# The Markets:
# 1st QUARTER
# 2012

## *Market Commentary by*
## The Archer Funds

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**1st Quarter 2012**

2012 got off to a strong start for equity investors as the Standard & Poor's 500 index (+12%) turned in its best first quarter since 1998. Other widely followed U.S. indexes posted positive gains as well with the Dow Industrials (+8%) and the tech-heavy Nasdaq (+18%) bracketing the performance of the S&P. Stock markets around the globe were generally higher led by Japan and Germany, while China (+2.8%) underperformed on concerns of slowing growth and Spain finished the quarter as the only major stock market in the red.

Big themes developing during the quarter which pushed the markets higher were a feeling that the European debt catastrophe was off the table thanks to the actions of the ECB and building growth optimism, particularly in the U.S.

US banks were the standout performers, gaining over 25% during the quarter. Investor sentiment was clearly negative on the group as 2011 drew to a close, but that sentiment turned quickly as regulatory clouds began to clear and the opportunity to return capital to shareholders resurfaced with the passing of another round of stress tests. Historically defensive sectors underperformed during the quarter, with Utilities bringing up the rear with a loss of 2.8%. Large-cap technology stocks were another bright spot for the markets, led by Apple which can seemingly do no wrong in the eyes of consumers and investors alike.

Commodity performance was mixed as natural gas prices plunged over 30% while silver was the best performer, up 16% year to date. Despite all the recent focus on oil, crude finished up only 4%.

Bonds were relatively quiet during the quarter except for a surge in yields mid-March as the FOMC suggested more "quantitative easing" was not in the offing. Thanks to the post-Fed meeting "pop", the 10-year U.S. Treasury yield ended the quarter around 2.2% after beginning the year hovering just under 2%. High-yield bonds were the best bond performers (prices up, yields down) as the appetite for risk extended to the credit markets and lenders became more comfortable with borrowers creditworthiness.

The S&P 500 has now more than doubled since the 2009 nadir and after three years of market gains and record corporate profits, the big rally in the first quarter of 2012 has been met with a fair amount of skepticism. Perhaps rightfully so, but our guess is that the cynicism is equal parts caution and regret. We take some comfort in the fact that there exists a large contingent of those calling for a steep market decline, for sharp declines normally take place when those voices are largely silent. Market corrections can occur at any time and, while unpleasant, are healthy occurrences. And while we cannot predict with any degree of accuracy when they will occur, we can be prepared for them by maintaining a disciplined approach to buying strong companies at reasonable prices. On the whole, we do not believe the market has peaked. Reasonable stock valuations, extremely accommodative Federal Reserve policy and relatively balanced sentiment are supportive.

Earnings season is upon us and we will be closely watching for signs of strength and weakness. To be sure, profit margins are at all time highs and will not continue their ascent forever. From a macro-perspective we are also mindful of a number of important issues on the horizon. There will be no shortage of headlines in the U.S. as the political rhetoric shifts into high gear ahead of the November elections. At the same time, Washington must be prepared to address the expiration of the Bush tax cuts and a number of dramatic cuts to discretionary spending which are scheduled to kick in at the end of the year – failing to address these issues would be disastrous. Globally, Europe appears to be likely entering a long-term, structural change to its political and economic systems. China's success in engineering a "soft landing" for its once booming economy will be critical, and the situation in Iran will continue to add volatility to the energy markets.

It appears to us that the aforementioned concerns are priced in to the market as a whole. As investors with a long term focus, we continue to invest in companies with sound balance sheets, attractive business outlooks and inexpensive valuations. Within the fixed income markets we remain selective and take advantage of opportunities when they present themselves. Based on current valuations, we continue view equities as relatively more attractive than bonds for a long-term investor, but we believe it is prudent for investors to take a balanced approach given the uncertain climate.

We welcome your comments or questions and thank you for your continued confidence.

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