

LarsonAllen Financial, LLC Market and Economic Update

SUMMARY

- I) **Equity Markets**—Equity markets continue to be range bound. Reasonably good corporate earnings along with accommodative Federal Reserve policy are supporting equities in the near term. Merger and Acquisition activity is also helping bolster the market. Longer term equities face several challenges from global sovereign debt issues to an uncertain global economic environment.
- II) **Credit Markets**—Corporate bond spreads in the U.S. continue to trade at levels that support a slow economic recovery. Credit is available today for large corporations through the corporate bond market. These spreads may begin to widen as governments around the world reduce their purchases of bonds (quantitative easing) over the next couple of months. Small business credit conditions remain bleak as they tend to depend on the banking system for credit. The fourth quarter 2009 FDIC report revealed continued pressures on the nation's banking system.
- III) **Economic Data**—Recent economic data is pointing toward a very muted economic recovery. A sharp “V” shaped recovery now looks to be out of the question. The economic outlook by many economists has gone from a “sustainable recovery” three months ago to a “bumpy and slow recovery” today. Recent economic data is pointing toward a slow and modest recovery. In addition, we believe that it would be premature to rule out a potential downturn in economic activity in late 2010/early 2011.
- IV) **Risks**—Sovereign debt risks continue to be one of the biggest risks that we see to the global economic system. No longer is the market solely focused on corporations (i.e. GM, Lehman, AIG) defaulting on their debt but entire governments defaulting on their debt. These sovereign debt issues have the ability to create another market panic such as that in 2008/2009. For this reason, we believe distressed government debt yields will remain elevated as investors will remain cautious. This may result in lower P/E ratios on equities and wider than normal spreads on bonds.

Conclusion—Debt and equity markets will most likely remain range bound. The bulls are focused on fundamental earnings and an accommodative Fed. The bears see a long list of risks from sovereign debt default risks, continued high unemployment, and weak housing and commercial real estate issues that continue to linger. We agree that risks are high and one needs a flexible investment strategy that can accommodate either of these views.

