it will be very difficult for the contagion of recession not to spread to the U.S. especially considering how vulnerably weak the U.S. economy is and our monumental debt problems which Congress is dragging its feet in addressing.

In the remote possibility that we avoid a recession I believe the market will at best produce anemic returns given the economic headwinds of deep seated Sovereign debt, high unemployment and a continuing housing recession.

The seriousness and deep seated nature of the European debt crisis is underscored by Fitch Ratings, who stated December 16, 2011 that:

A comprehensive solution' to the euro zone crisis is technically and politically beyond reach.

The aspirations behind the formation of the European Union (EU) are noble, but they are running into the reality of trying to force 17 different cultures, societies and economies into a single model. The longer the leading members cling to the hope of saving an economic union that lacks political unity, the worse the ultimate crisis will be.

The enormity, complexity, and potentially dire consequences of the Sovereign debt crisis simply cannot be underestimated! No matter what happens in the near term to address the current debt crisis, I believe **Sovereign debt in Europe and the U.S. will be a recurring problem for world financial markets—one that I believe will take years to solve, thereby continuing to underpin the secular bear market in stocks.** This is a very serious problem that will require painful cuts in spending over a long period of time. Spending cuts will mean less money for jobs and buying power for consumers. Corporate earnings are the main driver of stocks. With less corporate earnings (as a result of diminished consumer spending) stocks will be hard pressed to make any significant gains and I believe will be more susceptible to losses.

I believe most savvy investors who have an understanding of the economic headwinds discussed in this report will agree that the stock market is now in a period of increasing risk and decreasing profit potential with risks outweighing rewards with no potential end in sight!

Lightening Up On Stocks Too Soon?

Sometimes it's better to lighten up on stocks sooner rather than later, particularly given the negative economic fundamentals currently overhanging the market. We saw this in the years leading up to 2008. If investors sold stocks during the period 2004-07 they could have missed out on a return of as much as 25%. But when the secular bear market reemerged in 2008 they would have been redeemed as the market lost all of its gains and then some going back to 2004 as the major indices dropped 40% (with many stocks losing over 50%). One may say, "I'll get out of the market when it starts to drop. But why didn't most investors and even professionals do that in 2008? The fact is no one knows when the big drop will happen until after the fact. Most big declines are viewed as buying opportunities, or happen so quickly huge losses are hard to avoid. **This happened**

in 2008 when the S&P dropped 33% in only three months (August 8 to November 14), from 1296 down to 873.

I believe it will be no different this time around where big declines take most investors by surprise and any gains probably will be lost (and then some) before this secular bear market runs its course.

Intelligent Investing Guidelines

I believe I've outlined a combination of fundamental factors that have proven overwhelmingly negative for stocks. Considering all the negative fundamentals weighing on equities it's imperative to be an objective investor – one that understands his or her traditional portfolio will, in all likelihood, probably underperform for years to come (just as it has for the past 11 years). **This is the guiding principle for informed investors in today's markets!**

I firmly believe that, to make the proper decisions in life, it's always best to be true to oneself and act on one's beliefs from a rational perspective. It's certainly not my desire to sound like an alarmist when it comes to the prospects for an impending recession and a substantial decline in stocks. Of course, I wish the economic fundamentals affecting the markets were strong and the secular bear market in stocks was long over. But my view of the economic landscape leads me to believe otherwise. **Whatever potential gains may be envisioned in this environment, it's simply not worth the risk of having them wiped away (or worse) when the next major market decline begins.** For this reason, I would like to share with you my personal observations which I believe can serve as an intelligent investing guideline designed for in today's markets:

- Everything today has some element of risk. Nothing is 100% safe.
- Earnings on fixed income vehicles, such as having to tie up money for 5 years in a U.S. Treasury Bill, in order to get a depressingly pathetic return of less than 1%, virtually forces suitable investors to speculate!
- No matter what one's opinion of the stock market, with it virtually unchanged to lower over the past 11 years there is no denying we appear to be stuck in a vicious secular bear market! Although I expect sharp rallies, with the worst fundamentals since the Great Depression (Sovereign debt, a U.S. housing depression and record unemployment), all deep seated with no quick cure, what's the use of being fully invested in stocks when the risk is much greater than

the reward? Moreover any gains I may realize will probably turn into losses before this secular bear market is over.

- The primary stocks I have in my portfolio now are a small amount of large cap dividend paying stocks. But even there, it doesn't make sense to be anything more than lightly invested because I believe the Dow's destiny is to drop to around 9000 or below before this secular bear market is over. What is the sense of being fully invested in dividend paying stocks now when I believe the losses I will probably see in the price of those stocks will at one time be more than several times the dividend? Yes, I could buy at the lows and sell at the highs, but that is virtually impossible to do, even for the best of professional stock traders, unless they have a crystal ball!
- I'd rather wait until the market drops to around the 10,000 level and then cost average, buying select large cap established dividend paying stocks with strong cash balances better equipped to weather a recession.
- Having stated all this I have followed my beliefs by allocating a portion of my overall investment portfolio to a diversified group of Commodity Trading Advisors ("CTA") who can potentially profit in a challenging economic environment, both in up and down markets, and who have historically outperformed stocks with even less drawdowns! The risk of loss in futures and options trading can be substantial no matter who is managing money. Past performance is not necessarily indicative of future results.

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This piece has been prepared by Robert Boshnack, Chairman of Vision Financial Markets LLC, a registered Futures Commission Merchant. His views don't necessarily reflect those of the firm.

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