LarsonAllen® Financial, LLC
Member FINRA & SIPC

Market and Economic Update

April 2011

Executive Summary

Equity markets around the world have rebounded sharply from the sell-off that resulted from the Japanese earthquake and nuclear crisis in early March. Earnings thus far in the first quarter of 2011 have been mixed as companies with exposure to commodities (i.e. transportation, apparel) have seen an impact on margins. Many equity market indices have recouped their 50-day and 200-day moving averages which is a technically bullish sign. However, we are observing a double top formation in the equity markets as the recent recovery could not take out the February highs in the market. Seasonally, we are now entering what has historically been the "lowest performing" six months in the equity markets. Since 1950, more than 80 percent of the Dow Jones Industrial Average gains have occurred between November 1 and April 30. (Source: Stock Market Almanac) Given the 20 percent equity rally since last September, the equity markets are due for a correction/pause into the summer months. A stock market breakout to new highs is not likely with the uncertainty of QEII (Federal Reserve Quantitative Easing program) ending in June and also considering the seasonally weak summer months for the market. Below are the positives that we see for the market and economy:

- Manufacturing data continues to come in strong within the United States. (Source: ISM)
- U.S. retail sales figures continue to surprise to the upside. (Source: Bloomberg)
- Germany's economy continues to report extremely robust activity. (Source: Bloomberg)
- China's economy reported 1st quarter growth of 9.7 percent which continues to exceed economic forecasts. (Source: Bloomberg)
- Federal Reserve Policy remains extremely accommodative. Goldman Sachs Chief economist stated that he expects the Fed to maintain the near zero percent Fed funds rate through 2012. (Source: Bloomberg)
- We believe that massive liquidity due to the expansion of the Federal Reserve's balance sheet has had a direct impact on stock, bond and commodity prices creating a "wealth effect" for those that own stocks, bonds and commodities.
- Core inflation remains very subdued due to a lack of wage growth and home prices. (Source: Bloomberg)
- Interest rates remain very low providing low cost of funds for those willing and able to borrow. (Source: Bloomberg)
- U.S. corporations are lean, showing significant cash flow while various industries are starting to add staff to their work force. (Source: Ned Davis Research, Inc.)

The following are the risks that we see to the market and economy:

- Higher oil prices are serving as a tax on the U.S. consumer. We are close to the tipping point at $120/barrel and $4/gallon at the pump which may have a significant impact on consumer psychology and consumer spending. (Source: Bloomberg)

- Standard and Poor's downgraded the outlook on U.S. treasury debt from stable to negative last week. We have warned for some time that the U.S. government has to get its fiscal house in order and soon. The warning shot from S&P should put more pressure on Washington to take action in reducing our deficits. The United States will run a record deficit in 2011 between $1.5 trillion and $1.7 trillion. (Source: Congressional Budget Office)
- The European debt crisis continues as Greece debt and Irish debt hit record yields this past week. This problem has yet to be resolved and may be the canary in the coal mine that deserves watching. (Source: Zero Hedge)
- Quantitative Easing II is scheduled to end June 30th which may cause speculators to unwind a portion of their risk trades. (Source: U.S. Federal Reserve)
- Home prices continue to decline nationwide creating a psychological drag on the consumer. (Source: Bloomberg)
- Many economists are revising down their GDP forecasts for the first half of 2011 as well as their forecast for the entire year. (Source: Zero Hedge)
- The equity markets are developing what could turn out to be a double top formation which is a bearish technical pattern. (Source: Elliot Wave International)