MARKET UPDATE

I. Equity Markets

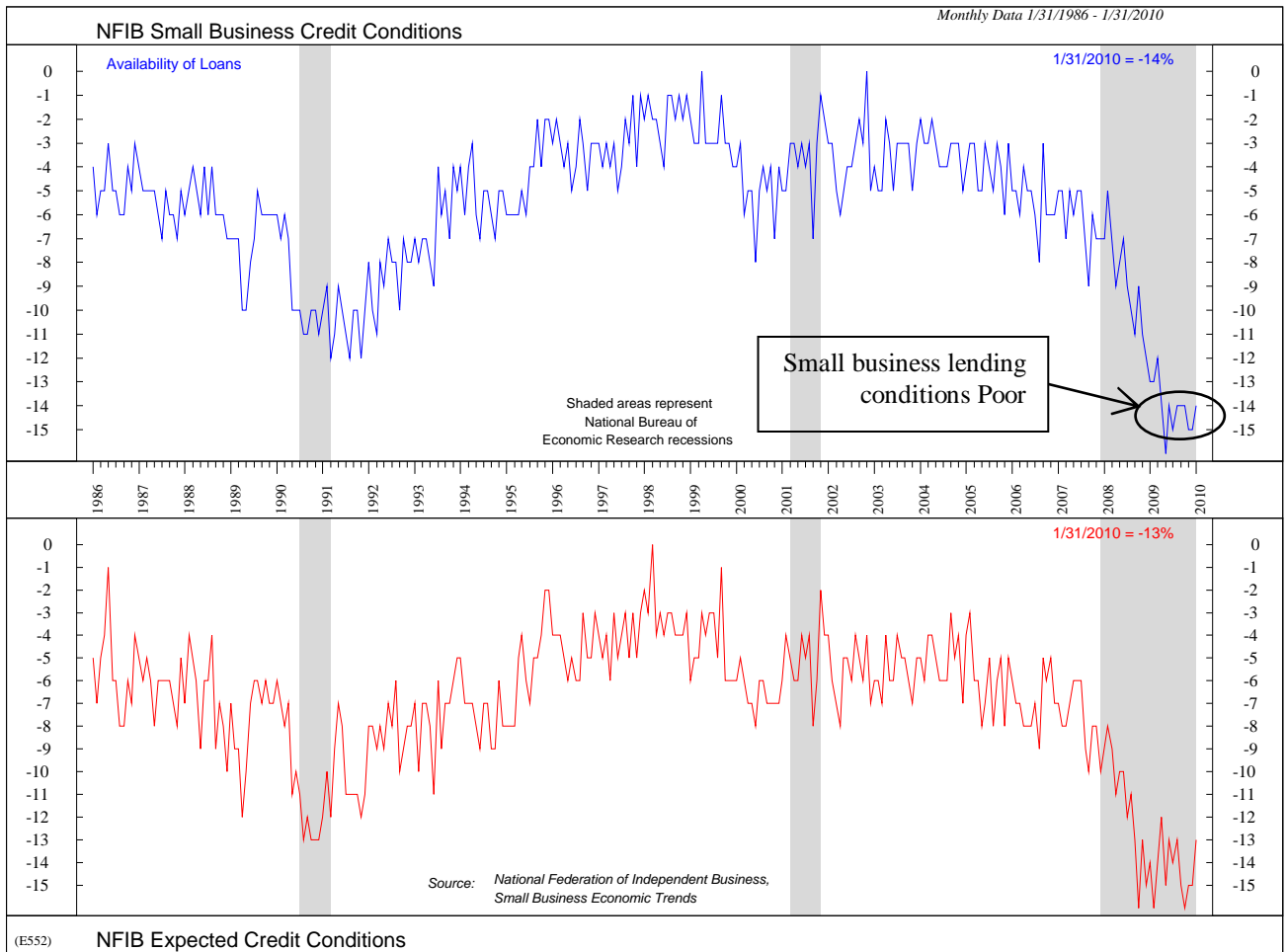
Equity markets rebounded slightly in February after a sharp decline that began in mid-January. Equity markets sold off sharply in late January over concerns of a Greece debt default. Markets have since recovered on hopes that the European Union or IMF will provide a bailout. Most equity markets around the world stayed above their 200 day moving averages which is supportive in the near term. We believe the market is currently trading above fair value and we will become much more concerned if equities became overvalued (S&P 500 1250-1350) or if equities were to break below their 200 day moving averages.

New York Stock Exchange Composite



II. Credit Markets

No longer is the focus on corporations defaulting on their debt but sovereign governments potentially defaulting. Many developed countries around the world have increased government debt during the “Great Recession” to help stem the downturn and in turn have placed them in a precarious position (see “Risks to the Recovery” section). Corporate credit spreads remain benign at this time showing confidence in the ability to service their debt. The banking industry continues to struggle with non-performing loans, consumers that are unwilling to take on more debt, and small business that does not need additional capacity. The U.S. Federal Reserve is about to step away from quantitative easing (buying bonds) at the end of March. This may cause some stress within the credit markets over the next few months. Bottom line: Credit markets have stabilized but remain tenuous.



