

March 2011

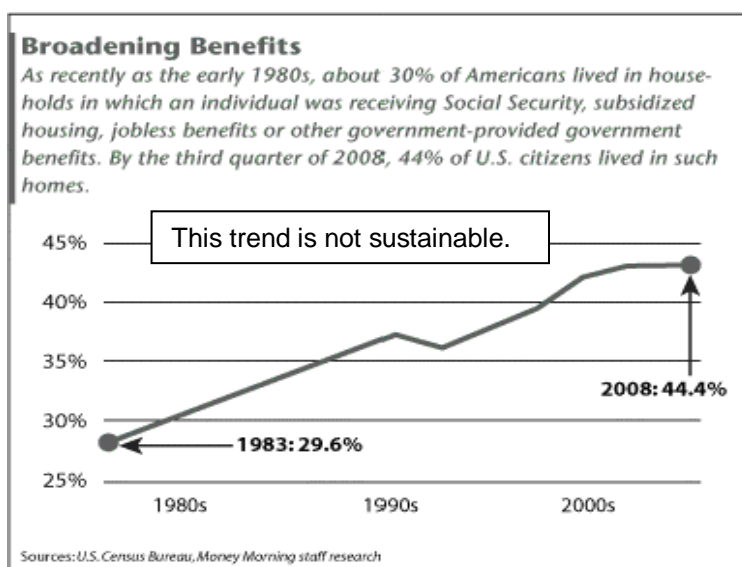
Executive Summary

The cyclical bull market looks to be intact; however, new risks to the current rally exist. Instability in the Middle East which in turn is driving oil prices higher can translate into a double negative for the U.S. economy. First, higher oil prices serve as a tax on the consumer and second, higher oil prices can affect consumer confidence causing the consumer to become more frugal. In addition, the turmoil surrounding public unions in Wisconsin, Ohio, and other states may impact sentiment of the U.S. consumer. The technical formations we discussed in January support the notion that we should expect a continuation of the bull market in equities. Earnings reports continue to come in strong for most companies. The concern analysts had six to nine months ago was that many companies were meeting or beating their earnings estimates due to strong expense control, but seeing little top line growth. We are now beginning to see the top line growth as the global consumer comes back to life. Following are the positives that we see for the economy and the capital markets:

- The U.S. consumer debt service to income ratio is now back to 1995 levels as consumers pay down debt, restructure loan terms, or default on debt. (Source: JP Morgan)
- Bank lending is slowly beginning to accelerate as we had suggested. (Source: JP Morgan)
- United States retail sales continue to report strong gains. (Source: Credit Suisse)
- United States manufacturing data is coming in at some of the strongest levels in recent years. (Source: Ned Davis)
- Inventory levels are very lean in many product categories as manufacturing capacity was cut during the downturn and additional capacity has yet to be added to meet increased demand (automobiles, tires, steel, farm equipment, recreational vehicles, and building products). (Source: Ned Davis)
- CEO confidence is at a three-year high. (Bloomberg)
- Corporations are flush with cash which should serve as fuel for a potential record in merger and acquisition activity in 2011. Share buyback announcements have been brisk. (Source: Federal Reserve)
- Select U.S. banks will be allowed to raise their dividends soon which could provide a boost to financial stocks in the near term. (Federal Reserve)
- Federal Reserve policy continues to be accommodative which is encouraging risk taking. Much of this excess liquidity is finding its way into investment assets instead of loans to business. (Source: Bloomberg)
- U.S. mutual fund equity flows are just now turning positive displaying a desire by investors to invest in equities after months of record inflows to bonds. (Source: Ned Davis)
- Dislocations in the municipal bond market may be creating a buying opportunity in our opinion.