Caution

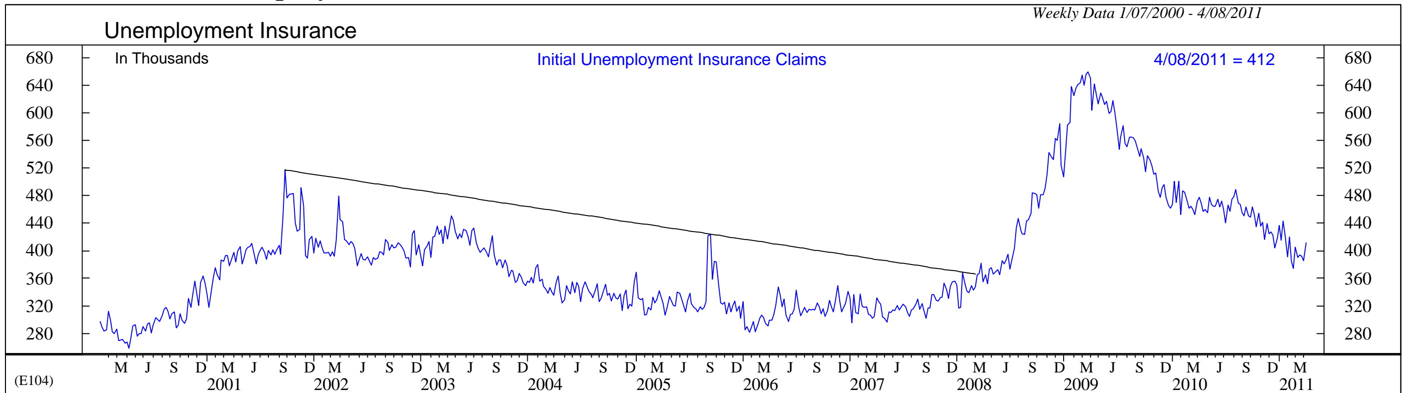
We would like to caution our readers from getting too bullish after a two year rally that is now resting near peak levels in this cycle. (Source: U.S. Federal Reserve) This is far from a "natural recovery." The Federal Reserve has expanded its balance sheet by $2.2 trillion over the past two years supporting speculation in equities, commodities, and bonds. We have also witnessed the U.S. Treasury run unprecedented deficits which have doubled the U.S. debt over the past five years. These extreme actions by our government officials were in response to the deep recession of 2008-2009. Continuation of budget deficits is unsustainable long-term and we will grow much more concerned if we do not see major reform on spending and entitlement programs in the next twelve months. It is important that investors understand these unprecedented risks to our economic system and high level of government intervention (most since the 1930s). (Source: Bloomberg)

Higher commodity prices are one of the substantial negatives of the current Fed Policy. The excess liquidity in the banking system is driving speculators to borrow money very inexpensively to buy commodity futures contracts. This in turn is driving commodity prices near all time high levels. We are seeing gold, silver, corn, cotton, sugar, wheat, and oil all trade near or above their all time high levels. This is serving as a tax on global consumers as their cost of living increases. Higher commodity prices may, at some point, serve as a substantial headwind to our economic recovery. (Source: Bloomberg)