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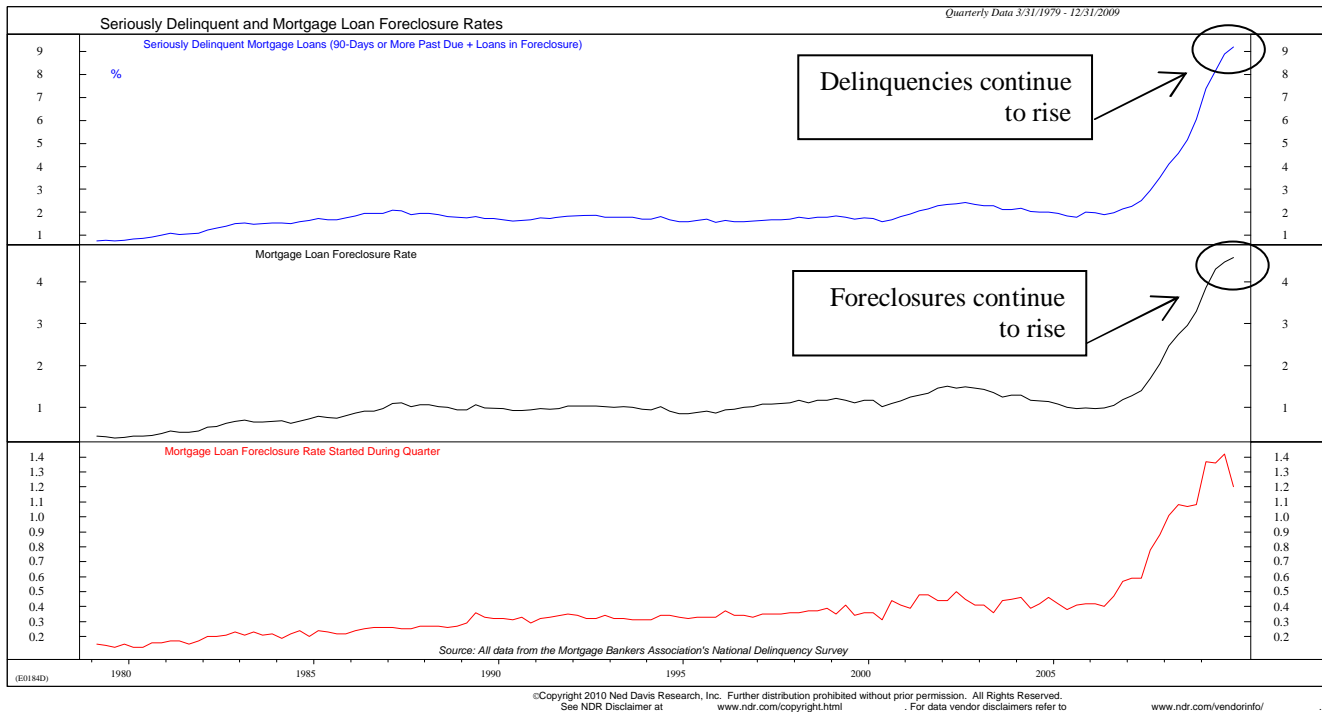
