

## LarsonAllen Financial, LLC Market and Economic Update

### SUMMARY

- Stock market technical indicators weakened significantly in June.
- Leading economic indicators are turning down, pointing toward slower economic growth in the second half of 2010.
- New claims for unemployment insurance remain stubbornly high. (Source: Ned Davis Research, Inc.)
- Inflation remains tame as consumer prices and wholesale price inflation remains non-existent. Personal income and wages remain flat to declining year over year.
- Home sales declined through May and June as the homebuyer tax credit ended on April 30. Inventories continue to swell as foreclosures hit a new record high in April, placing further pressure on home prices. (Source: Realty Trac)
- Credit markets in the U.S. remain strong indicating confidence in the ability of issuers to service debt.
- Corporate earnings continue to be strong and corporate balance sheets are the strongest in many years. (Source: Ned Davis Research, Inc.)
- Consumer Sentiment declined by nearly 10 points in June vs. May which is very uncharacteristic of a recovering economy. (Source: University of Michigan)
- Many government fiscal stimulus programs are coming to an end, removing much of the “sugar high” the economy has witnessed over the past 18 months. State and local municipalities will receive less federal money going forward putting more pressure on budgets in the year ahead.

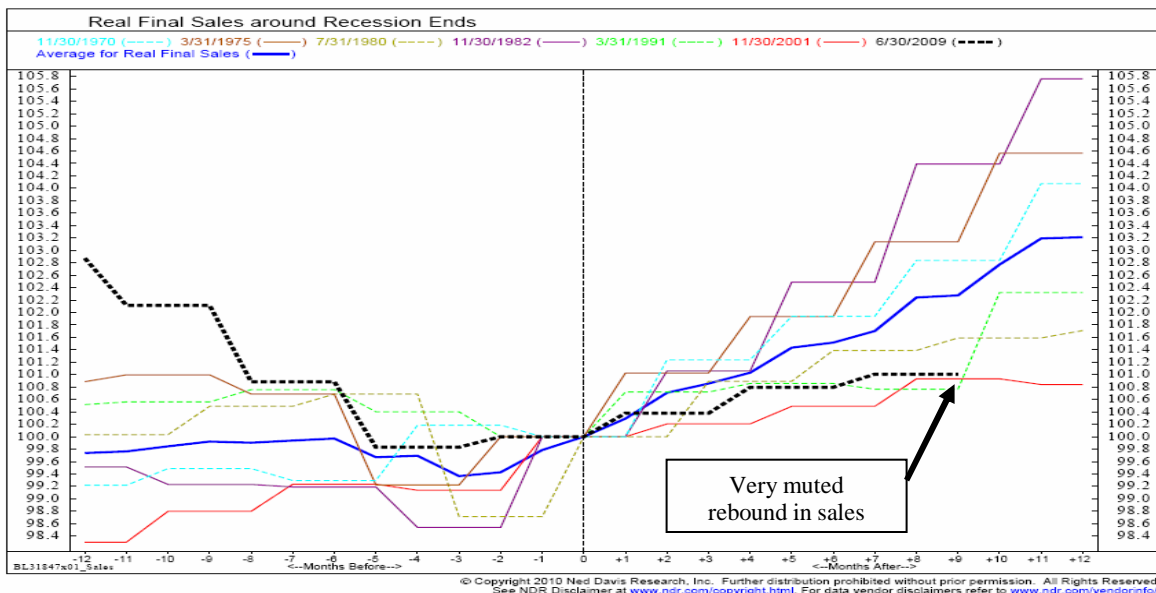
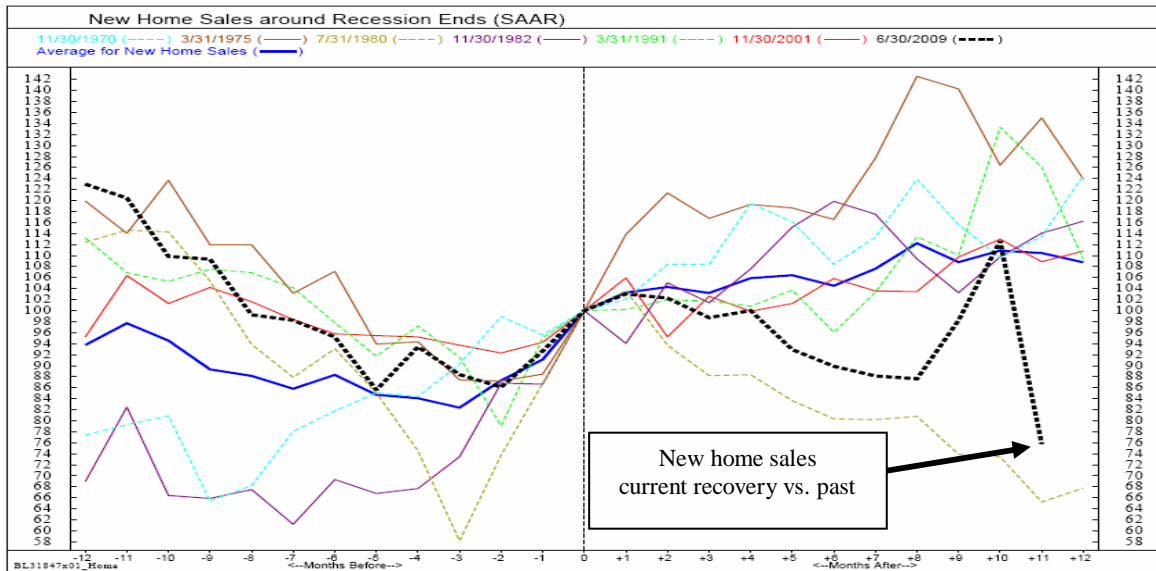
### **Conclusion**

