New Albany
Investment Management

# Market Insight…

- Performance
- Economic Update
- Charts of Interest*

*Provided by Strategas Research Partners

June 12, 2011

# Performance:

as of 6-10-2011

NAIM

| Sector | Week | 1Mo | YTD |
|---|---|---|---|
| S&P 500 | -2.2% | -6.1% | 1.9% |
| Russell 2000 | -3.5% | -8.8% | -0.1 |
| MSCI EAFE (Eurp. Asia, Far East) | -2.4% | -4.5% | 2.1% |
| MSCI Emerging Mkt | -2.3% | -3.2% | -2.0% |
| US Agg. Bonds (Barclay's) | 0.0% | 1.1% | 3.3% |
| High Yield Bonds (US) | -0.5% | -0.7% | 5.1% |
| GLD (Net asset value) | -0.7% | 1.0% | 8.2% |
| Real Estate | -4.0% | -6.0% | 6.0% |
| Energy | -2.5% | -4.0% | 8.3% |

# Economy: Chairman Ben Bernanke acknowledged that the U.S. economic recovery was "uneven" and "frustratingly slow…

Strategas' Economic balance sheet ticks down again as Consumer Confidence declines


*(The Bellwether index is constructed from the stocks most correlated with GDP).*

| Assets | Neutral | Liabilities |
|---|---|---|
| Interest Rate Env | Price Inflation | Budget Deficit |
| Capex Eqp | Wage Inflation | Trade Deficit |
| Cons. Spend | Nonres Constr | Consumer Conf. |
| Employment | Housing | |
| Credit Environ | Business Conf. | |
| Manufacturing | | |

| Economic: | May | Jun | Jul | Aug | Sep | Oct | Nov | Dec | Jan | Feb | Mar | Apr | May |
|---|---|---|---|---|---|---|---|---|---|---|---|---|---|
| Assets | 6 | 5 | 5 | 5 | 4 | 5 | 5 | 6 | 6 | 8 | 8 | 6 | 6 |
| Liabilities | 2 | 4 | 3 | 3 | 2 | 1 | 1 | 1 | 1 | 1 | 1 | 2 | 3 |
| Net | 4 | 1 | 2 | 2 | 2 | 4 | 4 | 5 | 5 | 7 | 7 | 4 | 3 |

# Economy: Neither Headwinds nor Tailwinds Dominating

<u>Headwinds to GDP in 2011 Overall</u>

**Political: Austerity in government budgets will subtracting from GDP and** payrolls.

**Economic: Tensions in the Middle East will continue to keep oil prices elevated, excess inventory** of homes will likely continue to exert downward pressure on prices, uncertainties in the market (and the corresponding weaker confidence levels) may hamper employment growth

<u>Tailwinds to GDP in 2011 Overall</u>

**Political: Greater disposable income from payroll tax cuts. Greater certainty of legislative process** as healthcare, financial regulation, and energy bills are done.

**Economic: Data soft patch currently exhibited, and the growing need for fiscal restraint, should** support the Fed keeping monetary policy easy for an extended period (the bar is still high for QE3, but both monetary and fiscal policymakers want unemployment lower in 2012). Also, with corporate cash on the balance sheet at such elevated levels, if firms want to boost sales, they likely need to increase spending (namely on employment) so consumers can and will spend more freely.

# Economy: Transitioning from recovery to Expansion which means we are past the acceleration phase.

Positive: High Corporate Cash and Profits should be redeployed boosting employment.

Negative: Government stimulus ending; austerity measures will inhibit growth.

Net: Maturing Business cycle, but probably 9 quarters to go before recession.

## Strategas Economic Forecasts

| | 2010 | | | | 2011 | | | | 2012 | | | |
|---|---|---|---|---|---|---|---|---|---|---|---|---|
| | 1Q | 2Q | 3Q | 4Q | 1QA | 2QF | 3QF | 4QF | 1QF | 2QF | 3QF | 4QF |
| Real GDP Q/Q % AR | 3.7% | 1.7% | 2.6% | 3.1% | 1.8% | 3.0% | 3.7% | 4.0% | 2.3% | 2.0% | 1.0% | 1.0% |
| Core CPI Q/Q % AR | 0.0% | 0.8% | 1.1% | 0.6% | 1.7% | 1.2% | 1.2% | 1.5% | 2.0% | 2.3% | 2.5% | 2.7% |
| Fed Funds EOP | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.1% | 0.5% | 1.0% | 1.5% |
| Mortgage Rate EOP | 5.0% | 4.6% | 4.3% | 4.8% | 4.9% | 4.6% | 5.0% | 5.1% | 5.3% | 5.3% | 5.3% | 5.3% |

F = Forecast; A = Actual; EOP = End of Period

With the package of weak economic data, the path for mortgage rates in 2011 appears lower.