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

- Advanced economies need to embrace austerity measures in order to balance their budgets. If these governments do not curb their spending in an attempt to balance budgets, it could potentially throw the global economy back into recession as sovereign bond buyers would require higher interest rates.
- The European debt crisis is far from over. Greece was downgraded again this week and a restructuring of the debt of Greece and other European countries is inevitable. This, we believe remains the single largest risk to the global recovery. (Source: Bloomberg)
- Political tensions in the Middle East are creating uncertainty, and the future stability of this region is questionable. Oil is the major export of these countries, so turmoil affects markets across the globe. Saudi Arabia will be a key country to monitor—instability there could drive oil prices substantially higher and create substantial uncertainty across global capital markets.
- The debate between municipalities and public unions is creating turmoil domestically, which could spill over and impact the sentiment of U.S investors.
- Federal, state, and local government budget cuts will force higher unemployment rates among the public sector work force placing headwinds on the economy and employment.
- Housing prices will most likely continue to be flat or move downward across much of the United States in 2011, as a record number of options Adjustable Rate Mortgages (ARM) reset in 2011 potentially increasing debt service levels for the home owners. We may begin to see a turn in housing in 2012. (Source: Realty Trac)
- Rising commodity prices may pinch margins for companies that depend on commodities to operate their business.
- The government is discussing the privatization of home mortgages and removing Fannie Mae and Freddie Mac as the backbone to the home mortgage industry. Although this will be a long term positive, the impact on housing in the near term is not yet clear. (Source: Bloomberg)
- Government entitlement programs must be addressed—and soon. Medicare, Medicaid, Social Security, and other entitlement programs currently account for nearly 45 percent of the federal budget. In fact, approximately 45 percent of American households receive benefits from the Federal entitlement programs, up from 29 percent in 1983 (see chart). In the long term, this is unsustainable. We don't see a way the government can move toward a balanced budget without modifying our entitlement programs.

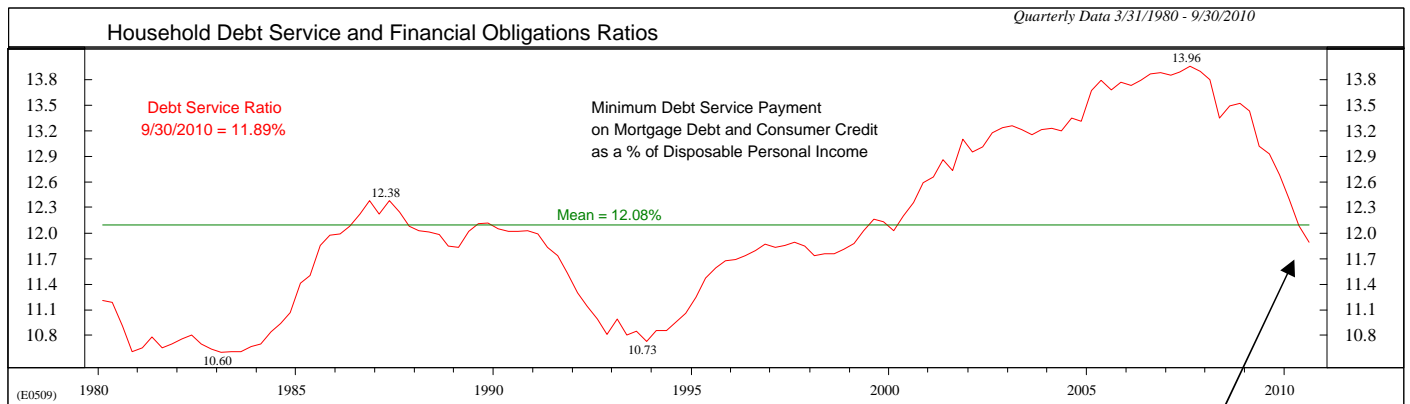


The President recently released his budget for 2011 trimming only \$6 billion from a \$3.7 trillion budget (Source: Bloomberg). It was believed that the President would begin to embrace spending cuts and work to move our country back toward fiscal responsibility. Expect Representative John Boehner (R-OH) and Representative Paul Ryan (R-WI) to become quite vocal and visible discussing the need to amend the President’s proposed budget. Republicans are using the debt limit as their negotiating tool to secure bilateral support for deeper budget cuts. Expect things to get heated in Washington DC as both Republicans and Democrats wrestle with the issue of fiscal responsibility. Our current annual deficit of \$1.5 trillion is unsustainable for any time period more than a few years (Source: Congressional Budget Office).

If the United States can move toward fiscal responsibility through budget cuts and pro-growth private sector initiatives, it could stimulate the overall economy and the capital markets. We believe we may now be at a tipping point with government finances. If our federal, state, and local government leaders do not implement serious austerity measures immediately by moving toward balanced budgets and solidifying the finances of entitlement programs, the prosperity of future generations could be in question.