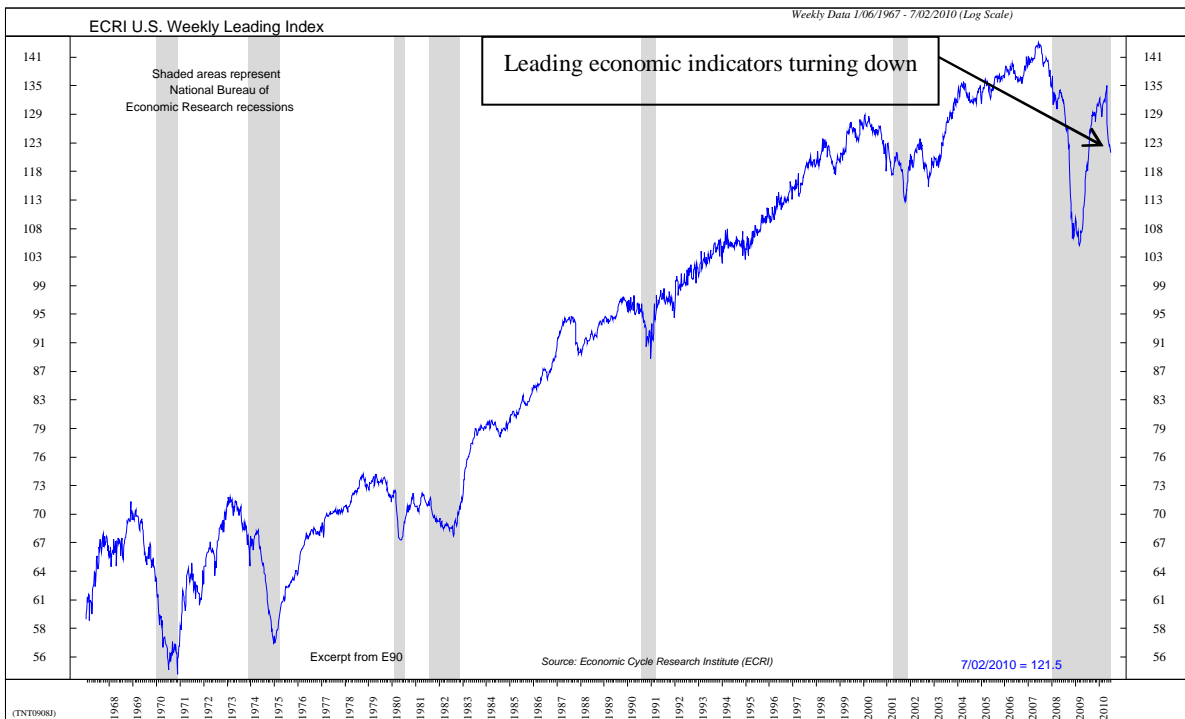
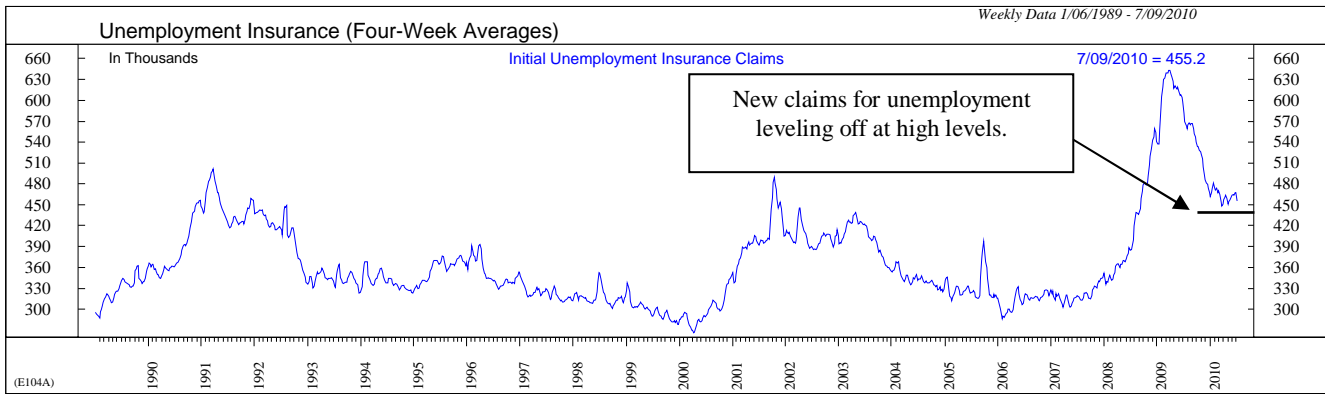
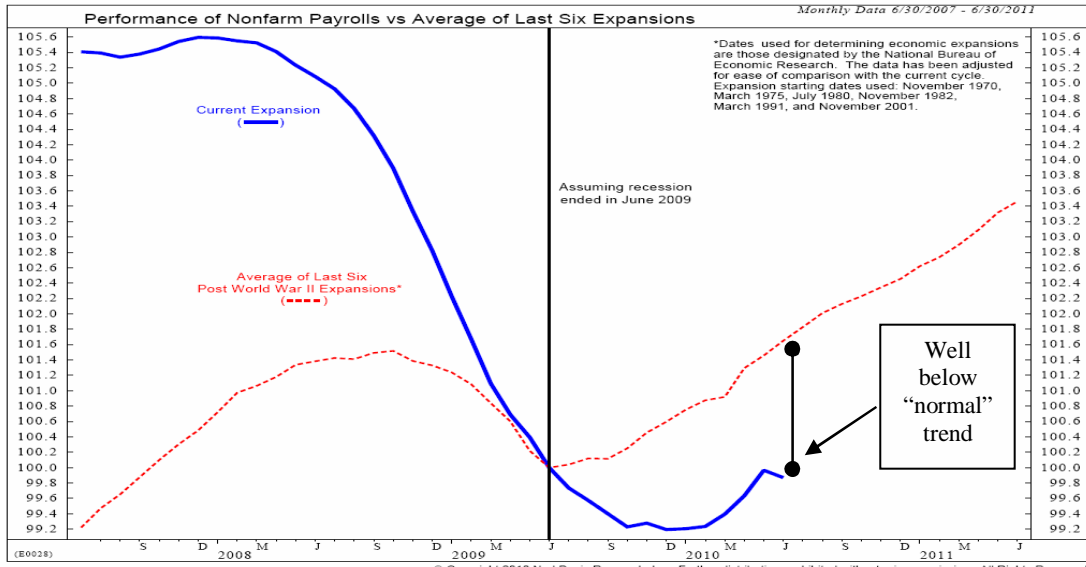
Economic indicators are pointing to a slower second half in 2010. Corporate earnings have been relatively strong thus far in Q2 2010. Markets are currently locked in a trading range trying to determine the extent of the economic slowdown in the second half of 2010 and the impact on corporate earnings.

