

LarsonAllen Financial, LLC Market and Economic Update

SUMMARY

Economy

- U.S. economic data continues to point toward a downturn in the second half of 2010. It now looks as though the second quarter of 2010 GDP growth may come in around 1.30 percent which is far below prior economist consensus' estimates of 2.5 percent. This is very anemic growth considering Washington's record levels of stimulus and low interest rates over the past 18 months (Source: Gluskin Sheff).
- A few economists are now questioning whether the first recession ever ended as the NBER (National Bureau of Economic Research) has yet to declare the end of the recession that began in 2007. An unemployment rate hovering near ten percent (Source: Bureau of Labor Statistics) and a chronically weak housing market would support this view.
- New claims for unemployment exceeded 500,000 for the first time since November 2009 indicating that the labor market is beginning to worsen (Source: Bureau of Labor Statistics.). Generally, employment growth does not occur until initial claims for unemployment are consistently below 400,000.
- Shadow home inventories are rising as banks continue to deal with record levels of delinquencies and foreclosures. Home sales continue to run well below trend. Surveys are showing that few consumers have confidence in housing and many believe that housing has further to fall over the next two years. (Source: NRA)

Equity market

- Although current earnings were relatively strong, some corporate executives have become cautious with their earnings outlook due to a lack of clarity on economic conditions over the remainder of the year. This in turn is beginning to place pressure on the equity markets.
- The U.S. equity markets have been similar to riding a mechanical bull over the past nine months. There has been lots of volatility, but at the end of the day, one has gone nowhere. The Dow Industrial Average is trading at the same levels as November 2009 (Source: Bloomberg).
- **Equities have yet to price in a double dip recession. We are potentially still in the recession that began in 2007, which makes equities vulnerable to negative economic data.**
- Technically, the stock market supports the thought that the cyclical rally we believe began in March 2009 may have seen its peak in April 2010.

Credit Markets

- Interest rates continue to fall. The yield on the two year Treasury note has moved to multi-decade low levels and the 10-year treasury has fallen to 2.60 percent as concerns of deflation continue to persist. U.S. Bonds have far outperformed U.S. stocks in 2010 and over the past ten years. (Source: Bloomberg)
- If we continue to see weakening economic activity into the fall, we would expect to see both Republicans and Democrats begin to support the extension of the Bush tax cuts into 2011. A tax increase at a time of faltering economic activity could have lethal consequences both for the economy and the equity markets in 2011.

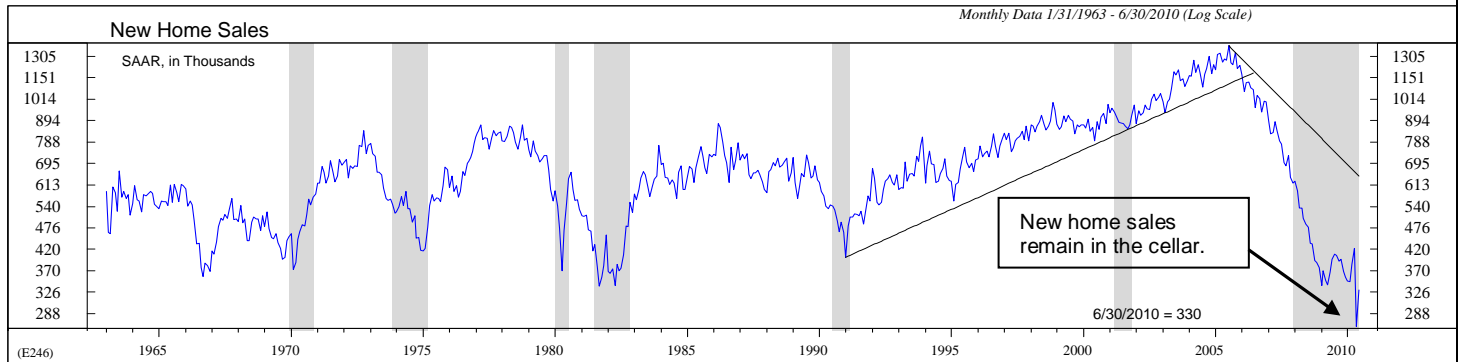
Conclusion

- Economic indicators are pointing toward very slow growth in the second half of 2010 and a second recession or further downturn is not currently priced into equities. We believe flat to negative GDP growth in the second half of 2010 is a high probability event and we maintain that investors should remain cautious regarding equities. From a seasonality standpoint, we are also heading into what have historically been the weakest months for equities (September/October). We expect interest rates to remain low for an extended period of time due to anemic economic activity.

