



**Market Insight...**

**... Performance**

**Economic Update**

**Charts of Interest**

May 2, 2011

## Market Performance:

Week ending 4-27-2011

Sector	week	1mo	YTD
S&P 500	1.9%	3.0%	9.0%
Russell 2000	2.3%	2.6%	10.8%
MSCI EAFE USD	2.5%	6.0%	9.5%
MSCI EM	-0.2%	2.8%	4.5%
Bar Cap US Bonds	0.6%	1.3%	1.7%
GLD (nav)	3.8%	8.9%	9.8%
Real Estate	2.6%	5.4%	13.0%
Energy	1.9%	1.3%	19.0%



## 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 however, with the GDP deflator up at a 1.9% pace and the core consumption price deflator up just 1.5%.
- The combination of extended monetary policy accommodation and additional stimulus from a weak dollar should act as a powerful force to keep economic growth from derailing.
- 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.**



## Fed Policy :

FOMC statement April 27, 2011

- In a unanimous move, the Fed 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 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.

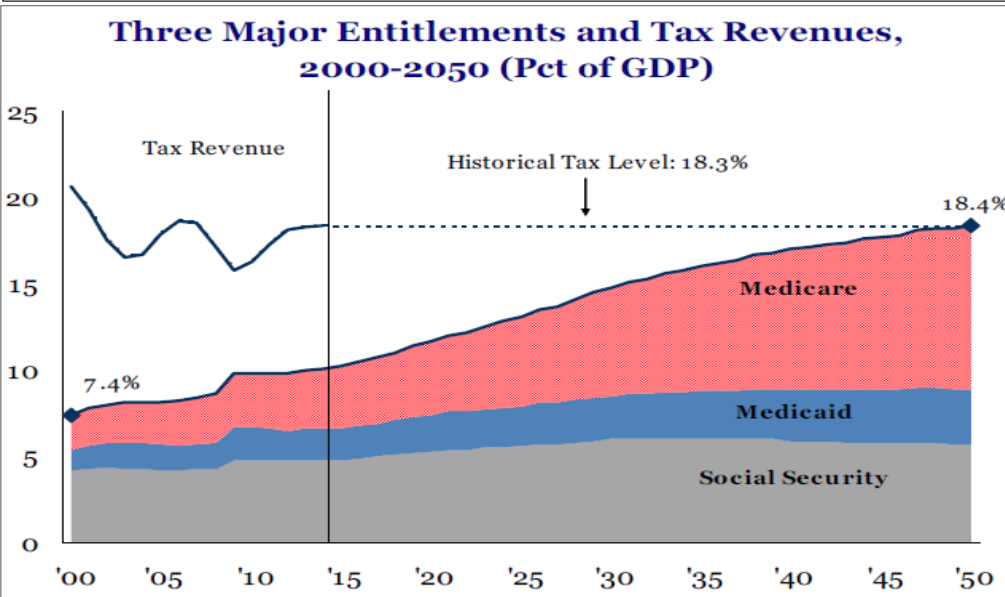
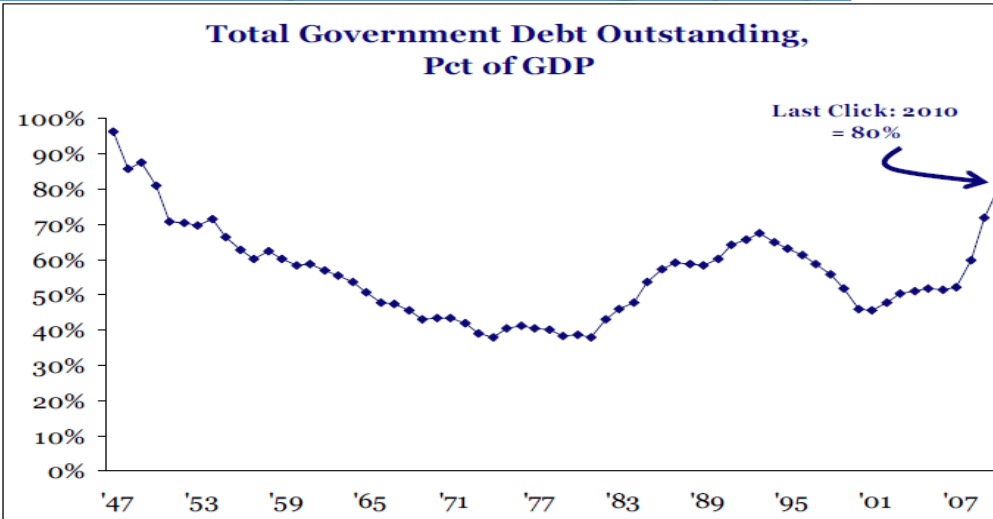
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## Fiscal Policy