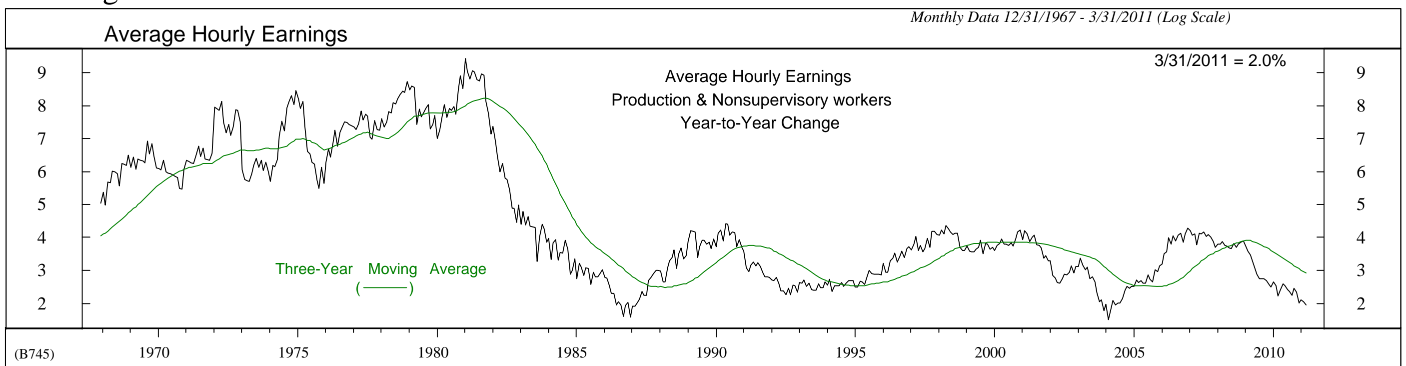
Macro Economic Data

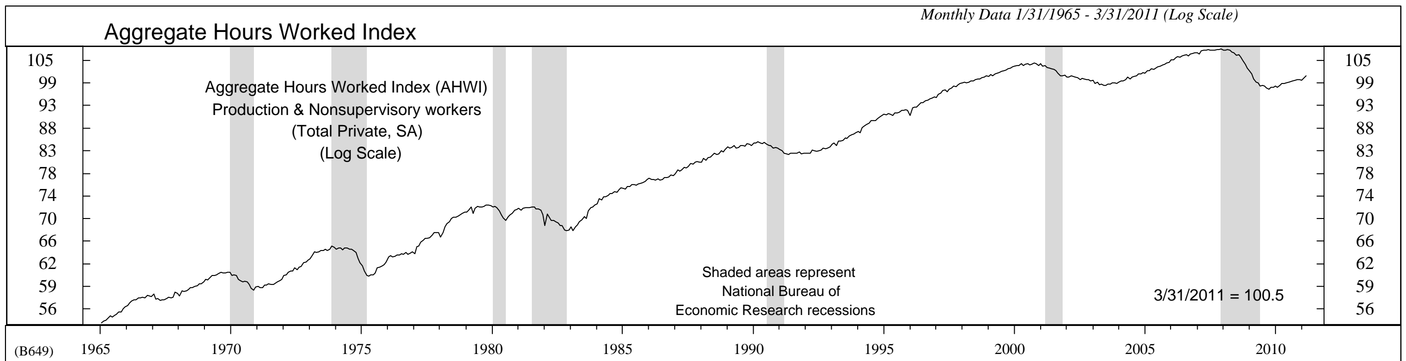
The overall economy has produced mixed results. We are witnessing many economists downgrade their 1st and 2nd quarter GDP numbers from four percent down to 1.5-2.0 percent. (Source: Bloomberg) Higher energy prices look to be the number one concern that most economists have for second half 2011 GDP growth. If energy prices remain at current levels or continue higher, we expect to see more downward revisions to second half expectations. This is most likely not priced into the equity market at current levels.