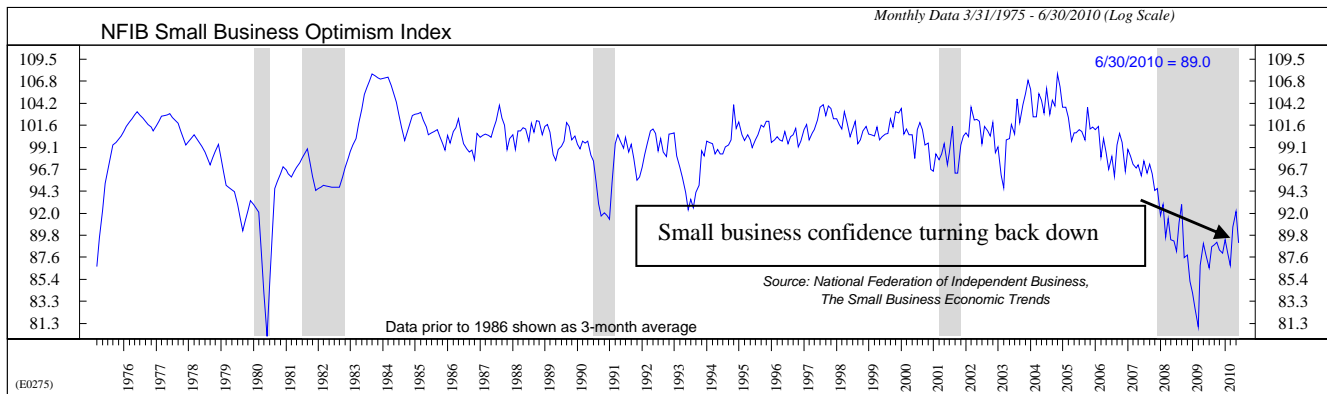
MARKET UPDATE

**Economic Analysis (Macro)**

The economic data in the past few weeks have provided us with more clarity in regards to the current state of the U.S. economy. A combination of economic indicators is providing evidence that this recovery is far from the typical post WWII 'V' shaped recovery. Home sales plunged in May as the tax buyer credit ended in April. (Source: Realty Trac) New claims for unemployment have remained stubbornly high for this stage in the recovery. (Source: Ned Davis Research, Inc.) Consumer Sentiment fell almost 10 points in June and consumer credit continues to contract, showing consumers are playing it safe in this environment. (Source: University of Michigan) The three charts below indicate just how muted this recovery has been when compared to past recoveries. With such a tenuous recovery, the slightest shock to the system has the potential to force consumers and business executives to lose confidence and could create another downturn in economic activity. Historically, the Federal Reserve has implemented strong monetary policies to restore investor and business confidence. Restoring confidence through these tactics may be more challenging in the future as the Federal Reserve has lowered the fed funds rates to 0 percent and already expanded their balance sheet to \$2.4 trillion through quantitative easing. (Source: Federal Reserve Board)







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### Equity markets

Equity markets are now developing a downward trend of lower highs and lower lows from the April 2010 top. The next few weeks will provide further evidence if this downward trend continues or if we can break back above resistance levels to renew the cyclical bull market. If the market remains below key technical levels it will provide support for a renewal of the secular bear market.