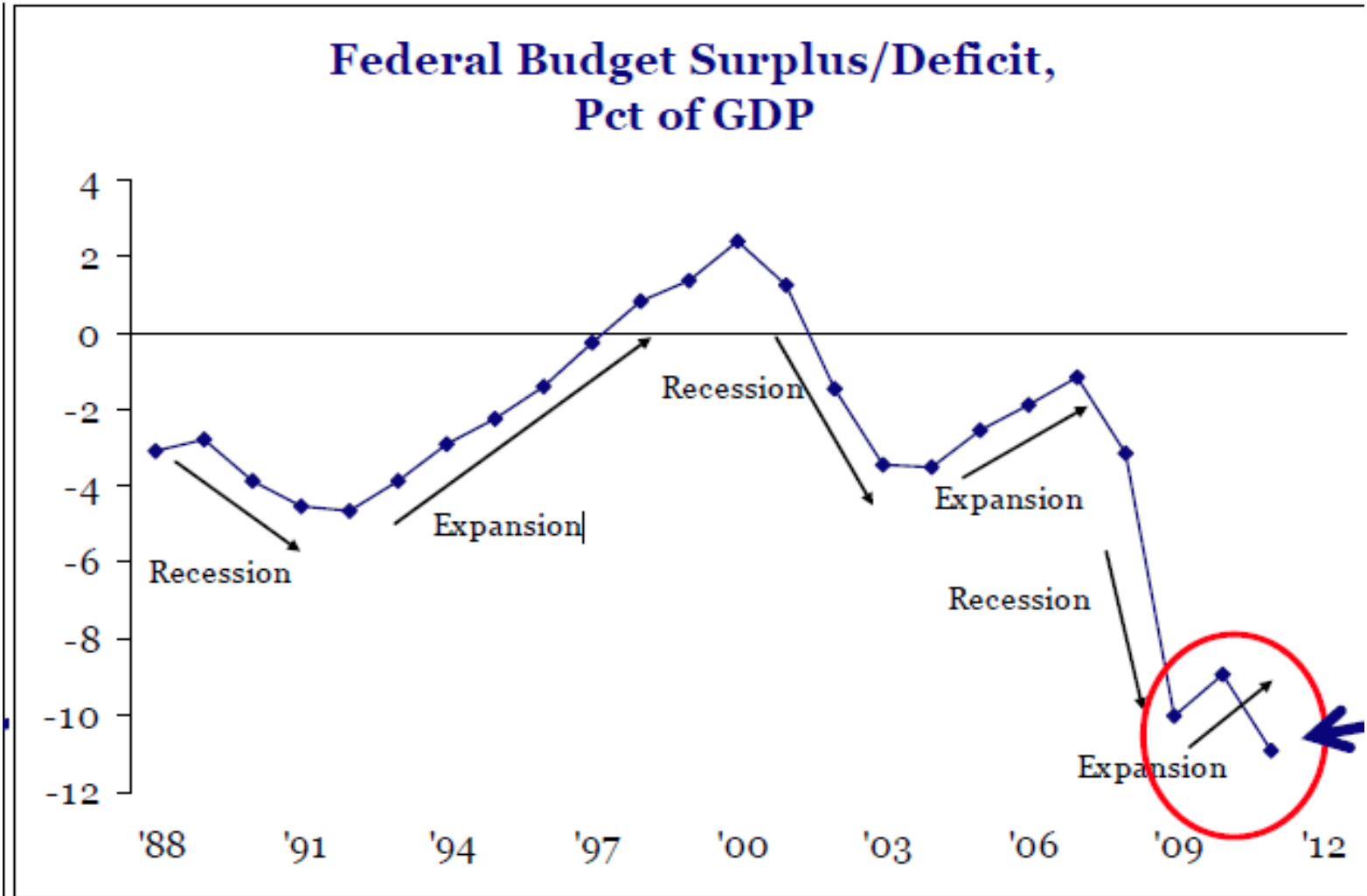
- S&P placed US debt on credit watch arguing that the possibility of a grand political deal on entitlement reforms seems too far off in the future. The issue is not an all-or-nothing proposition but rather a two-step process starting with smaller reforms such as a discretionary spending cap and Medicaid 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 AUSTERITY.** 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