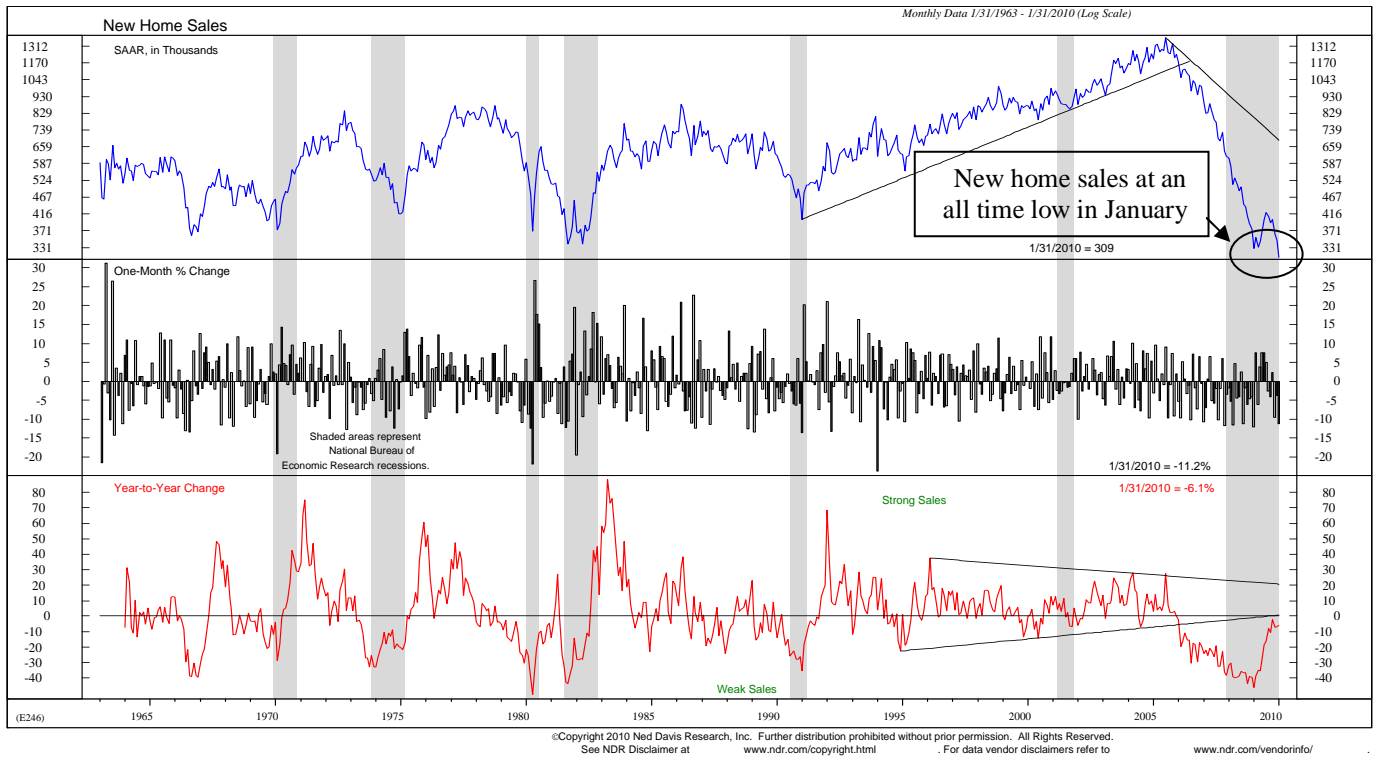
III. Economic Data