# Market Valuation:
## With current S & P level of 1290, market has room to run.



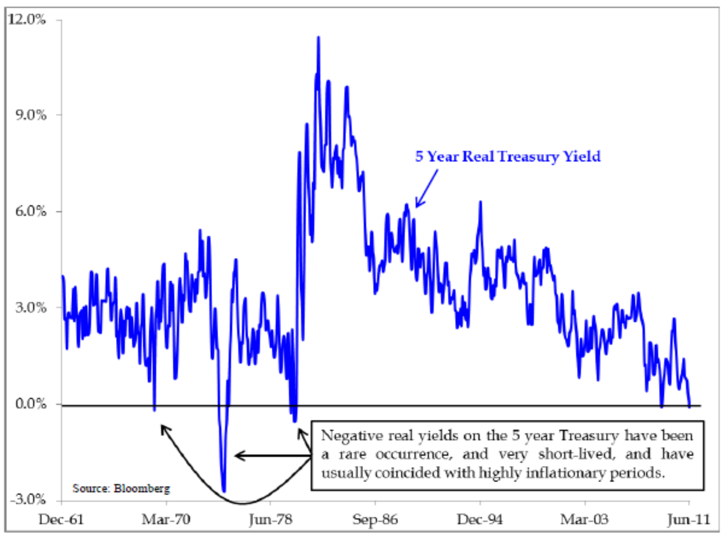
**2011 S&P 500 Expected Value Table**

| Odds | Outlook | Economy | S&P Earnings | Expected Multiple | Implied S&P 500 |
|---|---|---|---|---|---|
| 5% | Policy Error | Recession | $84.00 | 11x | 924 |
| 25% | Stimulus Driven Recovery | Macro Uncertainty | $94.25 | 13x | 1,225 |
| 60% | | Base Case | $94.25 | 16x | 1,508 |
| 10% | Upside Surprise | Too Hot | $98.00 | 14x | 1,372 |
| | | | | *Expected Value* | 1,394 |

# Markets: Negative Real Yields (Yield- Core CPI) Bullish for Stocks, Bearish for Bonds

History has shown that negative real yields (below inflation) tend to be short lived and have usually coincided with a **bottom in nominal yields and equity prices**, followed almost immediately by a sustained surge in both.

Performance of S&P after Treasury real yields turn negative




| S &P 500 | +3mo | +6mo | +12 mo |
|---|---|---|---|
| 4/30/2009 | 13% | 19% | 36% |
| 3/31/2004 | 1% | -1% | 5% |
| 5/31/1980 | 10% | 26% | 19% |
| 10/31/1974 | 4% | 18% | 20% |
| 4/30/1969 | -11% | -6% | -21% |

# Technical Analysis: Positives still Outweigh Negatives

| Market Positives | Market Negatives |
| --- | --- |
| * Trend is still firm - the longer-term 150 & 200-day moving averages both remain upward sloping. | * The Financial sector charts - the large-cap banks in particular - remain technically vulnerable. |
| * Internals remain "OK" - 88% of the stocks in the S&P 500 have their 50-day average above their 200-day average. 52-week lows are benign. | * Sovereign CDS spreads across the Continent continue to widen. The European bank charts are also technically weak. |
| * Sentiment is very bearish - the AAII Bull Survey is back to its July 2010 lows, and the Put/Call ratio is elevated (contrarian indicator). | * While off last week's lows, U.S. 10YR Yields have continued to work lower. We're watching Germany closely here for signal. |
| * Price action is oversold - 20-day lows have expanded and only 25% of the S&P 500 is above the 50-day average. | * The next support on the S&P 500 chart isn't until 1245-50, resistance not until 1330… market is in technical "no man's land." |
| * Financial conditions are still "OK" - corporate spreads & Libor, while up modestly, remain well below 2010 highs. | * Stocks have had trouble maintaining strength into the close - reminiscent of the weakness that played out about this time last summer. |
| * Copper is positively diverging - hasn't made a new low since early-May. | |
| * Economically-sensitive groups, like the Dow Transports, are holding up fairly well… the Railroads in particular. | |
| * Emerging Market relative strength has quietly improved, we're watching the China & Brazil charts closely. | |
| * Risk-oriented FX has held in quite well - the C$, A$, and emerging Asian currencies in particular. | |

# Markets: Watch Copper as indicator of Global Growth

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## COPPER CONTINUES TO ACT RESILIENT, DOW TRANSPORTS REMAIN IN LEADERSHIP POSITION