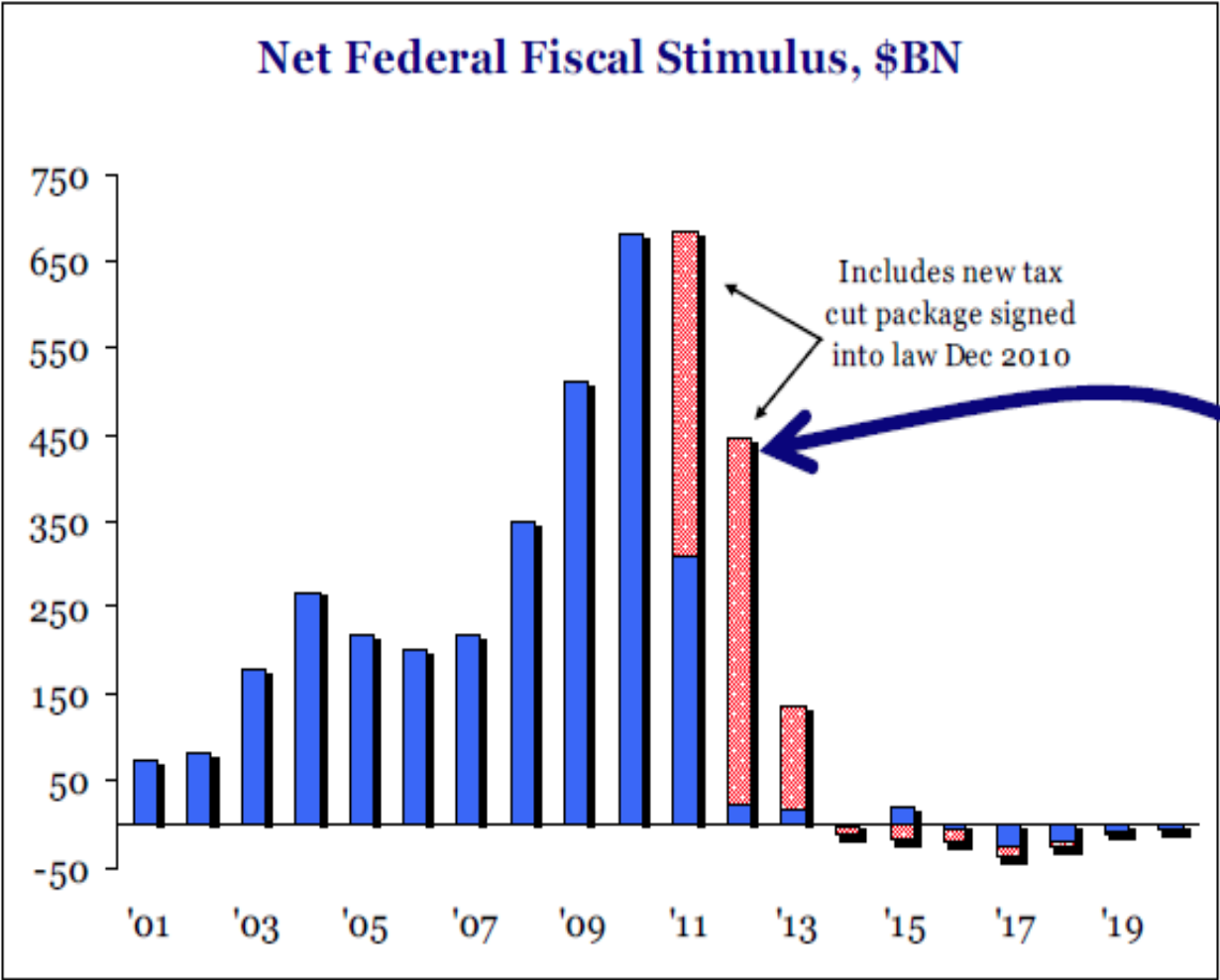
Over time, Medicare, Medicaid, and Social Security will consume all US tax revenues.

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





**Fiscal Policy: Core Issues: 1) Jobs 2) Gasoline & Food 3) Debt**



With growth expectations coming down, a renewed focus will develop in the second half of 2011 on the sizable “stimulus cliff.” We think it is likely that at least some of the drop in stimulus from '11 to '12 will be mitigated through an end-of-the-year package, despite parallel deficit reduction efforts.