New claims for unemployment

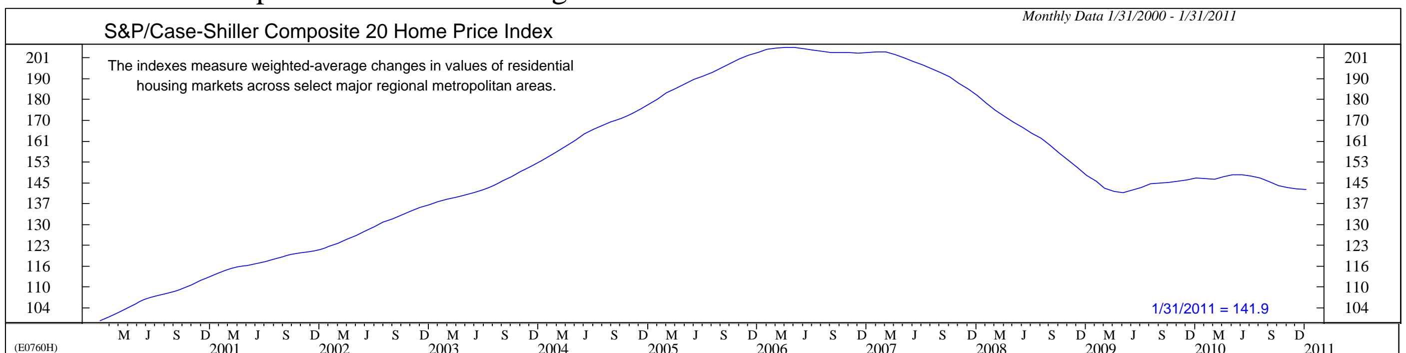


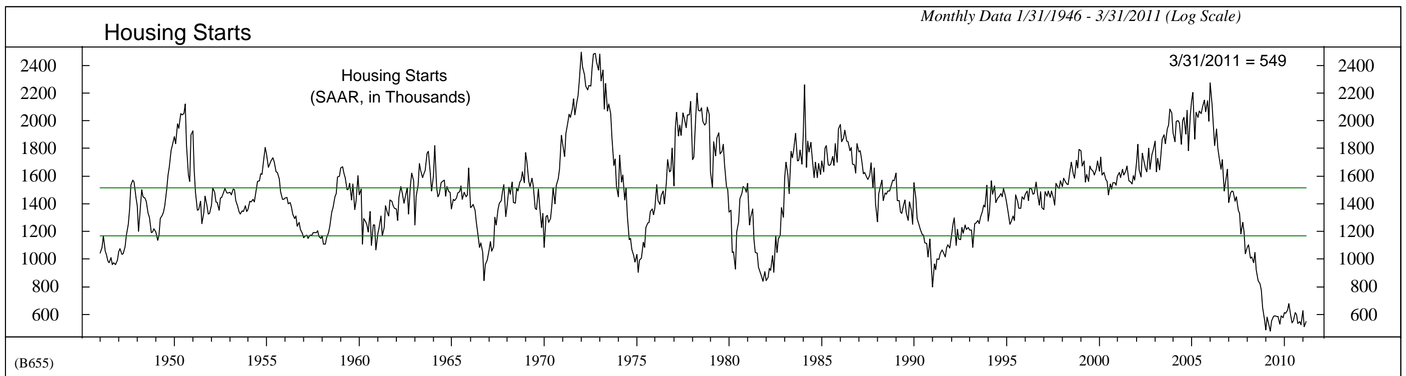
Real wages and hours worked





Case Schiller home prices with new housing start data





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Commercial lending

Chart has been modified.

Lending Standards for Commercial Real Estate Loans

Quarterly Data 9/30/1990 - 3/31/2011

Net % of Commercial Banks Tightening Standards for Commercial Real Estate Loans

Tighter Standards

Easier Standards

Q1 2011 = 0.0%

Q1 2011 = 12.3%

Increasing Demand

Net % of Commercial Banks Reporting Increasing Demand for Commercial Real Estate Loans

Decreasing Demand

(E0530A) Demand for Commercial Real Estate Loans

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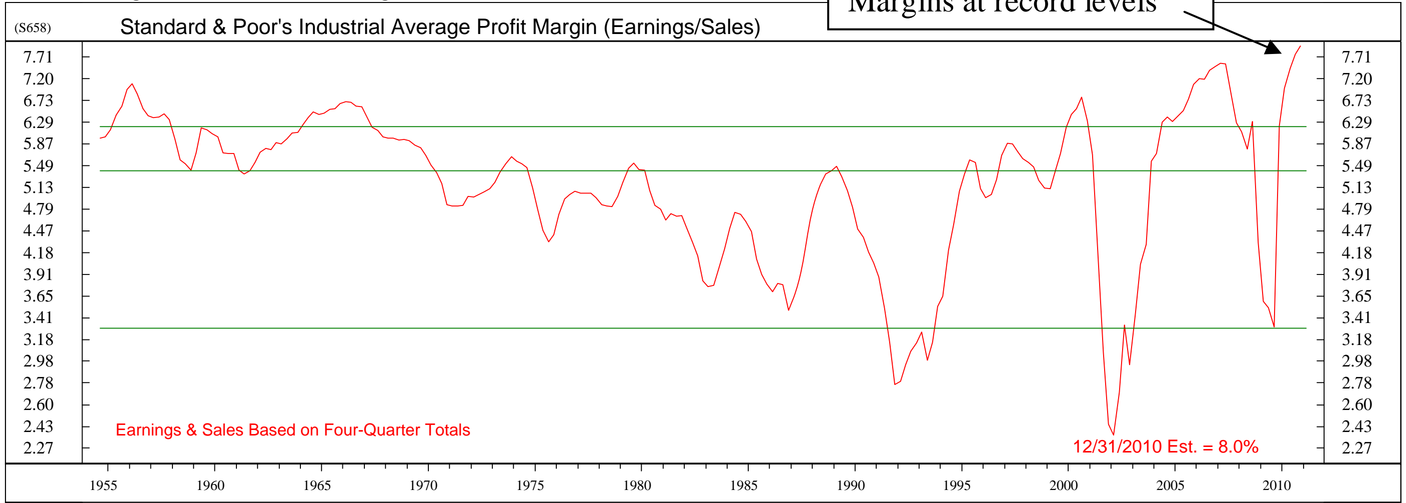
Valuation