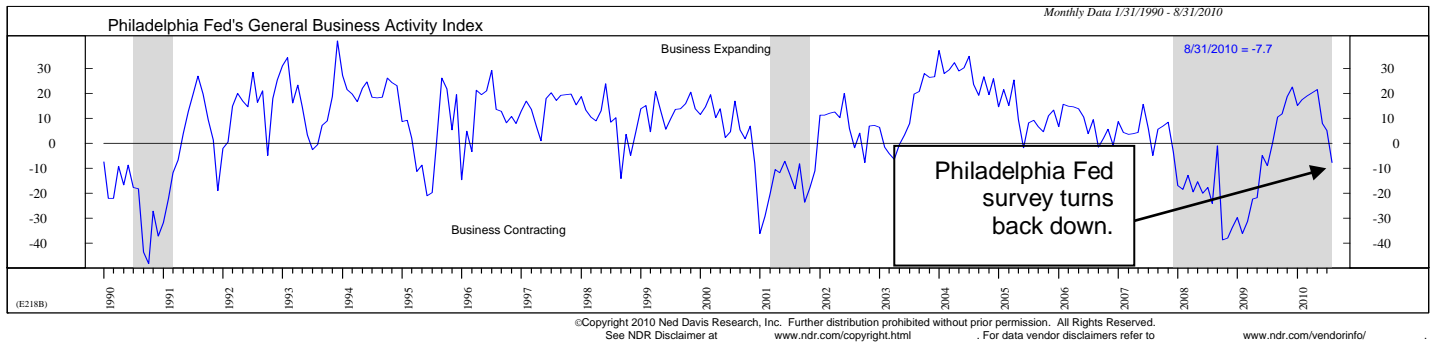
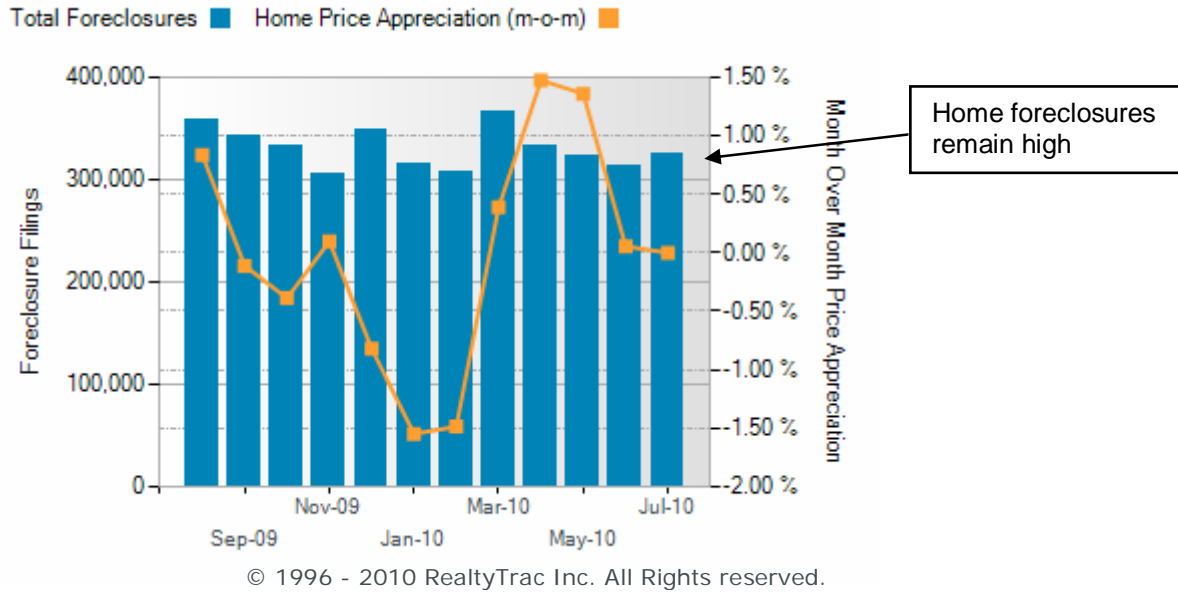
MARKET UPDATE

Macro Economy

Housing continues to show signs that things will not get better any time soon. Bulging foreclosures and inventories along with cautious buyers continues to place downward pressure on housing markets.