## Market View: Strategas

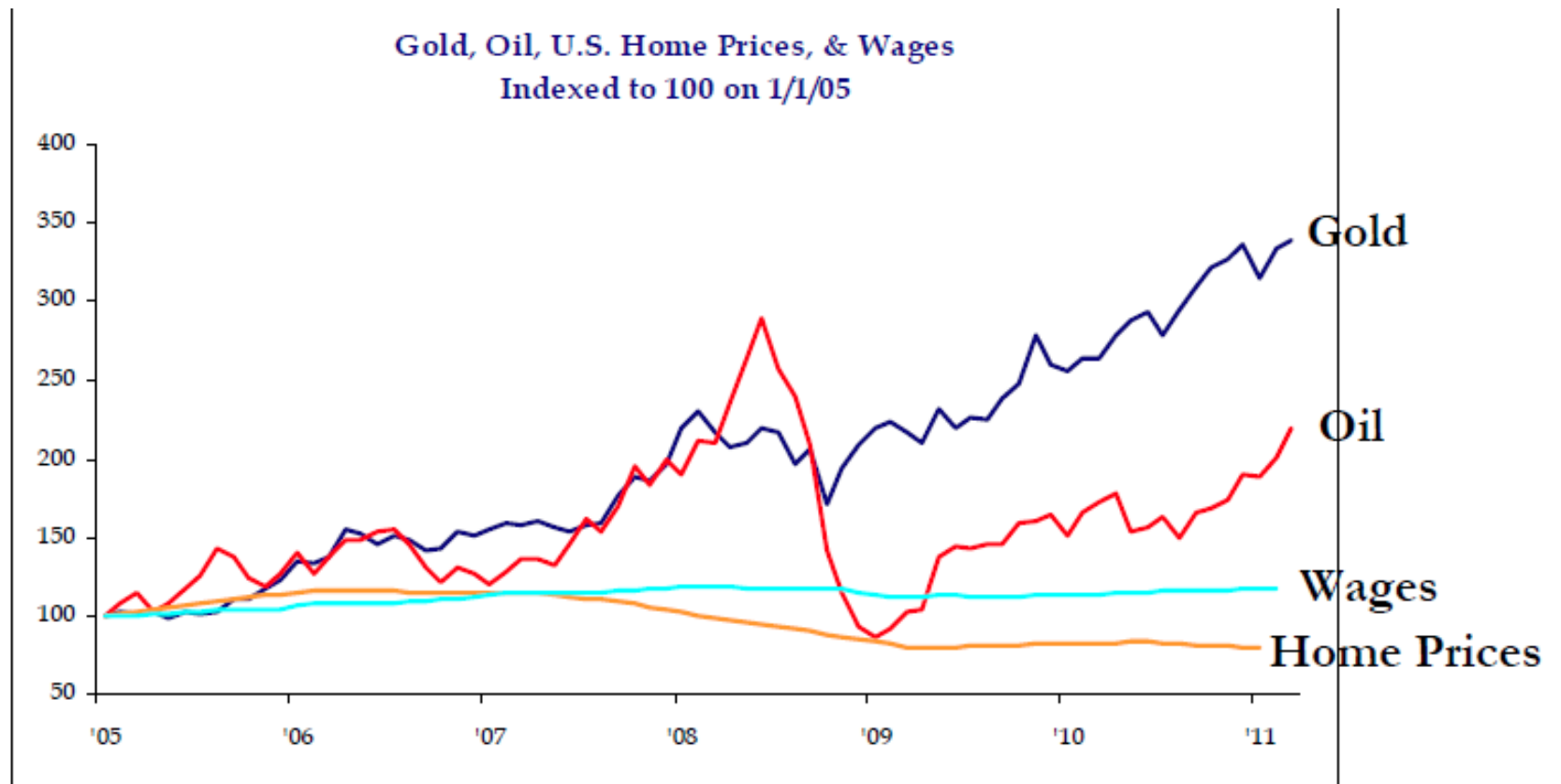
Bullish until these factors change significantly.....

### *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.



# Markets:

## STRENGTH AMONG THE TRANSPORTATION STOCKS REMAINS A KEY PLANK IN OUR 2011 BULL CASE



This week marked yet another Dow Theory buy signal as the cyclically important Transportation Index broke to a new all-time high (as did the Russell 2000). Until we see a major divergence between the Transports and the broader equity market, we believe the bull thesis remains intact for stocks.