Macro Economy

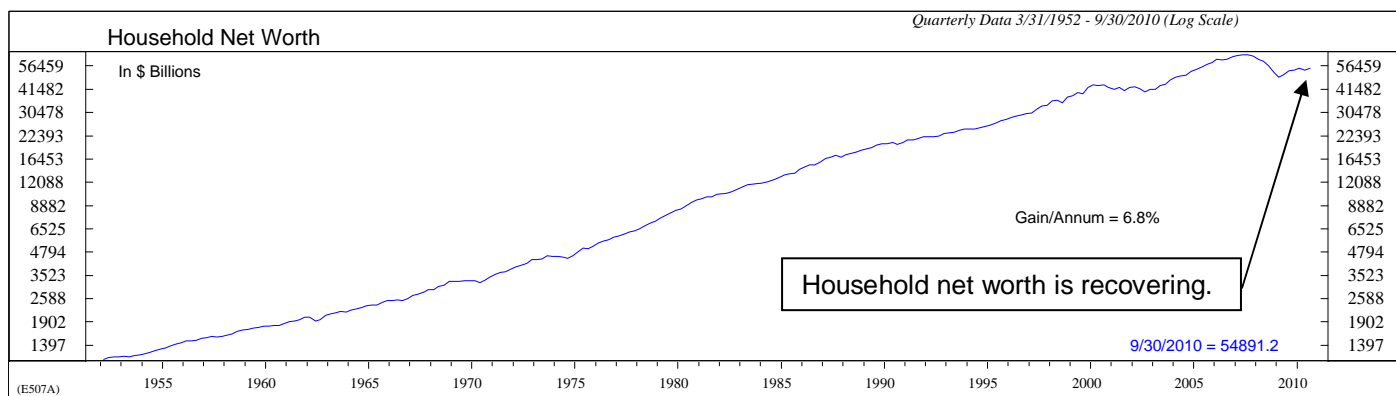
The ratio of U.S. consumer debt service to household income has returned to 1995 levels.



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Consumer debt service is back in “reasonable” territory.

U.S. consumer net worth has recovered \$5.99 trillion from the bottom of the recession in 2009. (Source: *Federal Reserve Flow of Funds Report*)



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Technical Patterns

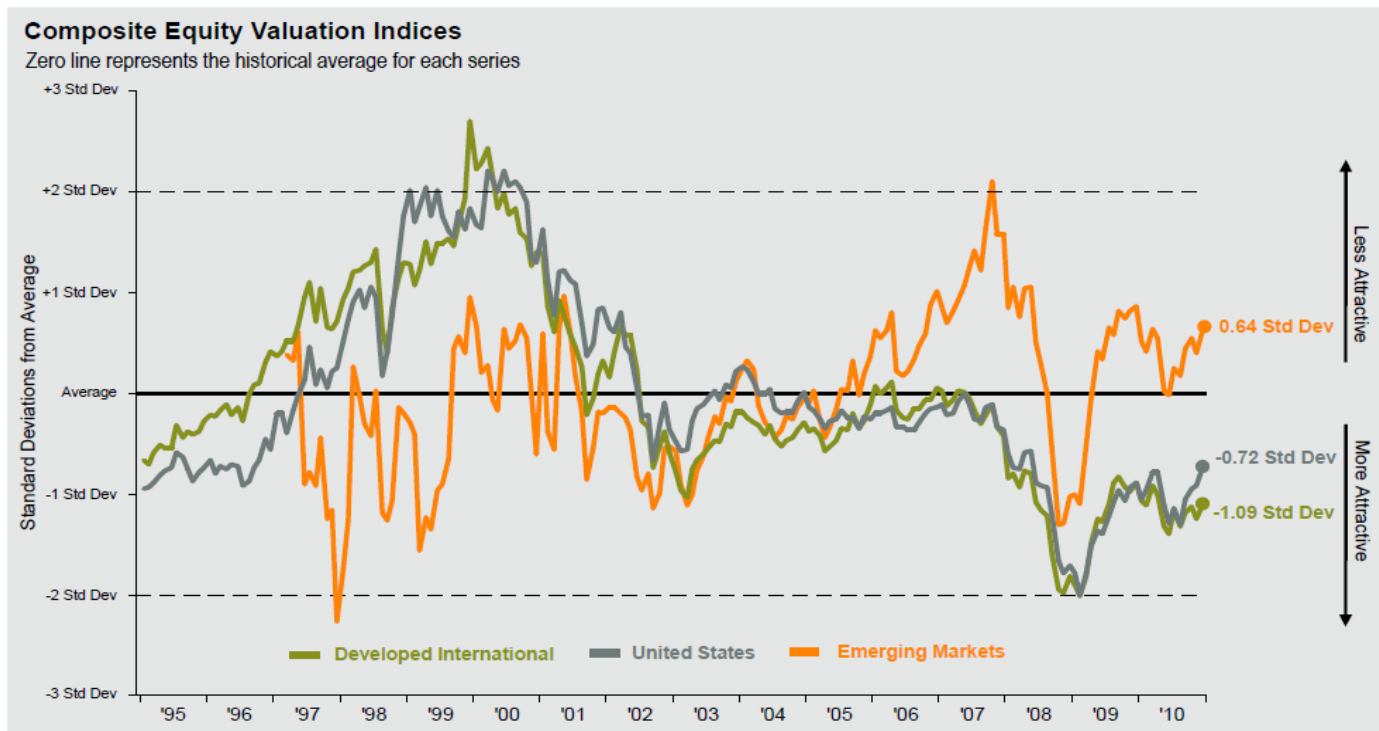
The equity markets continue to trade above their 50-day and 200-day moving averages.