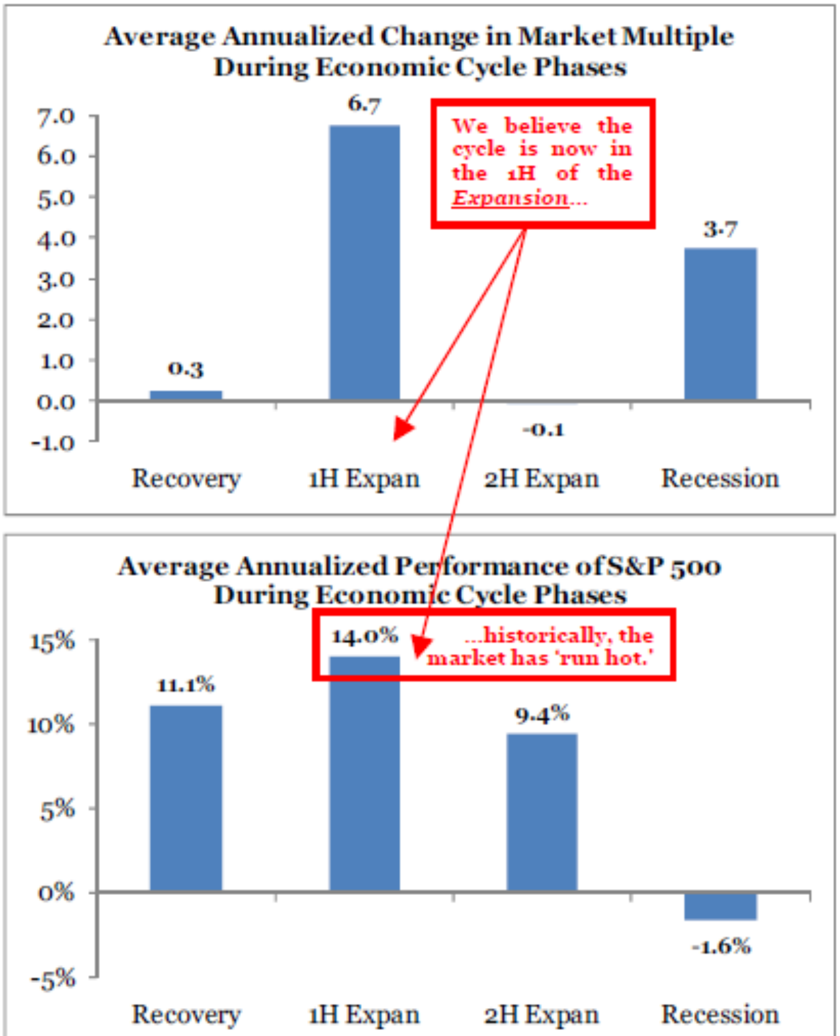


Two important bellwethers – Copper and the Dow Transports – remain in a solid technical position.

The Copper chart continues to act resilient – it has held upward sloping 200-day moving average support **and has outperformed the S&P 500 by nearly 1000 basis points over the last three weeks.**

It's almost difficult to believe, given all the negative headlines to hit of late, but the Dow Transportation Index has outperformed the S&P 500 by over 700 basis points since March. **This is a bullish signal for Dow Theorists.**

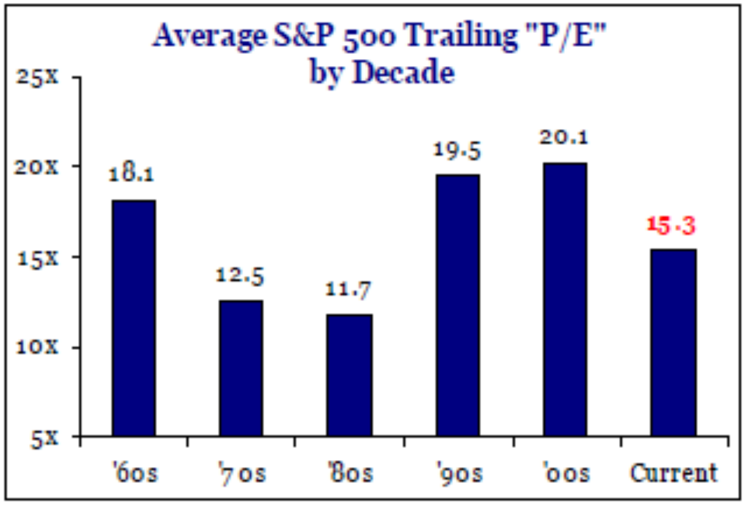
# Markets: Lower performance during expansion phase




With 70% the economy driven by consumption, the huge structural overhang of private and public debt will soon become a significant drag as the 'bill comes due' resulting in a shorter economic cycle. Shorter business cycles means more volatility in the markets.

As the economy moves through the expansionary phase, market multiples shrink and sector leadership changes will occur quickly. Recently, Health Care and Consumer Staples sectors are now outperforming the broad market indicating market anticipating slow down.

# Valuation: Stocks still look cheap compared to Bonds




Professor Shiller's measure of market P/E is still a cause of some anxiety for many investors. We believe it's important for investors to keep two things in mind: (1) the current level of the Shiller P/E is equal to that exhibited in 1995, and (2) bonds are more expensive than stocks in Shiller's construction now more than at nearly any time prior to the financial crisis. **For those that need to be fully invested, equities may remain the best house in a bad neighborhood of asset allocation choices.**