

## In this issue



By Robert McConaughy  
Head of Equity

## Summary of Contents

**Does the political reaction to the financial crisis risk future growth?**

**Corporate earnings — What happened to “beat and raise?”**

**Is the latest jobs data real?**

**The Institute of Supply Management Survey suggests U.S. economic growth is accelerating**

**The President’s mortgage refinance program: More bark than bite**

## The Trend Toward Less Economic Freedom

With a sluggish global economy hamstrung by the colossal indebtedness of the developed world, it is crucial to be aware of any changes in the forces that fuel or handicap growth. One issue I am particularly concerned about is the direction of global economic freedoms. Many studies strongly suggest a high correlation between changes in economic freedom and economic growth. Today, there is significant evidence that economic stresses and perceived imbalances are driving governments and politicians around the world in a populist direction that will limit economic freedoms. While such a reaction in the aftermath of 2008’s financial crisis are understandable and predictable, it does not bode well for the rekindling of economic growth.

The two most widely accepted indices for measuring economic freedom are the Economic Freedom of The World (EFW), published by the Fraser Institute and the Index of Economic Freedom, published by the Heritage Institute. The EFW has a longer history, but the Index of Economic Freedom may be more broadly studied today, especially as it is utilized and augmented by World Bank studies on this issue. The long and short of it is that based on either metric, after decades of positive progress on economic freedom, results since 2007 have shown backwards movement for the world as a whole. Ongoing events around the world suggest that this reduction in economic freedom may only accelerate from here.

There is evidence around the world for the creeping growth in state influence in economic affairs. This past week’s State of the Union address by President Obama was a marked departure from

last year’s “Winning the Future” speech. While easy to dismiss as simply election year rhetoric, it is hard to argue that the President’s explicit pride in increased regulation, proposed tax increases and the pursuit of government enforced “fairness” will not dampen economic freedom on the margin. In France, the front-runner for this May’s presidential election is the socialist challenger, Francois Hollande whose platform is based on staking out “the world of finance” as his “main adversary.” Given France’s key role in helping the European Union (EU) to stabilize and grow out of their debt morass, this is worrisome. In China, concerns about social unrest and a desire for stability through the upcoming government transition have driven a tightening of controls across the board, from greater censorship to a significant increase in control on the banking system.

The cover story of last week’s *The Economist* is an excellent examination of “The Rise of State Capitalism.” The main point is that the combination of China’s success and the financial crisis in the Western world have led to a broader embrace of deeper government involvement and planning in economic development. As the article says, “The invisible hand of the market is giving way to the viable, and often authoritarian, hand of state capitalism.” However, there is a school of thought that would argue that China’s success is not a result of authoritarian control and masterful central planning, but almost the opposite, a success coming as the result of unleashing the entrepreneurialism that came with the loosening of state controls over the past two decades. That focus of the delta or se-

(Continued on page 2)

*"I am worried that while there are strong arguments for reining in the excesses of unfettered capitalism and thinking hard about systematic ways our societies can reduce inequalities, the consolidation of control of economies in the hands of the state has **not** historically been a recipe for accelerating growth."*



**By Tom West**  
Director of Equity Research

*(Continued from page 1)*

cond derivative of economic freedom is a key distinction to solely focusing on the absolute levels of freedom. I am worried that while there are strong arguments for reining in the excesses of unfettered capitalism and thinking hard about systematic ways our societies can reduce inequalities, the consolidation of control of economies in the hands of the state has not historically been a recipe for accelerating growth. In these challenging economic times, sputtering growth does not need any additional headwinds. As *The Economist* article concludes,

## Who Moved My "Beat and Raise?"

If the economy is "muddling through," why should we expect anything different from corporate earnings? That has been the question from the "top-down" types like strategists and economists for some time now. This same time last year, the "bottoms-up" company analyst types replied that the concerns were valid, but that there were still plenty of opportunities for earnings to outpace the economy: margin recovery still to come, acquisitions, new products that could outperform the general economy, etc. The analysts were more or less right, but as they look at fourth quarter 2011 results and parse the CEO commentary to formulate estimates for 2012, the extra earnings levers are more scarce, and the Earnings Per Share estimates are on more of a "muddle through" trajectory.