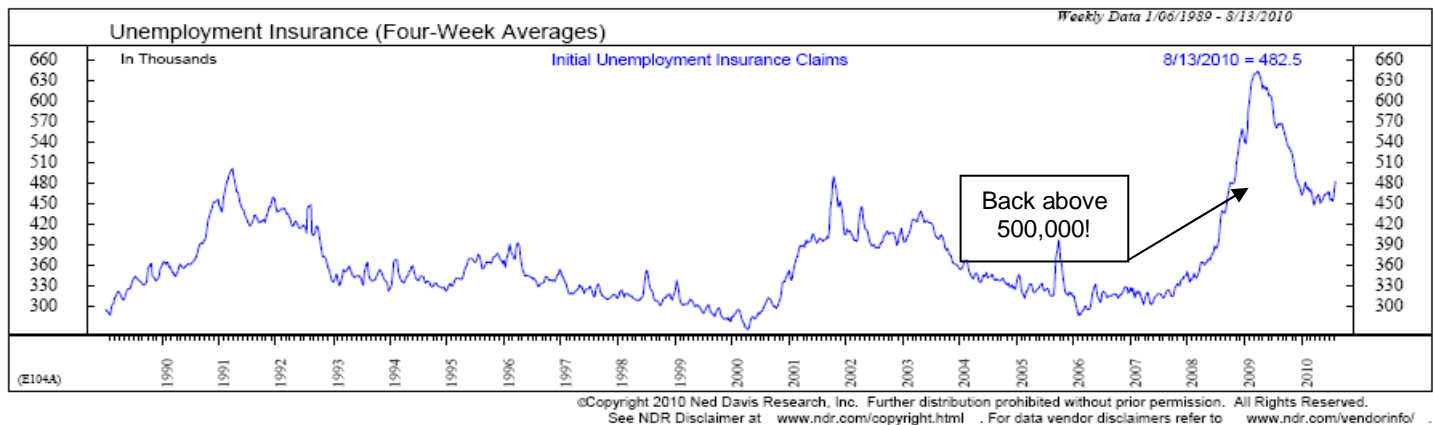


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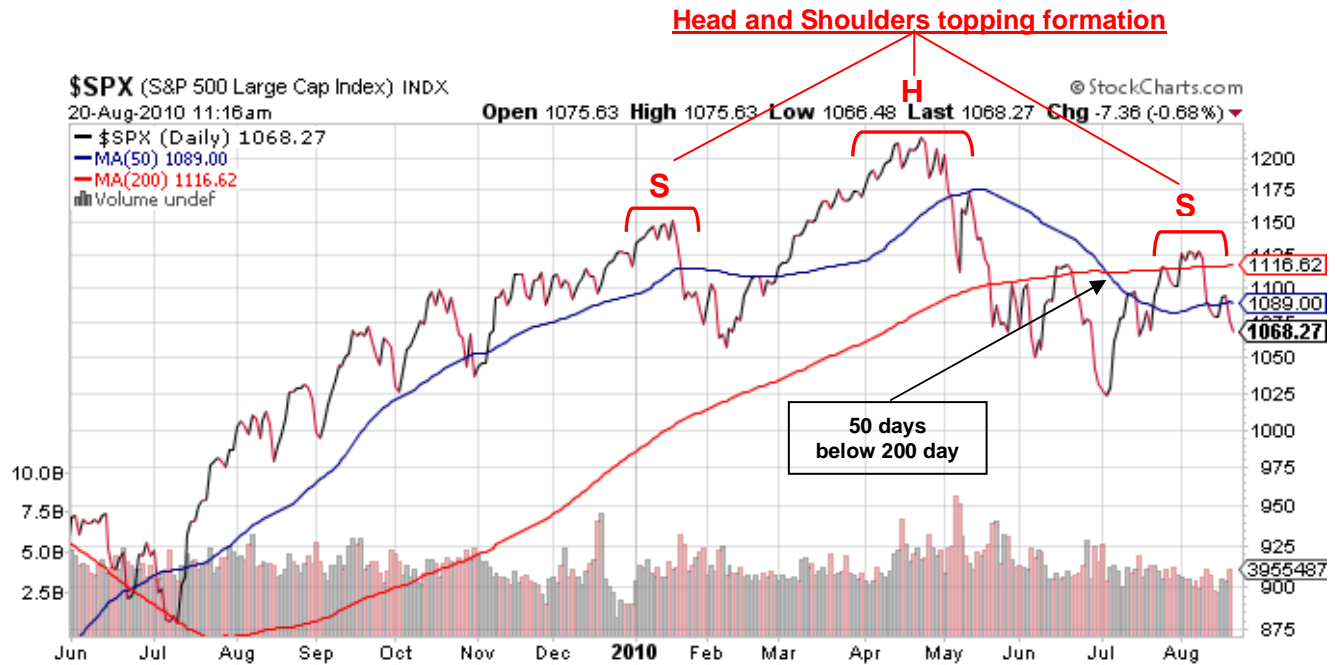
Labor