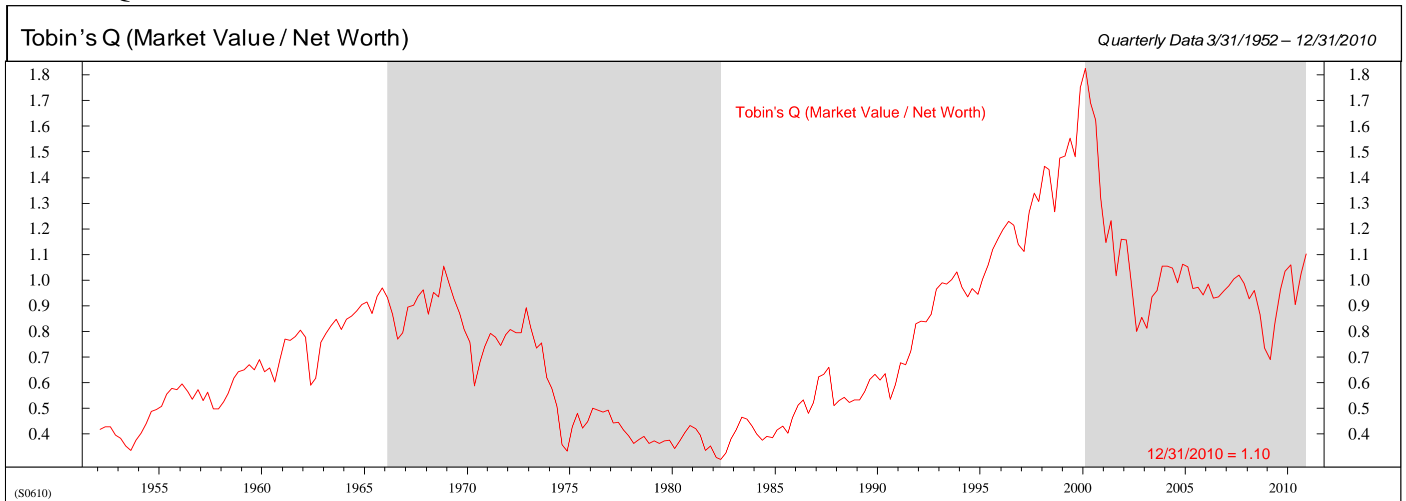
Valuations of equities in the United States are no longer what we would deem as “cheap.” At best, one can argue that equities are just above fair value. Corporate profit margins are at record levels currently due to the lack of hiring by many companies. Historically, profit margins tend to fall back to average levels which may create some difficulty for corporations to continue to expand profits at current levels. One measure of valuation (replacement value) is now at the highest in history (excluding the 1999 tech. stock bubble) over the past 100 years. (Source: Ned Davis Research, Inc.) The dividend yield on the S&P 500 is now back close to where it was at the peak of the 2007 market cycle (1.87 percent today vs. 1.70 percent

