New Albany Investment Management

Market Insight…

… Performance
Economic Update
Charts of Interest

April 25, 2011

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Market Performance:

Week ending 4-21-2011

Sector	week	1mo	YTD
S&P 500	1.8%	4.1%	6.9%
Russell 2000	2.2%	4.1%	8.2%
MSCI EAFE USD	2.2%	4.9%	6.9%
MSCI EM	2.0%	7.7%	4.7%
Bar Cap US Bonds	.5%	.3%	1.0%
GLD (nav)	.7%	5.7%	6.3%
Real Estate	3.0%	4.6%	10.2%
Energy	3.3%	2.0%	17.1%

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Economy:

•U.S. real GDP rose at a tepid 1.8% q/q annual rate in 1Q of 2011, which is a touch lower than the expectation of 2.0%, and certainly a weak number. The inflation story is benign: with the GDP deflator up at a 1.9% pace and the core consumption price deflator up just 1.5%.

•Much of the U.S. housing market still best characterized as "flat", and thus, it is tough to get much of a boost to the economy from this area.

•Services part of the economy & consumer spending, which is tied to rent and household formation, is only just starting to recover.

•Real retail sales: while growth has slowed, there's still upward momentum (albeit in choppy form) in this important component of the economy. Additionally, while investment in goods such as capital eqp has also been choppy, tax policy (ie, accelerated depreciation in 2011) seems likely to provide an impetus for a reacceleration as we move through the year.

•A continued spike in oil remains the biggest risk to this economic momentum, in our view (WTI was $112 at the end of last week). But barring another shock, the **business cycle is probably still in a reasonably good position: transitioning from an economic recovery to an economic expansion.**

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Fed Policy :

FOMC statement April 27,2011

• In a unanimous move, the Fed said today that it is set to continue with QE2 and to continue the reinvestment policy (ie, no tightening).

•The Committee will maintain the target range for the federal funds rate at 0 to 1/4 percent and continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations, are likely to warrant exceptionally low levels for the federal funds rate for an extended period".

•The Fed also noted that the economic recovery is "proceeding at a moderate pace". While commodity prices have risen, and inflation has picked up some, "underlying" inflation measures and inflation expectations appear steady enough. **The current inflation picture is also believed to be "transitory" – despite the recent data, the Fed is sticking to its models (and its focus on slack).**

•The Fed forecasted real growth to be slightly lower (3.1% to 3.3%) in 2011, but also saw better labor market conditions, with the unemployment rate at 8.4% to 8.7% at the end of this year.