With a little more than half of the S&P 500 companies reporting (covering about 3/4 of the market cap), fourth quarter 2011 earnings surprise statistics have been 35% miss, 25% in line and 39% beat, as tabulated by UBS. This is a respectable performance, but a lower mix of "beats" than was seen in the first three quarters of 2011, which in turn squares with the comments above on earnings levers. This lack of upside surprise has also weighed on 2012 estimates, which have dropped about 1.3% since the beginning of the year and about 2.5% since November 2011.

state capitalism "concentrates power and corrupts it" by "introducing commercial criteria into political decisions and political decisions into commercial ones" with the ultimate result being that "liberty is fatally weakened." I do not think we are at the point where I would use the word "fatally," but given the fragility of our global fiscal and economic situation, the incremental changes in economic freedoms deserve serious scrutiny and I fear that the trend is not our friend.

CEOs often find it best to under promise and over deliver, setting themselves up to "beat and raise" guidance as they go through the year. This year though, the conservatism seems a bit higher than usual.

The tech sector is holding up the best—enterprise spending is holding up ok, with strength coming more from the better mouse-trap companies such as Apple or software companies that are enjoying share gains or growing markets. Healthcare utilization and investment is supporting that sector, while industrials are also holding up well due to global demand and pricing that remains healthy. In the consumer sector, pricing is tough, with companies having to "invest in the brand" to keep sales up. Almost all of the sectors are bracing for a "foreign exchange headwind." In 2011, global profits reported in dollars received a boost from a weaker dollar — this has a good chance of reversing and becoming a drag in 2012.

And finally, it did seem as though more and more companies across all sectors were responding to investors' wishes with more concrete plans for return of cash to shareholders via share buybacks or dividend increases.



By Marie Schofield  
Chief economist

## Believe it Or Not!

The January labor market report was nearly too good to believe with gains of 243K in nonfarm payrolls, held back slightly by 14K job losses in government jobs. As a result, the private sector added 257K jobs in January. This is well above the quarterly average 100K to 150K gains seen in the survey of businesses in nearly a year. Even more shocking was the rise of nearly 1 million (not a misprint) jobs in the household survey. This was on a rise of 500K of new people into the labor force (who found work) in combination with 340K fewer unemployed (who also found work), and this caused the unemployment rate to drop to 8.3% (it rounded up to that) from 8.5%. So what's going on, you ask? First, both the business survey and the household survey were unquestionably strong. With respect to the household survey, the Labor Bureau introduced new population controls in January — essentially new estimates of the non-institutional population and its working and non-working components. This happens periodically but was done in conjunction with the benchmark revisions to the business survey that are normally rolled out in January each year. This huge revision added almost 2 million people to the working-age population, but only a quarter of them were added to the labor force — somewhat out-of-sync with the current labor force participation rate of 64%. As a result, the participation rate fell to a new 30 year low of 63.7%. The remainder of that new population of nearly 1.5 million working-age people was added to those “not in the labor force” and therefore not counted, hence the sharp drop in the participation rate. It is unclear who these people are. Growth in the working age population had been falling for some time and had decelerated to only 0.7% (annually). Many believed this may be due to demographic trends like increased retirements. But with these additions in January, the growth rate sprung back to 1.5%, near rates last seen in 2003. While we should approach the data with some caution, it had little effect on the falling unemployment rate. This is tough to reconcile with other data which continues to reflect muted business hiring. But we know many people are exhausting their unemployment benefits and may be dropping out of the

labor force. If we forgive the one-month jump in the size of the labor force, the drop in the unemployment rate would have been more modest — to 8.4%. But based on the Bureau of Labor Statistic's reports, it does appear that labor force slack is being absorbed at a fairly fast clip, with the level of unemployment falling over 1 million in the past three months.

The job gains in the household survey were sizable (but these tend to be volatile) and there was a jump in the self-employed category. But typically the household survey does lead the business survey data by some months, and this started to improve in earnest last August. Further, the business survey showed surprisingly broad-based gains and no pull-back in seasonal jobs that many expected might prove a drag last month. Transportation services and retail did not lay off workers as expected; indeed they added them. Favorably warm weather likely helped construction employment advance by 21K. Manufacturing jobs rose 50K, as auto and related manufacturers added to factories and production lines. Mining is a bright spot with a 10K rise likely on oil and shale drilling. Professional and business added 70K with temp and administrative jobs the stars. Health and leisure/hospitality also provided a steady demand for about 35K jobs each. The diffusion index reached 64, about where it was a year ago. And hours worked advanced at a rate similar to December. Lastly, we saw several months of strong payroll gains in the early part of 2011 which weakened as the year progressed. This data includes seasonal adjustments, and some economists suspect problems in these adjustments now resulting from the dislocations in the post-Lehman period in 2008. The result would bias seasonally adjusted data much stronger in the winter months and much softer in the summer months. One month does not a trend make — and based on last year's head fake, we need to discount it to some degree. The labor market definitely has a stronger tone, but has yet to be confirmed with secondary hiring data such as Institute for Supply Management. We need to monitor broader data sets and also see if the strength here can be sustained, and that will take a few months.