The equity markets are tracing out a pattern similar to the recovery of 2003-2007.

Valuation

U.S. and developed international equities look to be in “reasonable” territory from a valuation perspective.



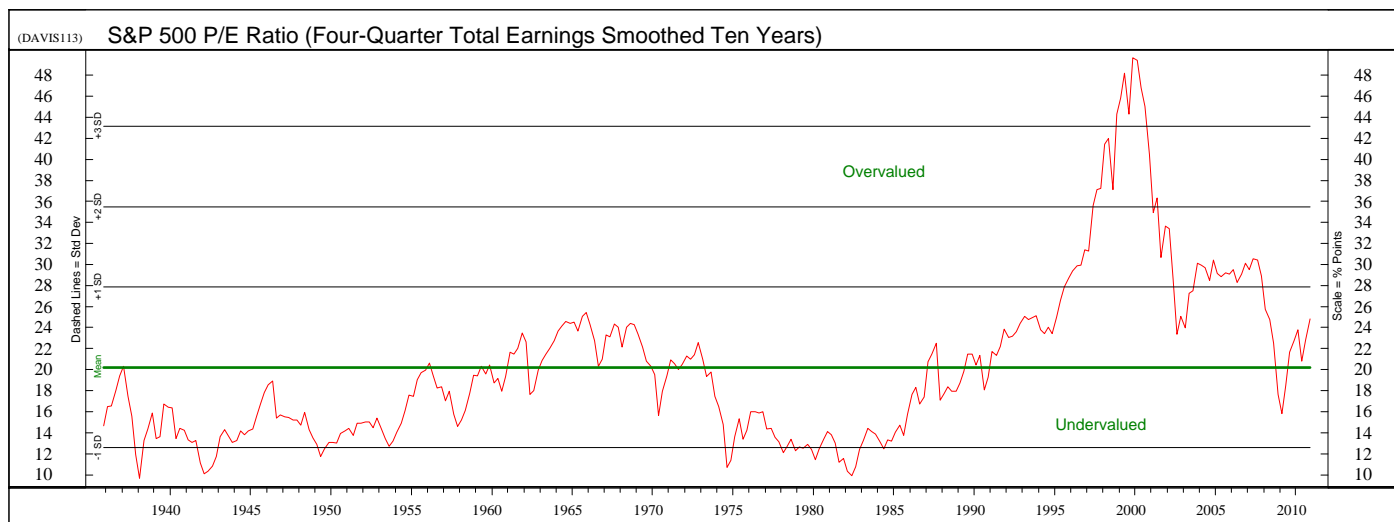
Sources: MSCI, FactSet, J.P. Morgan Asset Management.

*Note: Each valuation index shows the number of standard deviations from the mean of a composite of four equally weighted metrics (forward price to earnings, price to book, price to cash flow and price to dividends) for MSCI US, MSCI EM and MSCI EAFE.

Data are as of 12/31/10.