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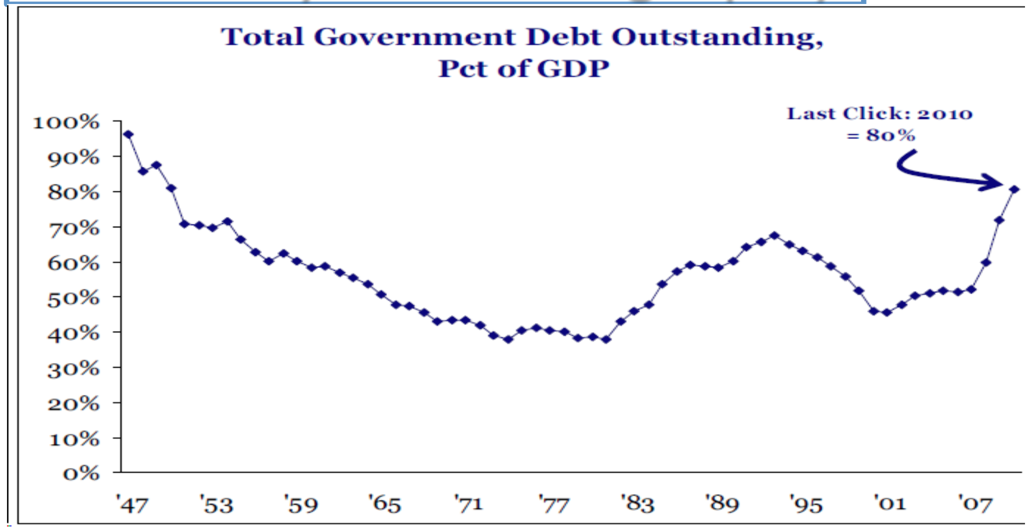
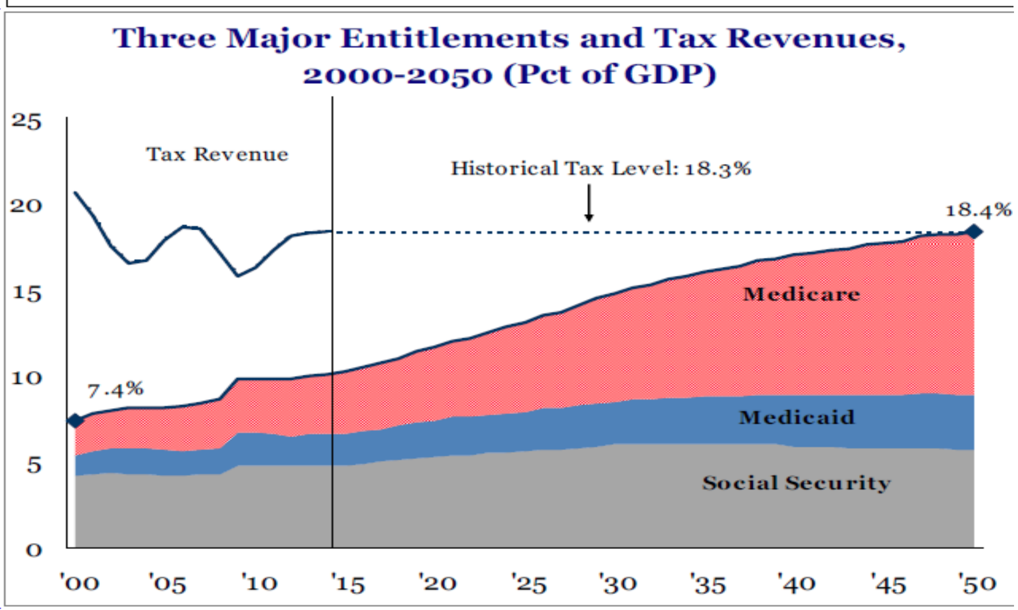
Fiscal Policy

- S&P placed US debt on credit watch arguing that the possibility of a grand political deal on entitlement reforms seems too far off in the future. The issue is not an all-or-nothing proposition but rather a two-step process starting with smaller reforms such as a discretionary spending cap and Medicaid reforms as part of the upcoming debt ceiling increase. Smaller reforms now will buy policymakers time to come up with a solution for the larger reforms on Medicare, Social Security, and taxes, which will likely be the story in 2013.
- Budget Debate: The debt limit has been lifted 10 times in the past decade and, in that time, net debt has more than doubled. The debt limit could serve as a catalyst for a positive reform making the S&P warning ending actually a catalyst for good change.
- Previously, ('95-96) a debt limit debate the S&P 500 declined more than 3 pct as fears about a debt limit increase took hold. But the S&P 500 closed 8 pct higher from its low when the debt limit was increased 6 weeks later. The S&P is currently down a similar 3 pct from its high.
- POLICYMAKERS FACE A CHALLENGE SELLING AUSTERIT. Economic concerns, such as jobs, and gas prices are still paramount to voters. Yet, voters by a roughly 2 to 1 margin oppose cutting entitlements and tax increases.