Jan-12	Mo	6mo avg
<b>Non Farm Payrolls</b>	<b>243</b>	<b>167</b>
Public Sector	(14)	(10)
<b>Private Sector Payrolls</b>	<b>257</b>	<b>177</b>
(Goods) Mfg	50	16
Construction	21	11
Mining	10	6
(Services) Retail	11	12
Transp	13	7
Wholesl Tr	14	8
Utilities	0	1
Info/Tele	(13)	(6)
Finance	(5)	2
Prof/Bus	70	52
Temp	20	18
Education	6	8
Health	30	27
Leisure/Hosp	44	28
Other Svcs	7	5

## ISM Surveys Signal Expansion



By **Anwiti Bahuguna**  
Senior Portfolio Manager  
Asset Allocation

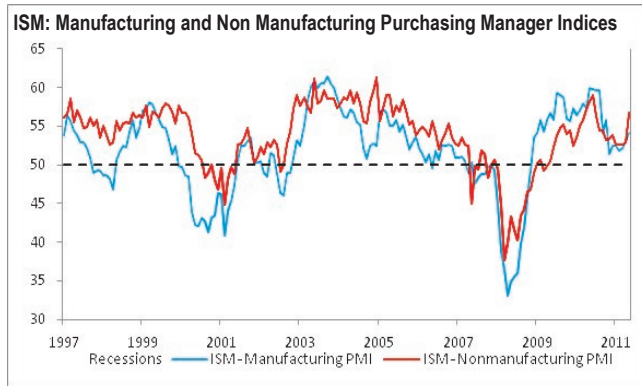
The Institute for Supply Management's (ISM) manufacturing and the non-manufacturing indices both rose in January indicating a moderately expanding economy. Last year by mid-summer, the manufacturing index had fallen sharply from around 60 in the first quarter to near 51 in June and had raised fears of a double dip recession. Subsequently, it had remained stuck in the 51-53 range for the remainder of the year. The break out to 54.1 in January, although within the range of market expectations, set a positive tone for the New Year. Details of the manufacturing report were growth friendly as the forward looking new orders component rose to 57.6 in January from 54.8 in December, reaching its strongest reading in nine months. It was recently announced that the New Orders Index within the overall manufacturing ISM index will replace the supplier delivery index as a component of the Leading Economic Index (LEI). January results will most likely make a positive contribution to the January LEI, a first positive contribution by new orders after eight straight months of contraction. Another positive sign for the manufacturing sector of the economy was the percentage of respondents reporting better new orders. This figure increased from 23% of respondents in November, 29% in December to 35% in January. Other details of the report were mixed with employment and production indices showing little change.

The non-manufacturing or Services Purchasing Manager's Index (PMI) rose nearly four percentage points from 53.0 in December to 56.8 in January indicating moderate expansion in the services component of the economy. These results were the best since beginning of last year and exceeded consensus expectation which were in the range of 52 – 54. The Ser-

ices PMI is constructed by equally weighting four sub-component indices: business activity, new orders, employment and supplier delivery. All components showed solid expansion with solid gains in new orders and employment. The employment component is an important indicator of labor markets' health as services make up a larger share of the overall U.S. economy. Although only one month's data, the increase in the employment index from 49.8 in December to 57.4 in January appears to confirm some of the strength in last Friday's payroll report. This increase is also a break from the see-saw pattern near the neutral mark observed since June of 2011.

Both manufacturing and services indices did raise some concerns about costs as the price components of both the reports showed increases after falling last year and have now risen modestly for the past three months, most likely as a result of rising gasoline prices. Survey respondents were also concerned about the sustainability of the recent increase in activity. Nevertheless, both the manufacturing and the services sectors appear to be regaining some ground after the softness seen in the summer of 2011. The Federal Reserve Chairman, Ben Bernanke, commented to the House Budget Committee that he remains concerned about the "frustratingly slow" pace of economic growth. His comments were interpreted as a sign that the Fed might be willing to engage in more quantitative easing. Whether the recent improvement in economic activity will be maintained remains to be seen.