Economic data is beginning to show some signs of economic slowing or weakness which significantly reduces the odds of a V-shaped recovery scenario. Most economists are now moving into the “slow and bumpy recovery” camp and we believe we need to watch closely to assure that we don’t fall into the “no recovery camp” by Q4 2010 as the stimulus programs and quantitative easing programs wind down. We have seen a host of data recently that points to a very challenging environment for the economy over the next few quarters. New claims for unemployment unexpectedly rose in February, and new home sales were the worst ever recorded in the month of January, with existing home sales down 7 percent during the month. Consumer confidence plunged 15 percent from January’s reading as consumers became less confident about the future of our economy and job market (source: graphs in related sections following).

IV. Housing

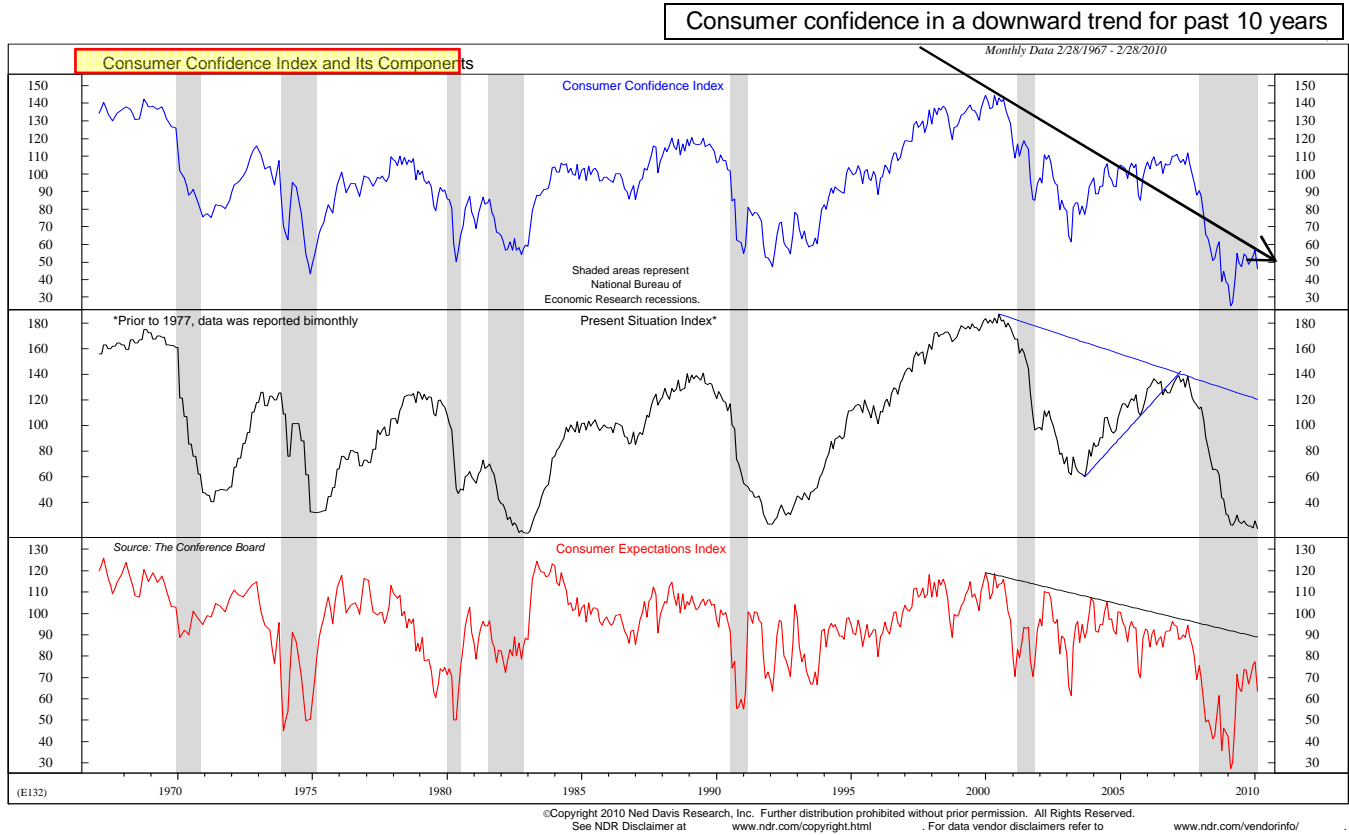
Housing data continues to remain weak. In the month of January, 1,000 new homes were sold each day while there were 4,300 foreclosures and 5,100 notices of default sent each day nationally (Source: John Mauldin). The housing market looks as though it may worsen again in 2010 as foreclosures are expected to increase to over 3.5 million units which is an increase of 10 percent from elevated 2009 levels (source: Realty Trac). It also looks as though we may have “pulled” several buyers forward with the first time home buyer credit last fall. We are now left

with an ever increasing supply of foreclosures and fewer remaining buyers. This most likely means that home prices will fall further in 2010. S&P is calling for another 9 percent decline in housing prices in 2010.