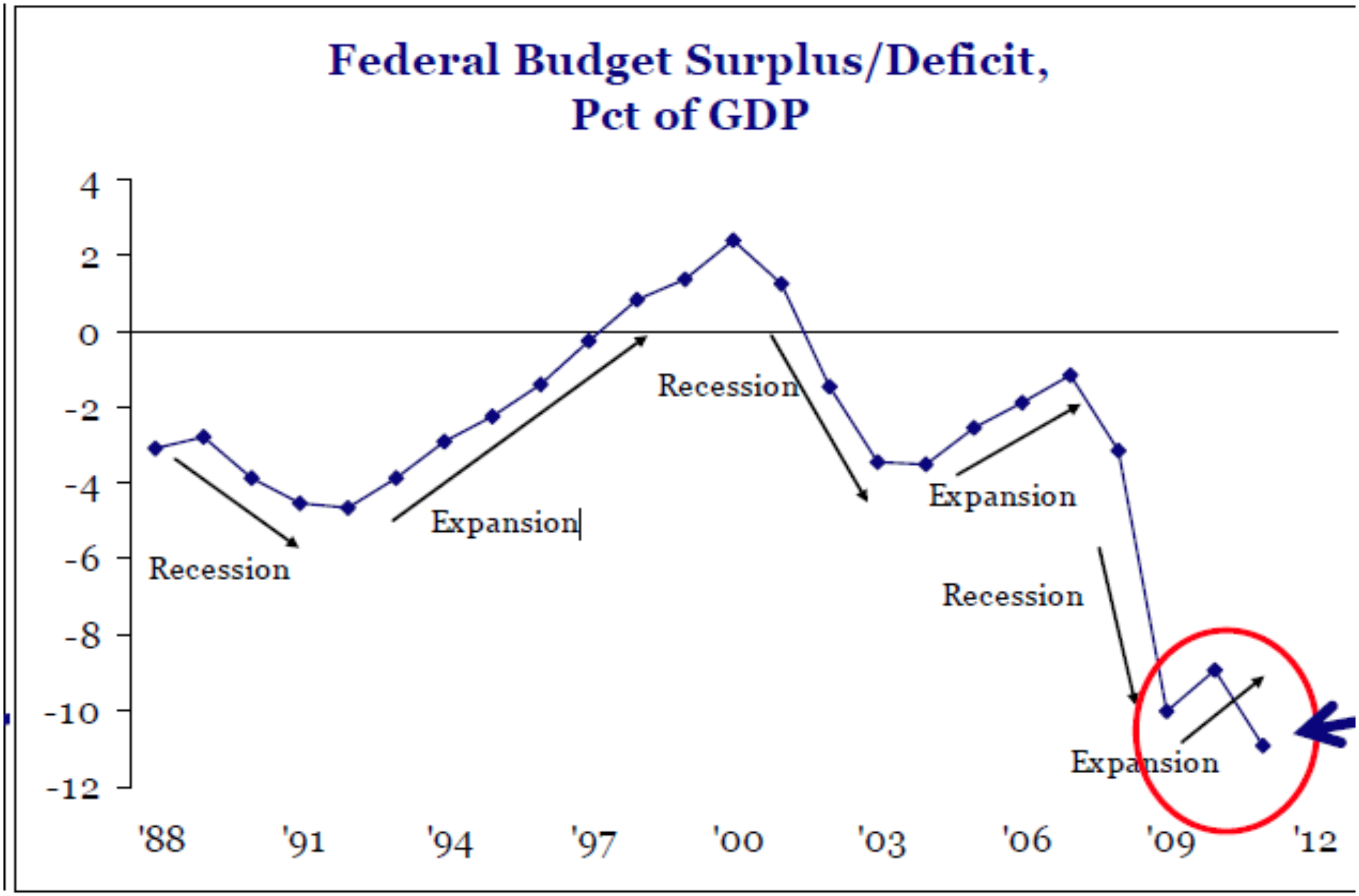
Fiscal Policy: Debt rising rapidly





Over time, Medicare, Medicaid, and Social Security will consume all US tax revenues.

Fiscal Policy: Despite expansion, deficit continues to grow due to rise in debt payment and entitlement programs