However, the better than expected economic data reported last week along with some signs of growth in employment is likely to keep the Federal Reserve from engaging in further monetary easing in the very near term.



Source: Columbia Management Investment Advisers, LLC



By Jason Callan  
Senior Portfolio Manager  
Mortgage Backed Securities

## The President's Refinance Plan: More Bark Than Bite

Following up on the State of the Union address, President Obama announced details last week of a new plan to support housing. The proposal is multi-faceted and attempts to address numerous issues that challenge the housing market. The three key aspects of the plan are:

- 1) Provide refinancing access to all non-Government Sponsored Entities (GSE's e.g. Fannie Mae and Freddie Mac) borrowers. The proposal would provide non-GSE borrowers access to lower rates through the Federal Housing Association (FHA). Borrowers would need to be current on their mortgage for the past six months and not be delinquent more than once in the past 12 months. Underwriters will verify employment, but appraisals and income testing will be waived. The proposal would incur an estimated cost of between \$5-\$10 billion, which would be paid for by a tax on large financial institutions. Because it would involve the FHA guaranteeing loans with loan-to-values (LTVs) above the statutory mandate of 97.5%, this proposal would require congressional approval to be implemented. Legislative approval will be very challenging given the current political environment.
- 2) Streamline refinancing for all GSE borrowers.

The current Home Affordable Refinance Program (HARP) focused on borrowers with LTV's greater than 80%. The proposal would provide access to HARP for borrowers that have significant equity. The benefits primarily center on eliminating appraisal costs and increasing competition among mortgage lenders. This will not lead to a meaningful increase in refinancing, but instead change the classification of higher equity borrowers that refinance as HARP borrowers. This will attempt to make the HARP program look more successful than the previous two years by counting borrowers that don't need the special assistance as a HARP refinance.

- 3) Large-scale disposition of foreclosure properties. The Federal Housing Finance Agency is announcing a pilot sale of foreclosed properties to be turned into rental properties. This will reduce the number of distressed assets for sale, easing downward pressure on housing values.

**The proposal is consistent with the piecemeal approach expected by the market. The foreclosure disposition program is a good first step to reduce the number of distressed assets available for sale, although the other attempts to encourage refinancing are likely to have a minimal impact.**

**The views expressed are as of the date given, may change as market or other conditions change, and may differ from views expressed by other Columbia Management Investment Advisers, LLC (CMIA) associates or affiliates. Actual investments or investment decisions made by CMIA and its affiliates, whether for its own account or on behalf of clients, will not necessarily reflect the views expressed. This information is not intended to provide investment advice and does not account for individual investor circumstances. Investment decisions should always be made based on an investor's specific financial needs, objectives, goals, time horizon, and risk tolerance. Asset classes described may not be suitable for all investors. Past performance does not guarantee future results and no forecast should be considered a guarantee either. Since economic and market conditions change frequently, there can be no assurance that the trends described here will continue or that the forecasts are accurate.**

Columbia Management is committed to delivering timely insight on financial markets, economic trends and investment opportunities. Please visit the Market Insights section of our website:

[columbiamanagement.com/market-insights](http://columbiamanagement.com/market-insights)

To learn more about the support and services available to you, contact your Columbia Management representative at 800.426.3750.