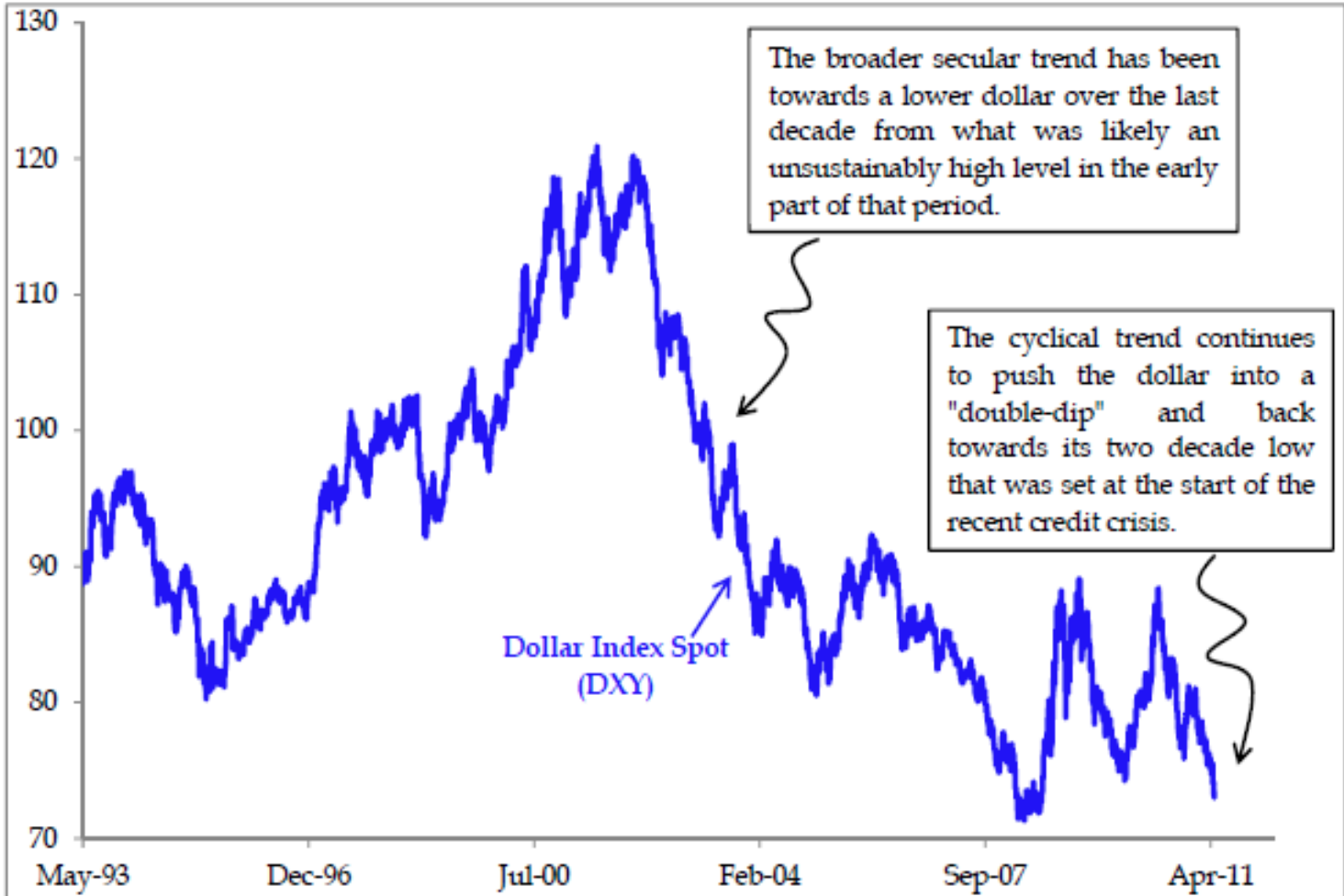


Alongside the Dow Transports, the S&P 500 also broke out from a very constructive technical pattern this week which, in the near-term, projects to the next resistance level at roughly 1430 – about +6% from current levels.



# Markets: Dollar

## Why is Dollar falling? INFLATION, STAGNATION, OR BOTH?



# Markets: Bonds

Steep yield curve implies Bond markets expect growth ahead . Thus dollar fall, due to accommodative policy rather than weak growth.