Market View: Strategas

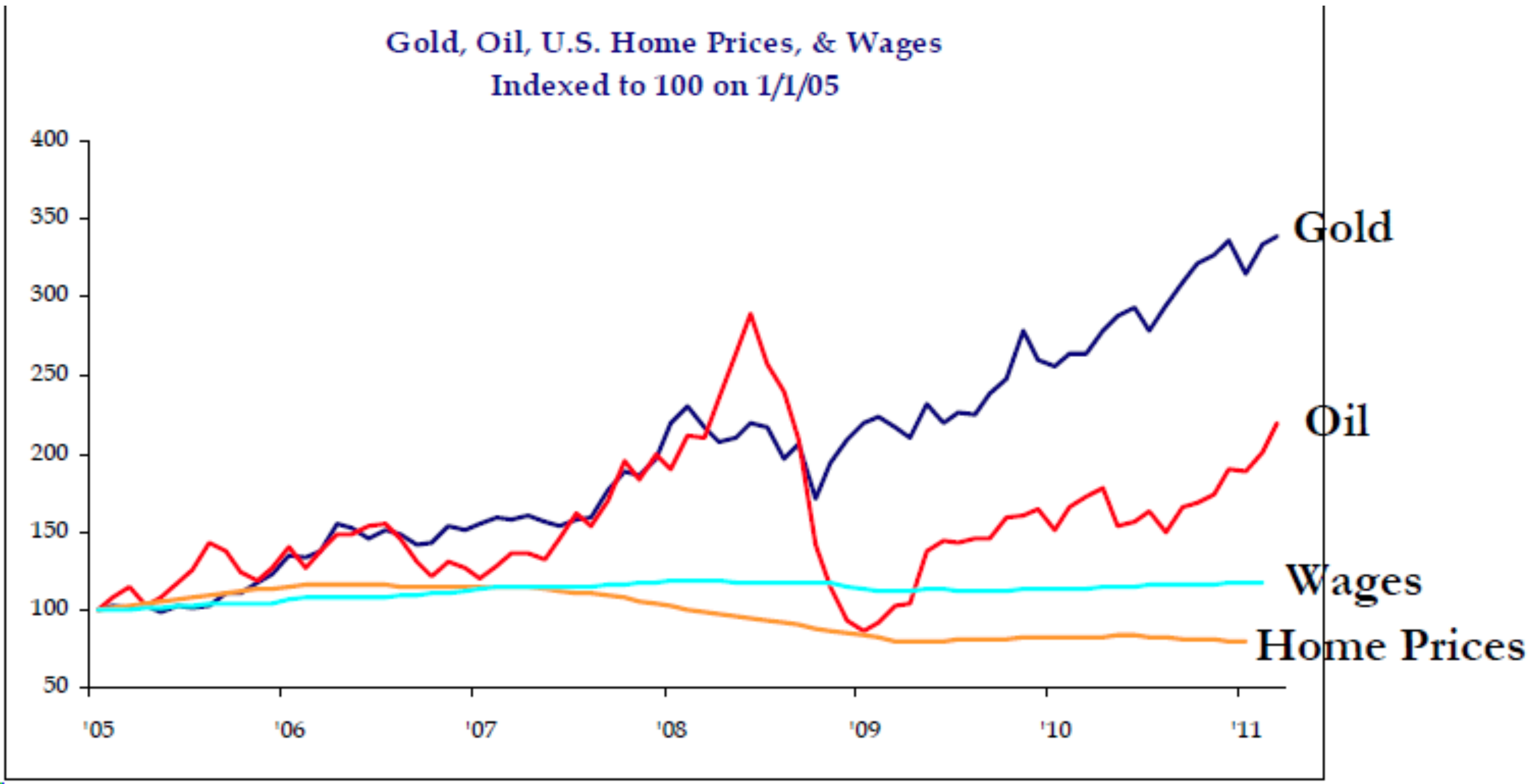
Bullish until these factors change significantly…..

We're Bullish Until…

- **30/10 Spread** *(Watching 10-Year yields alone is unlikely to give the early warning signs of incipient increases in inflationary expectations).* ✓
- **3-Month US$ Libor Flashes Signs of Financial Stress** *(Despite problems in Europe, Libor is actually declining).* ✓
- **Mortgage Rates Push Back Towards 6%** *(All clear here, now roughly 5%).* ✓
- **Commodity Price Inflation Forces China to Meaningfully Slow Economic Growth** *(This has started).* ✗
- **Our Proprietary Bellwether Index of Economically Sensitive Stocks Breaks Down** *(No signs of structural weakness).* ✓
- **Signs of Protectionism Creep into Global Policy** *(Although this remains a concern, there is little evidence of this - yet).* ✓

Inflation in the Modern World:

The concept of "bi-flation" – China will likely continue to inflate the prices of everything that it needs (oil, copper) and leave the prices of everything it doesn't (U.S. homes, American labor) to its own devices.