## Weekly Market Summary as of 02/03/12

	Last	Week Ago		Month Ago		YTD		Year Ago	
	Yield	Yield	Chg	Yield	Chg	Yield	Chg	Yield	Chg
<b>Bonds</b>									
U.S. 2-year	0.23	0.21	0.02	0.26	-0.02	0.24	-0.01	0.70	-0.47
U.S. 10-year	1.92	1.89	0.03	1.95	-0.02	1.88	0.05	3.55	-1.63
Barclays Capital U.S. Aggregate	2.11	2.10	0.01	2.28	-0.17	2.24	-0.13	3.14	-1.03
Barclays Capital U.S. Agg Corporate	3.43	3.46	-0.03	3.80	-0.37	3.74	-0.31	4.11	-0.68
BofAML High Yield Index	7.84	7.96	-0.12	8.47	-0.63	8.54	-0.70	7.47	0.37
AAA Muni 10-year	2.21	2.17	0.04	2.28	-0.07	2.28	-0.07	3.44	-1.23
<b>Equity Indices</b>	<b>Price</b>	<b>Price</b>	<b>TR Chg</b>	<b>Price</b>	<b>TR Chg</b>	<b>Price</b>	<b>TR Chg</b>	<b>Price</b>	<b>TR Chg</b>
S&P 500 Index	1,344.9	1,316.3	2.2%	1,277.1	5.5%	1,257.6	7.1%	1,307.1	5.1%
Russell 1000 Growth Index	630.5	616.0	2.4%	588.9	7.1%	580.9	8.6%	598.9	6.9%
Russell 1000 Value Index	666.6	652.1	2.3%	636.2	5.0%	626.1	6.7%	663.2	3.1%
Russell 2000 Growth Index	479.4	460.4	4.1%	430.4	11.4%	425.0	12.8%	449.1	7.4%
Russell 2000 Value Index	1,092.3	1,050.8	4.0%	997.0	9.7%	979.3	11.7%	1,077.9	3.5%
MSCI EAFE Index	1,529.5	1,495.6	2.3%	1,446.6	5.8%	1,412.6	8.4%	1,723.0	-8.2%
MSCI EM Index	1,048.4	1,016.6	3.1%	939.9	11.6%	916.4	14.5%	1,133.1	-5.2%
<b>Commodities</b>	<b>Price</b>	<b>Price</b>	<b>% Chg</b>	<b>Price</b>	<b>% Chg</b>	<b>Price</b>	<b>% Chg</b>	<b>Price</b>	<b>% Chg</b>
Gold	1,726.3	1,739.1	-0.7%	1,603.5	7.7%	1,563.7	10.4%	1,354.4	27.5%
Crude Oil	97.8	99.6	-1.7%	103.0	-5.0%	98.8	-1.0%	90.5	8.1%
USD Index	78.9	78.9	0.0%	79.6	-0.9%	80.2	-1.6%	77.7	1.5%

Source: Columbia Management Investment Advisers, LLC

**Past performance is no guarantee of future results.**

### DESCRIPTION OF INDICES

The Barclays Capital Aggregate Bond Index is a market value-weighted index that tracks the daily price, coupon, pay-downs, and total return performance of fixed-rate, publicly placed, dollar-denominated, and non-convertible investment grade debt issues with at least \$250 million par amount outstanding and with at least one year to final maturity.

The Barclays Capital Corporate Investment Grade Index is an unmanaged index consisting of publicly issued U.S. Corporate and specified foreign debentures and secured notes that are rated investment grade (Baa3/BBB- or higher) by at least two ratings agencies, have at least one year to final maturity and have at least \$250 million par amount outstanding. To qualify, bonds must be SEC-registered

The BofA Merrill Lynch High-Yield Bond Master II Index is an unmanaged index that tracks the performance of below investment grade U.S. dollar-denominated corporate bonds publicly issued in the U.S. domestic market.

The Standard & Poor's (S&P) 500 Index tracks the performance of 500 widely held, large-capitalization U.S. stocks.

The Russell 1000 Growth Index measures the performance of those Russell 1000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 1000 Value Index measures the performance of those Russell 1000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The Russell 2000 Growth Index measures the performance of those Russell 2000 Index companies with higher price-to-book ratios and higher forecasted growth values.

The Russell 2000 Value Index tracks the performance of those Russell 2000 Index companies with lower price-to-book ratios and lower forecasted growth values.

The Morgan Stanley Capital International Europe, Australia, Far East (MSCI EAFE) Index is a capitalization-weighted index that tracks the total return of common stocks in 21 developed-market countries within Europe, Australia and the Far East.

The Morgan Stanley Capital International Emerging Markets Index (MSCI EMI) is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets. As of June 2006, the MSCI Emerging Markets Index consisted of the following 25 emerging market country indices: Argentina, Brazil, Chile, China, Colombia, Czech Republic, Egypt, Hungary, India, Indonesia, Israel, Jordan, Korea, Malaysia, Mexico, Morocco, Pakistan, Peru, Philippines, Poland, Russia, South Africa, Taiwan, Thailand and Turkey.

Investment products are not federally or FDIC-insured, are not deposits or obligations of, or guaranteed by any financial institution, and involve investment risks including possible loss of principal and fluctuation in value.

Securities products offered through Columbia Management Investment Distributors, Inc., member FINRA. Advisory services provided by Columbia Management Investment Advisers, LLC.