Bernard Wealth Management

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Welcome to Bernard Wealth Management Corp. Enclosed you will find a Portfolio Statement showing the holdings and breakdown of your accounts, and Statements of Management Fees for the first quarter of 2012.

In this, the first quarterly report from Bernard Wealth Management, I will share some brief thoughts on 2011 and the outlook for 2012.

The Year That Was

2011 began with optimism. The economy gradually expanded in the first quarter and corporations logged record profits. Employment slowly improved, and inflation remained within the Federal Reserve's tolerance. The previous summer's European debt issues were a distant memory.

Sentiment began to shift in March, following the tragic earthquake and tsunami that struck Japan. The damage was extensive enough to throw the third largest economy into recession. The economic ripples were felt around the world, slowing activity in the US as well.

By itself, the natural disaster would have been a temporary setback for stock markets. However, European sovereign debt began to make headlines again. Concerns mounted that Southern European countries, including Greece, Portugal, Spain and Italy, might not be able to make future payments on their debt. Stocks began a slide in early May that lasted until the beginning of October, falling mostly due to headline fears. At the same time, the economy in the US and abroad slowed further. Corporate earnings generally held up well during these months, but were largely ignored, as investors focused on the potential for sovereign default and European bank failure. Global stock markets exhibited volatility reminiscent of late 2008 and early 2009. Investors sought the safety of US Treasuries, sending bond yields down to record lows in September.

In the fourth quarter, developments in Europe started to steady fragile investor sentiment. European leaders, including Chancellor Angela Merkel of Germany and Prime Minister Nikolas Sarkozy of France, began working towards solutions to the sovereign debt crisis. This has resulted in an agreement for tighter fiscal controls in Eurozone member states, which should help to trim bloated budgets.

Most importantly, the European Central Bank (ECB) has taken a more active role in stemming the debt crisis. The ECB surprised markets at the beginning of December by cutting interest rates for the second consecutive month. And at the end of the year, the ECB announced a new borrowing facility for European banks, extending credit to fund the purchase of sovereign debt. This enables the ECB to bolster European bank balance sheets and reduce Eurozone government borrowing costs, much as the Federal Reserve did in staunching the mortgage debt crisis of 2008.

In 2011, bonds generally outperformed stocks, with US Treasuries posting the strongest returns. US corporate bonds and mortgage-backed securities also produced solid results. The benchmark S&P 500 led most equity indices, rising 2.1% in an extremely choppy year. International holdings dragged portfolios lower, after outperforming for most of the previous decade. Markets in China, Japan and Europe fell more than 16% for the year. Most other Asian markets finished with similarly disappointing returns.

Outlook

After a year in which the S&P 500 rose sharply and then fell nearly 20% before finishing close to break even, investors may ask what next? European sovereign debt concerns will continue to weigh on equities, and headline risk may keep volatility near 2011 levels in the near term.

However, the U.S. economy has shown signs of recovery from the second and third quarter pause. Purchasing manager surveys, factory orders and construction spending have generally portrayed a gradually expanding economy. In addition, the U.S. private sector has created more jobs than expected in each of the past three months. Corporate balance sheets are flush with cash and debt levels are historically low. Stock valuations remain below long-term averages. In addition, with interest rates still near record lows, many high quality companies now offer dividend yields higher than 10-year U.S. Treasury bonds. This backdrop should be supportive of U.S. equity prices.

US government bonds had a banner year in 2011, but this performance may be difficult to duplicate in 2012. As the economy continues to firm, interest rates may begin to tick back up, putting some pressure on longer maturity, lower interest bonds. US corporate bonds, offering higher coupons, provide some cushion against rising interest rates. As fundamentals improve, credit spreads should tighten, adding to corporate bond total returns.

I would like to take this opportunity to introduce Katie Schultz, who will be working with me to handle your administrative needs. Katie has more than five years of experience working with investment advisor clients. We are committed to providing the responsiveness and care that you have come to expect.

In the coming weeks I will be contacting you to review your financial picture. In the meantime, I encourage you to contact me with any questions or concerns.

Sincerely,

Kenneth M. Bernard, CFA