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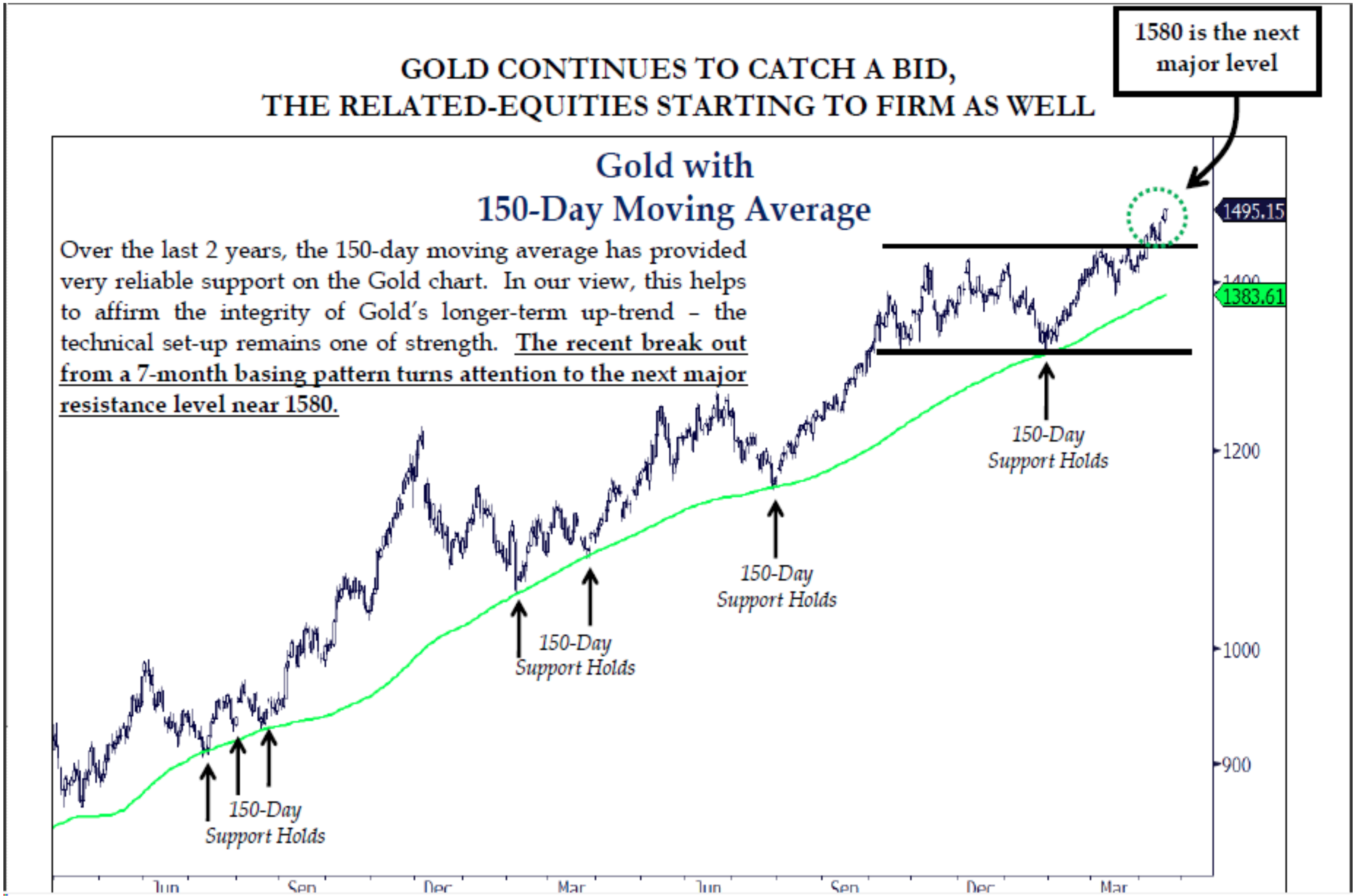
Markets:

- Equity Correction still not a major top. Major tops in stocks are, more often than not, accompanied with severe stress in the credit markets – to date, there is no meaningful evidence of this playing out Credit spreads in LIBOR, Investment Grade, and High Yield remain benign.
- Market correcting against the backdrop of rising moving averages. This is healthy

The 50, 100, 150, and 200-day moving averages all remain upward sloping. <u>**Pullbacks, against the backdrop of upward sloping moving averages, tend to remain contained events.**</u>

Markets: Gold



Markets: Dollar

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