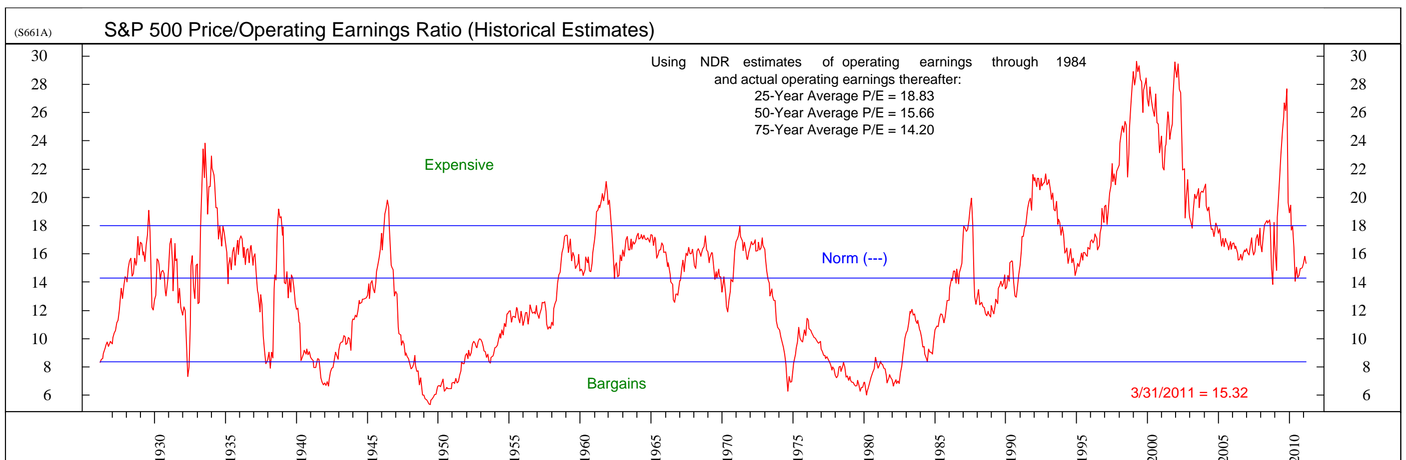
in 2007). Higher input costs will also begin to impact corporate profits for those companies that are heavily reliant on commodities. European and emerging market equities look more attractively valued at this point. (Source: Leuthold Group)

Profit margins (mean reverting)



Tobin's Q





Technicals

Market technicals remain constructive.

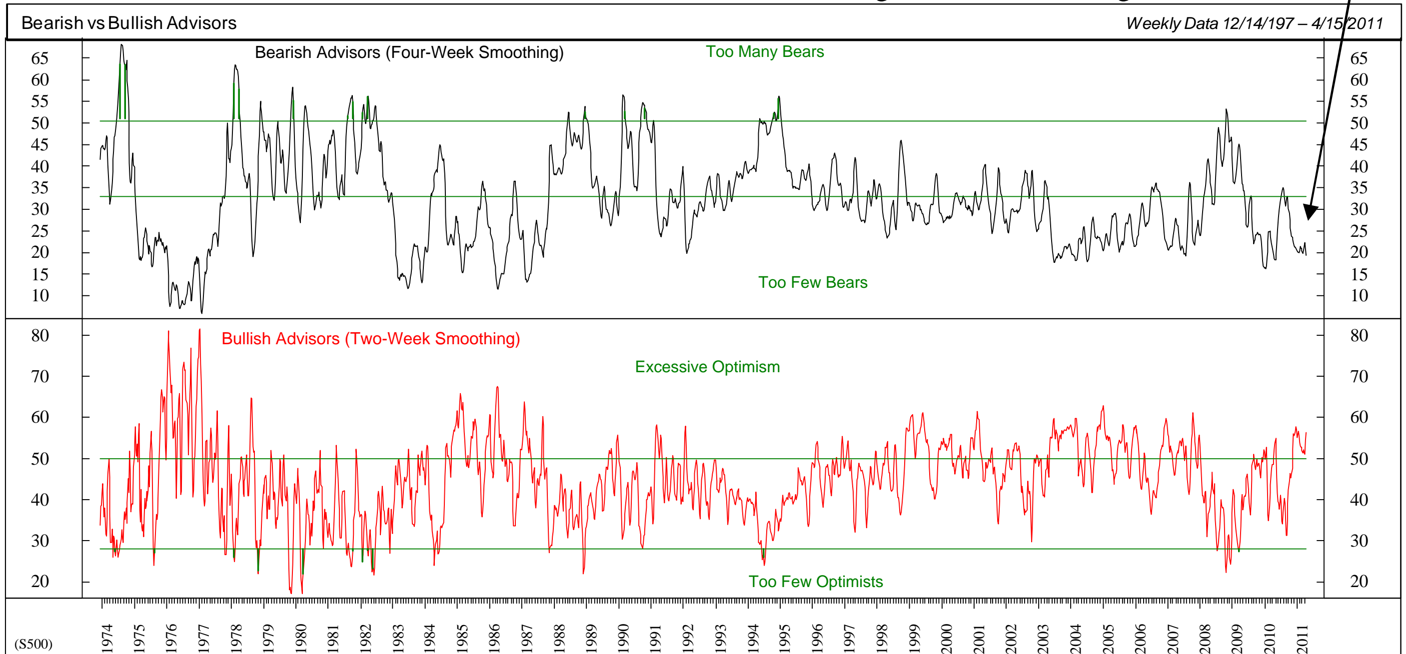
50-day and 200-day moving averages for the S & P