Labor markets are now beginning to turn back down with new claims for unemployment hitting the highest level since November 2009. (Source: David Rosenberg/Gluskin Sheff)



Technical Indicators

The U.S. equity market is developing a major head and shoulders top. Technical indicators are very bearish for equities at this time with most major averages trading below their 50- and 200-day moving averages. The 1–2 year cyclical rally that we thought began in March of 2009 is increasingly looking as though it has seen its top.



Valuation

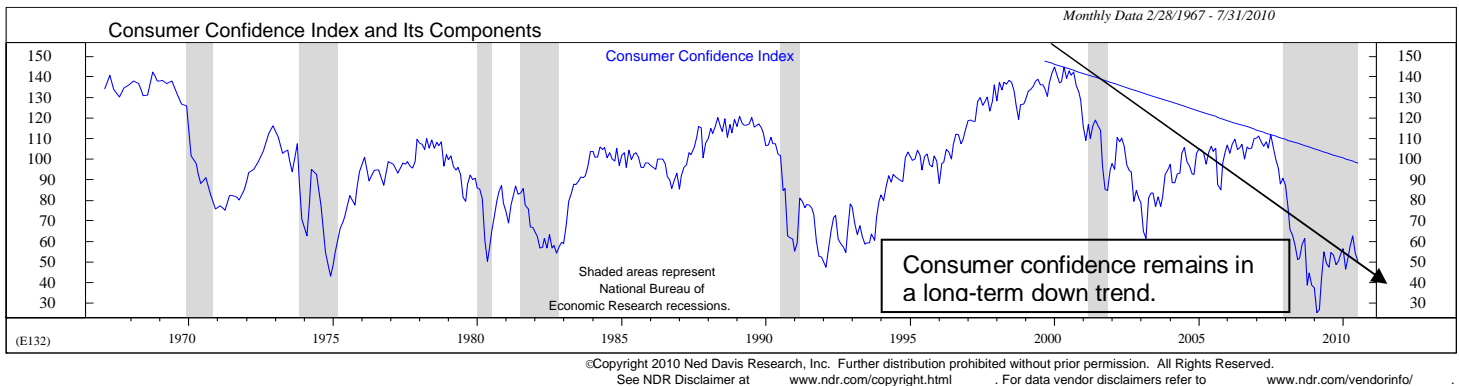
We believe we are within a secular bear market that began in 2000. Secular bear markets tend to end with equities at extremely low valuations and very high dividend yields. We are far from these extremes as the S&P 500 currently sports a low 2.0 percent dividend yield and P/E ratios are currently at 20-year average levels (Source: Ned Davis Research). We believe P/E ratios need to trade below historical averages for the following reasons.

- 1) We are now de-levering our economy (paying down debt) vs. leveraging up our economy. This in turn may place downward pressure on GDP growth in the coming years, making it more challenging for companies to find top line growth. Slower growth supports lower P/E ratios.
- 2) With the baby boomers now being burned twice by equities over the past ten years their demand for equities has likely diminished. Boomers are now more interested in the return of their principal rather than the return on their principal. The move to investments with income producing characteristics may be a generational move. Lower demand for equities supports lower P/E ratios.
- 3) Banks are far less willing to finance leveraged acquisitions of companies. Leverage ratios will probably be much more conservative going forward and thus take outs must be done at lower P/E ratios to get the appropriate IRR for the acquirer. Less leverage supports lower P/E ratios.

- 4) We have just witnessed the implementation of the biggest regulatory reform in U.S. history. Higher regulation has historically led to slower growth which in turn should result in lower P/E ratios.

Sentiment

Typically one would watch short-term bull and bear sentiment indicators to determine the short-term direction of the market. One of the indicators we are watching is consumer confidence in the U.S. We believe consumer confidence is in a long-term secular decline as one can see by the chart below. The consumer balance sheet has been turned on its head over the past few years with declining real estate values and declining equity markets all while consumer debt levels increased.



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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