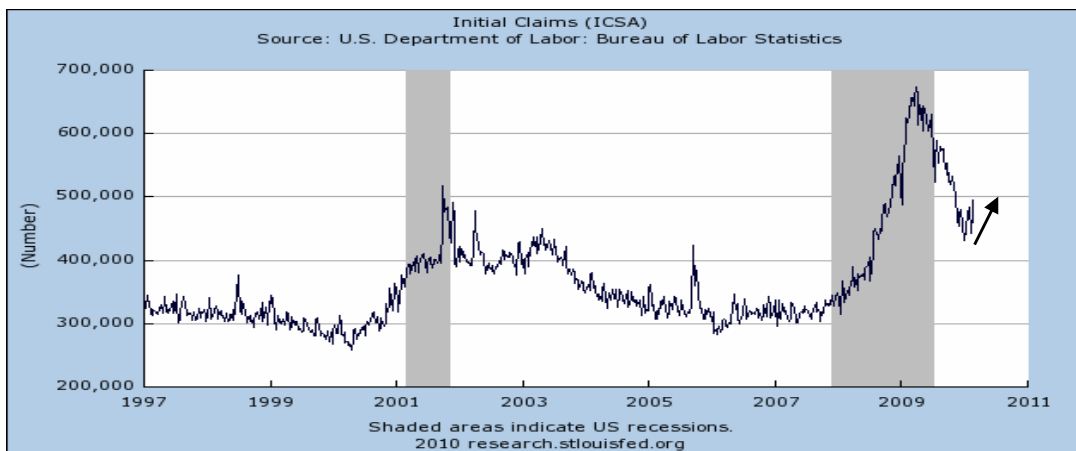
V. Consumer Confidence

Consumer confidence has been in a downward trend since the bear market started in 2000. This will most likely result in a change in consumer behavior from “shopper” to “saver” which is a watershed change from the last several decades.



VI. Employment

After a few months of steady declines, new claims for unemployment are beginning to increase again. This may be a result of the lack of confidence by small business owners as most are not seeing a rebound in their volumes. Unemployment is expected to remain high as small business owner confidence is not expected to rebound any time soon.

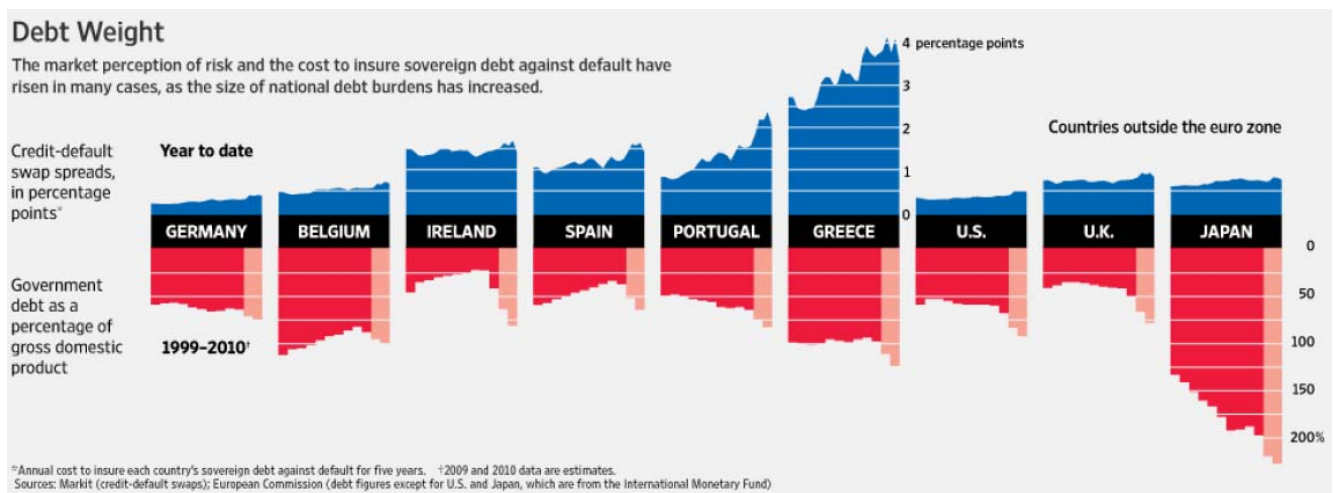


VII. Risks to the Recovery

Sovereign debt risk

As we stated in our January issue, we now believe that sovereign debt issues are the greatest risks to the global economic system. Governments around the world have levered up their balance sheet to compensate for consumers reducing their debts. The net result is simply transferring liabilities from the private to the public sector. After accumulating record levels of debt at the consumer, corporate, and government levels over the prior 70 years (source: Credit Supercycle BCA), politicians and governments around the world have no stomach to allow this debt to deflate. Debt deflation would create a period of falling demand, falling prices and a very long subdued economic environment. Thus governments around the world are trying to inflate their way out of the situation by taking on more debt. Can we fix a problem of “too much debt” by adding more debt? Politicians have historically and will most likely continue to “kick the can” down the road to future generations. Markets must also be willing to play “kick the can” with the government. As we found over the past few months, “Mr. Market” decided he no longer would allow Greece to play this game. The markets did this by increasing the cost Greece must pay on their bonds from 3.7 percent to over 7 percent. This in turn has placed Greece in a very precarious situation in regards to their ability to meet their debt service requirements, increasing the potential for default. One of the few things that seems to get the attention of politicians is a crisis. We suspect most governments around the world will most likely not move toward belt tightening until the market requires them to do so.