Sentiment

Recent market sentiment is very concerning as we are seeing a significant drop in the number of people who are bearish and we are seeing a rise in those that are bullish.

Very few bears

Market sentiment is now at extreme levels. Bearish sentiment readings and rate of change



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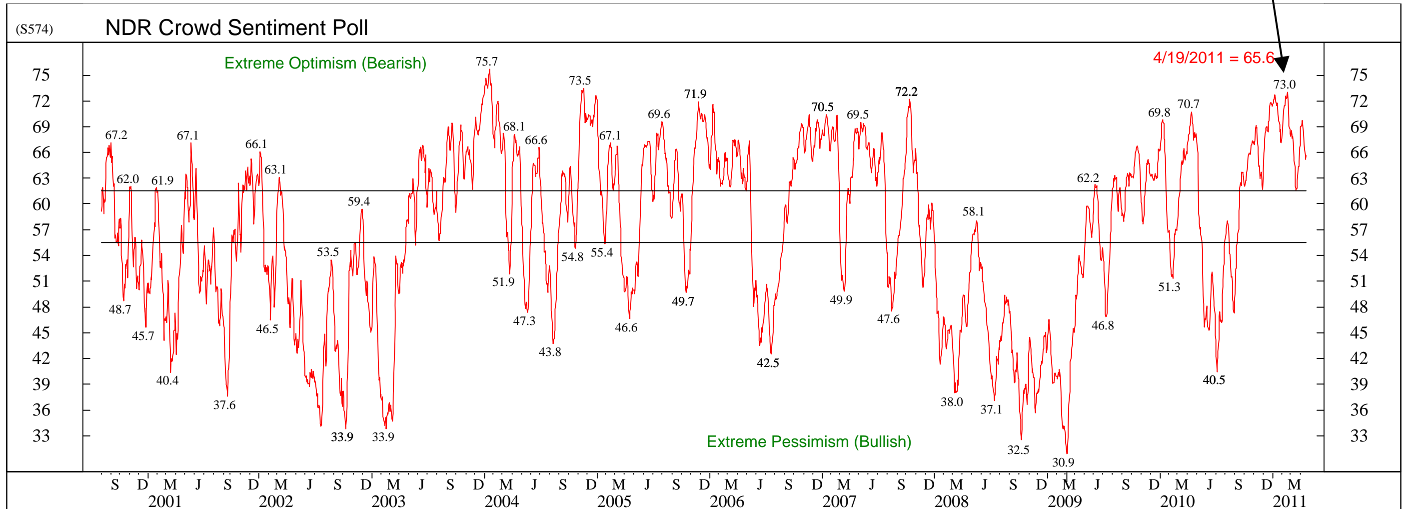
Bullish sentiment

Many bulls



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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 or contact one of our principals below.

Tony Hallada, Managing Principal
thallada@larsonallen.com

Chuck Betz
cbetz@larsonallen.com

Larry Fiorini
lfiorini@larsonallen.com

Mike McConnell
mmcconnell@larsonallen.com

Steve Bien
sbien@larsonallen.com

John Gustavson
jgustavson@larsonallen.com

Jean Wolfe
jwolfe@larsonallen.com

Bruce Bushman
bbushman@larsonallen.com

Nick Houle
nhoule@larsonallen.com

Dominic Zamora
dzamora@larsonallen.com

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