



COMMENTARY

Two Sides of the Same Coin

by Gene Dongieux, Chief Investment Officer

2011 has been laden with unknowns. Political, economic, financial, sovereign debt, employment and global strife have dominated the headlines persistently and in exaggerated fashion throughout the year.

The unknown propagates uncertainty.

Most recently, the eleventh-hour admission by the congressional super committee of its inability to reach consensus on cutting the national deficit by \$1.2 trillion by the November 23rd deadline triggered an escalation in uncertainty. The impasse also created a new unknown surrounding the impact of the committee's continued dissent on the future of payroll tax cuts and extended unemployment benefits scheduled to expire at year end. On a global level, the ongoing challenges (and unknowns) faced by the European Central Bank (ECB) create new fodder for uncertainty on a daily, even hourly basis.

Uncertainty induces volatility in the market.

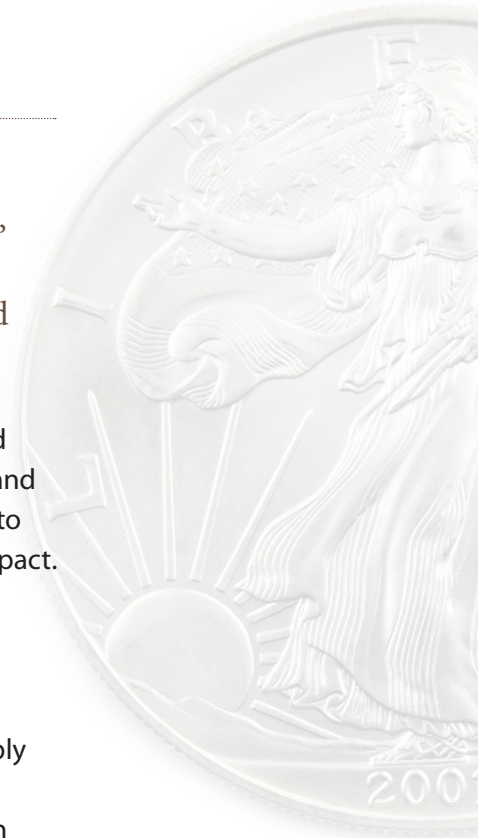
As investors, we have become painfully aware of the ever-changing market landscape of 2011 as a result of the myriad factors that have contributed to its increasingly exacerbated volatility levels. As the various indices' performance pendulums swung from high to low

extremes of the spectrum, from record gains and highs to near record losses and lows, our collective psyche was made to sustain the escalating force of each impact.

Persistent market volatility precipitates "risk-off" trades.

As you well know, risk and return are related. Investment return is inextricably tied to investment risk. Any level of expected return is commensurate with a specific level of expected risk. In order to amplify return, an investor must be able to assume an increased level of corresponding risk. This differential — the *risk premium* — represents the willingness to take on more risk in order to reap an incremental return.

In a bull market, where levels of uncertainty and volatility are likely inconsequential and/or contained, an investor is positively and incrementally rewarded for assuming greater risk — herein exists the essence of the risk premium benefit. Stated differently, this scenario reveals the positive side of the risk premium coin.



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COMMENTARY: TWO SIDES OF THE SAME COIN

In a bear market, where uncertainty runs high and the peaks and valleys of performance volatility read like a stress-test EKG, the risk premium benefit works in reverse; an investor is negatively and incrementally impacted by the degree of risk assumed. Over the short-term, a portfolio with the heaviest weighting, or tilt toward risk premiums will suffer the greatest losses. This scenario exposes the negative side of the risk premium coin.

In today's market, we see the negative side of the risk premium coin. Further exacerbating the lack of positive return in risk premium asset classes is a phenomenon known as "risk-off" trading. A significant global risk-off trade has been accruing slowly over the course of 2011 and has become increasingly more evident and prevalent with each passing month.

A risk-off trade occurs when investors react to media headlines and volatility in the market and abandon their long-term investment policies and strategies. They rush to shed their riskier holdings in search of safer investments. As a result, the small, value and emerging markets stocks that we know offer incremental return for the additional risk taken (a.k.a. risk premium) are abandoned as investors flee toward the perceived safety of other asset classes. Global investors have also sought refuge in the dollar over the euro, yen or other foreign currency.

This global exodus from the very asset classes that provide incremental return for assuming additional risk has contributed significantly to the precipitated devaluation of these risk premium asset classes. Unfortunately, it is the investors who do the best job of taking investment risk who lose the most in a short-term risk-off scenario such as the one that is playing out today.

Lasting volatility breeds discomfort and doubt.

More often than not, being the best requires more energy, conviction and mental fortitude than deciding to take the easy way out. This is especially true in the investment arena during times of great uncertainty and volatility.

It is exceedingly difficult to maintain investment discipline when the influence and impact of real world events are effecting negative change to your portfolio holdings and encouraging you to abandon your thoughtfully established investment policy and strategy. One of the most pervasive investment missteps occurs when an investor succumbs to external noise, is influenced by unfavorable short-term results and consequently reacts impulsively.