Other countries playing “kick the can” such as Spain, Ireland, Italy, Portugal, and the UK are being watched closely to see if Mr. Market suddenly places a much bigger risk premium on their debt which in turn may create another Greek style crisis. This we believe will be one of the most critical factors to watch, for if another sovereign credit crisis occurs, it could translate into a global credit panic similar to that of 2008-2009. The US and Japan are also included along with the above mentioned countries in what the PIMCO group calls the “Ring of Fire.” The U.S. and Japan look to have more staying power in the game of “kick the can” as their debt service/tax receipts remains reasonable. However their outright debt/GDP (U.S. 83 percent, Japan 183 percent, source: Ned Davis Research) and their annual budget deficits are at extreme levels (U.S. -12.5 percent, Japan -10.5 percent, source: IMF).



CONCLUSION

As the famous 20th century economist John Meynard Kenyes stated, “Markets can stay irrational longer than you can stay solvent.” Markets today are being supported by unprecedented government stimulus programs around the world. These programs are beginning to be dismantled, thus we need to watch credit and equity markets closely to see how they function without “the sugar high.” Despite the massive amount of policy being implemented, we are seeing economic data begin to soften which may question the strength of the economy in the second half of 2010. Markets most likely will remain range bound due to the large number of risks to future economic activity limiting upside while massive government stimulus will provide support potentially limiting downside. Sovereign credit risks remain large. If Greece is bailed out, we doubt the concern ends as Spain, Portugal, Italy, Ireland, the UK and Japan all could witness similar problems. The U.S. is in a similar boat; however, most believe the U.S. has more time than the others. To think that the U.S. accumulated approximately \$3.5 Trillion (source: CBO) of government debt in the prior 226 years leading up until 2002 and that we will now accumulate that much debt within 2½ years is a sad fact. In Fiscal Year Ended 9/30/2011, the Congressional Budget Office is projecting a \$1.3 trillion deficit and they have forecasted more than \$6 trillion of additional federal budget deficits over the next ten years (source: CBO). The average U.S. citizen can see that this is an unsustainable path, yet Washington just keeps spending. We will most likely need to wait for the next crisis for Washington to act.

Projected Deficits and Surpluses in CBO’s Baseline

(Billions of dollars)

	Actual												Total, 2011-	Total, 2011-
	2009	2010	2011	2012	2013	2014	2015	2016	2017	2018	2019	2020	2015	2020
On-Budget Deficit	-1,551	-1,434	-1,076	-757	-659	-608	-619	-659	-659	-669	-765	-793	-3,719	-7,263
Off-Budget Surplus ^a	137	86	96	108	120	133	139	138	134	127	116	107	595	1,216
Total Deficit	-1,414	-1,349	-980	-650	-539	-475	-480	-521	-525	-542	-649	-687	-3,124	-6,047
Memorandum:														
Total Deficit as a														
Percentage of GDP	-9.9	-9.2	-6.5	-4.1	-3.2	-2.7	-2.6	-2.7	-2.6	-2.6	-3.0	-3.0	-3.7	-3.2
Debt Held by the														
Public as a														
Percentage of GDP ^b	53.0	60.3	65.3	66.6	66.3	65.6	65.4	65.5	65.5	65.7	66.1	66.7	n.a.	n.a.

Source: Congressional Budget Office.

Note: GDP = gross domestic product; n.a. = not applicable.

- a. Off-budget surpluses comprise surpluses in the Social Security trust funds and the net cash flow of the Postal Service.
- b. Debt held at the end of the year.

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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