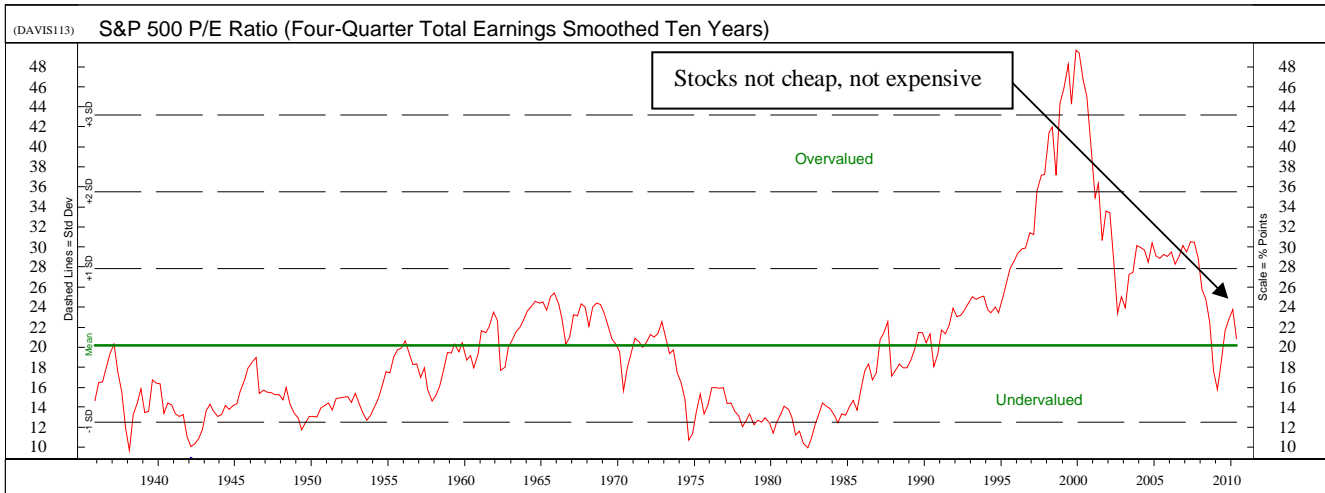
### Technical Indicators

Equity markets have been trading below their 200 day moving averages for some time and are a bearish indicator. In addition, the 50 day moving average is now passing below the 200 day moving average (death cross, see chart below) which has historically been a caution flag of trouble ahead for the equity market. It will be critical for the equity market to move back above the 200 day moving average and remain above that level for several days for the market to regain its technical integrity.



**Fundamentals**

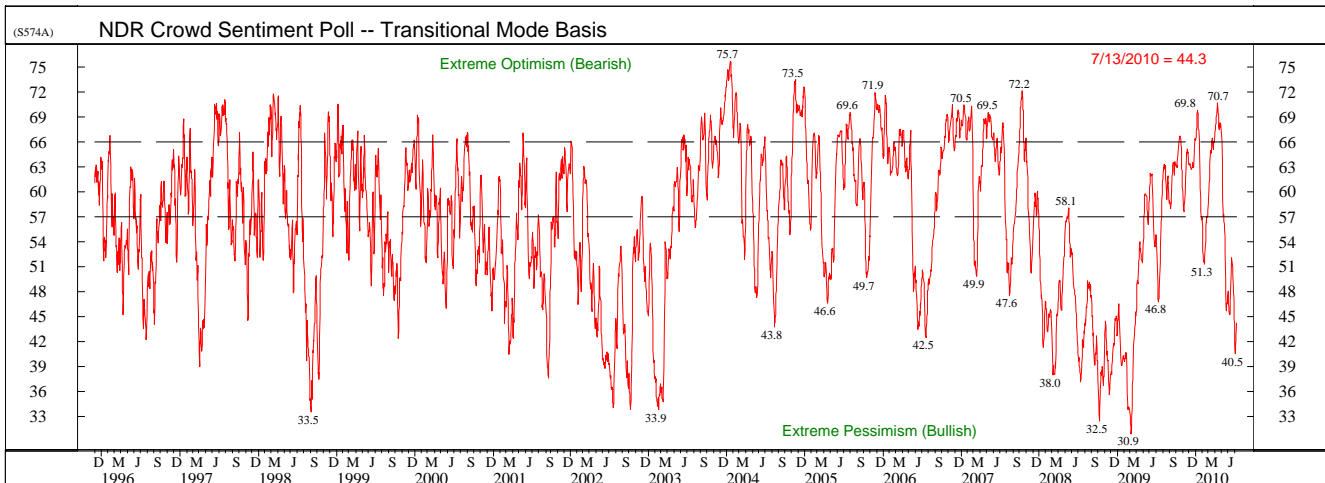
Valuations have moved back closer to historical averages based on forward operating earnings projections, yet remain far from what we would deem cheap. Earnings forecasts are indicating very high growth in business in the second half of 2010. However, forward earnings forecasts tend to be the least reliable and often subject to revision. A second half slowdown or recession is most likely not priced in the equity markets at current levels.



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**Sentiment**

Investor sentiment has become more negative which may provide an indication that equities are reaching a near term support level.



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Although equity prices have corrected from the recent peaks, we would advise investors to remain cautious. As we have stated in the past, we believe we are within a secular (long-term) bear market that began in 2000. We have witnessed government policy over the past 24 months that is far beyond anything witnessed since the 1930s in an attempt to restore economic order. Even with this massive policy implementation, we are running at far subdued economic levels relative to past recoveries (see charts 1, 2 and 3).

### **Portfolio Construction**

After adding risk to our portfolios (equities, high yield bonds) in May 2009 when the stock market appeared undervalued, we began reducing risk (equity/high yield bonds) in client portfolios in November 2009. We continued to de-risk portfolios more significantly in June as we grew more concerned that the economy is on the verge of slowing in the second half of 2010. While low inflation, cheap interest rates, and reasonable equity valuations historically provide a good background for stocks, the leading economic indicators combined with deteriorating stock market technical factors point to caution in the near and intermediate term.

*This Market and Economic Update is prepared by LarsonAllen Financial, LLC. If you have any questions, please call 1-888-925-2926 and ask to speak with a Senior Wealth Advisor.*

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