These feelings of concern and fear, along with that nagging sense that you must do something are symptoms of the negative side of this same risk premium coin. You've

.....
Uncertainty actually is the friend of the buyer of long-term values.
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Warren Buffett

signed on for the greater risk and have paid the price in this year's returns. Uncomfortable as these feelings are, it is imperative that you stand resolutely behind your risk premium strategy. If you modify your course/strategy now, you cannot be rewarded for the risk that you have already taken (and paid for). Those who abandon a well-conceived and thoughtfully directed discipline invariably come to regret the impulsive decision.

Validated risk premiums pay in the long-term.

Academic research and historic modeling have validated repeatedly the risk premiums tied to stocks vs. bonds, small vs. large company, value vs. growth and emerging market vs. domestic stocks.

Your investment portfolio is a thoughtful compilation of the goals, expectations, responsibilities and life vision that comprise your unique financial agenda. You have every reason to expect that you will be paid in the long-term for the risk premium asset classes held within your portfolio.

MARKET OVERVIEW

A Look Back at November

by Terri Spath, CFA, Investment Strategist

The Markets

AFTER A FULL-ON RALLY IN OCTOBER, that old demon Europe again wreaked havoc on the markets last month, inducing above-average volatility. Also in November, the total failure of the U.S. Super Committee to reduce the 10-year deficit is indicative of how divided Congress has become, raising uncertainty for the U.S. economy. The tech-heavy Nasdaq took the biggest hit, while a strong rally on the month's final day helped bring the large-cap dominated S&P 500 and small-cap focused Russell 2000 up to just below even. The Dow — the sole gainer for the month — bounced in and out of positive territory for the year, managing once again to regain the 12,000 threshold it has been criss-crossing for weeks. European equities underperformed and all euro government bond markets sold off. Emerging markets continued to enjoy dramatic growth but with the side effect of potentially igniting inflation, those stocks steadily lost ground. Demand nudged the yield on the 10-year Treasury downward to just over 2 percent. Meanwhile, anxiety

about the euro's future caused the currency to slide from \$1.41 to \$1.33 against the dollar.



Month in Review

Despite bond-buying by the European Central Bank, the overseas debt debacle spread from Greece, Portugal and Ireland to larger economies, costing the Greek and Italian prime ministers their jobs in the process. Yields on Italian and Spanish debt neared or exceeded the 7% level that triggered the need for bailouts in the smaller countries. As investors became more reluctant to lend in Europe, even France and Germany showed signs of weakness. On the last day of the month, six central banks, including the Federal Reserve, adopted measures to help boost global liquidity and promote economic growth, especially in Europe.

Market/Index	2010 Close	Prior Month	As of 11/30	Month Change	YTD Change
DJIA	11577.51	11955.01	12045.68	0.76%	4.04%
Nasdaq	2652.87	2684.41	2620.34	-2.39%	-1.23%
S&P 500	1257.64	1253.30	1246.96	-0.51%	-0.85%
Russell 2000	783.65	741.06	737.42	-0.49%	-5.90%
MSCI EAFE	1658.30	1505.00	1427.27	-5.16%	-13.93%
MSCI Emerging Markets	1151.39	995.56	928.63	-6.72%	-19.35%
10-year Treasury	3.30%	2.17%	2.08%	-9 bps	-122 bps

Index pricing represents price change, not total return.
Source: Bloomberg, 2011.

MARKET COMMENTARY: A LOOK BACK AT NOVEMBER

The congressional Super Committee charged with finding ways to cut the national deficit by \$1.2 trillion admitted total failure. The dissent among committee members also raised questions about the potential for resolution of other issues, such as payroll tax cuts and unemployment benefits that are scheduled to expire at year's end.

Growth in real Gross Domestic Product (GDP) for the third quarter was revised down to an annualized rate of 2.0%, catching analysts off guard. Nevertheless, the figures continued to indicate acceleration over growth in the first and second quarters. Unemployment lurched downward in November to 8.6 percent, the lowest level since March 2009.

While personal income grew and inflation remained tame, the growth of consumer spending slowed in October. Lower energy costs helped reduce inflation

at both the consumer and wholesale levels, and the Consumer Price Index shed 0.1%.

Sales of existing homes rose 1.4% with flat condo and co-op sales and single-family home sales up 1.6%. The median existing home price fell to \$162,500, shedding 1.4% over the month on a seasonally adjusted basis and 4.7% over the year, while the supply of homes for sale tightened from 8.3-months to 8.0-months.

Eye on the Month Ahead

The eurozone's struggles and/or progress with a solution to its debt problems merit continued high attention. Positive data suggesting that the U.S. economic recovery might be picking up steam could fuel optimism and shake off lingering fears. Robust domestic demand has cushioned emerging markets from the fiscal stressors the eurozone and the resilience of those economies amid global turmoil will command investor attention. ❖

Sources: Broadridge-Forefield, U.S. Treasury, FXStreet, Bureau of Economic Analysis, U.S. Bureau of Labor Statistics, National Association of Realtors, CNN, Bloomberg.

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