J.P.Morgan
Asset Management

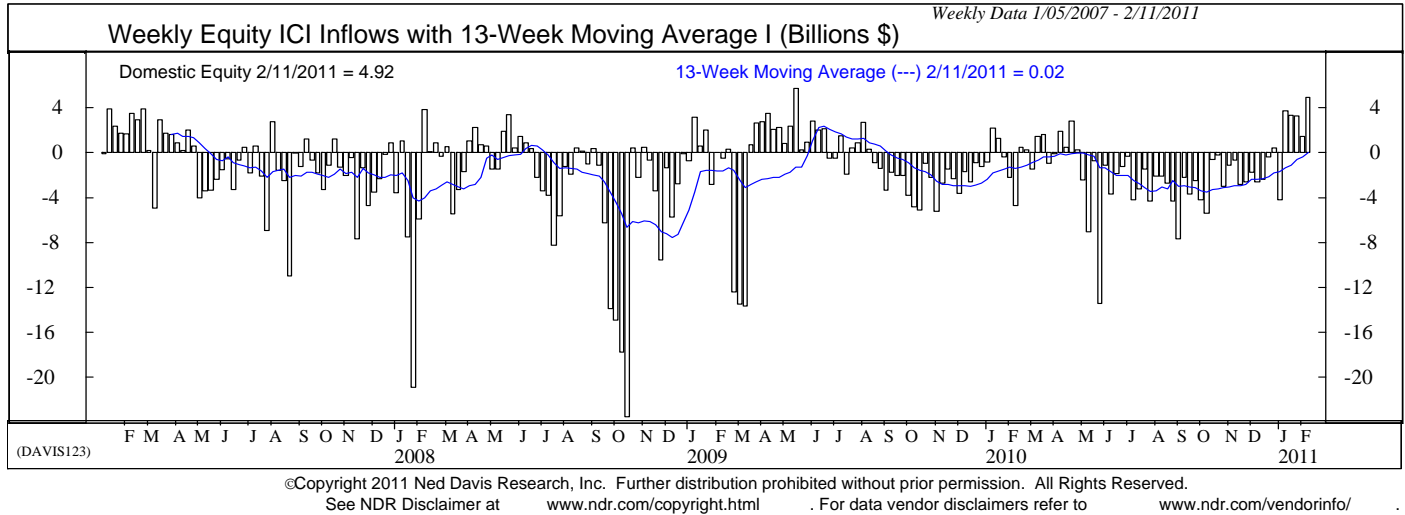
The U.S. market looks fairly valued.



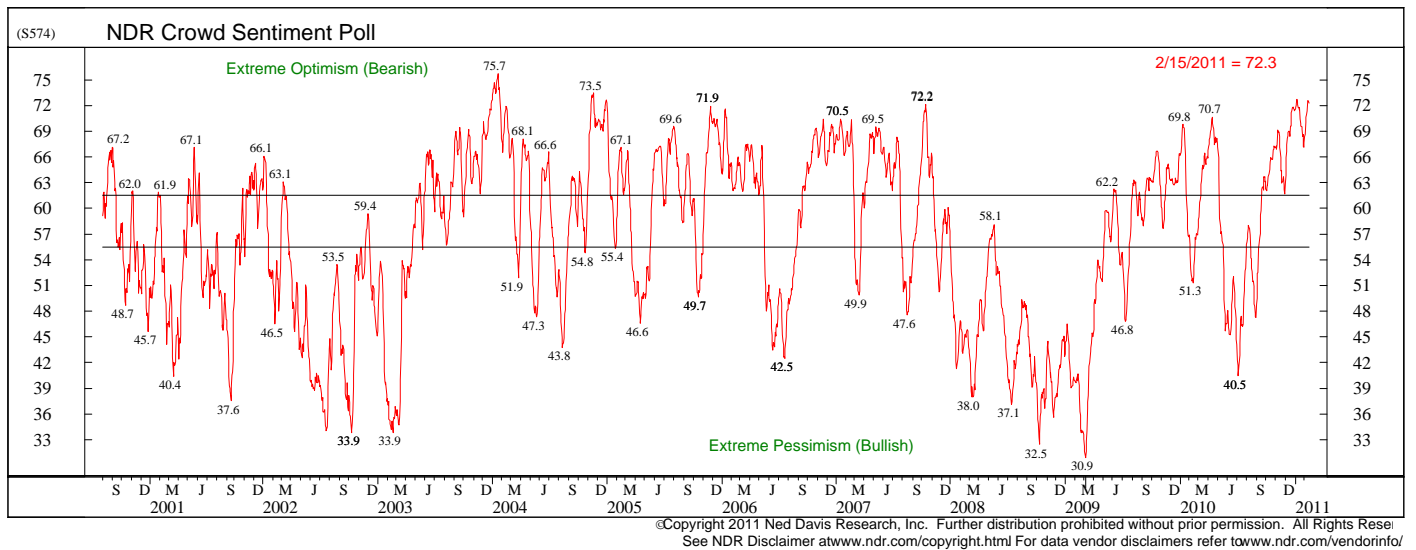
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Sentiment

Money flows are just now turning positive for U.S. equities after seven months of net redemptions in 2010. This may be the first sign of investors becoming more confident in equities. Historically, these trends have lasted two to three years in strong bull markets. (Source: Ned Davis)



Investor sentiment remains high, which usually means a short-term market correction may be ahead. Seasonally, the U.S. stock markets have topped out in April followed by corrections throughout the summer months. This year may follow the script.



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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