LADENBURG THALMANN
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Ladenburg Thalmann Asset Management
LAMP Market Commentary
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Overview

During the first quarter, markets have proven to be resilient as equities continue to climb the wall of worry. Despite many predicaments overseas, there are signs that the economic recovery continues. Unemployment levels remain above average historical levels but are improving and have come down from 9.8% in November of 2010 to 8.9% in February 2011. Manufacturing production has increased in the US, and consumer spending is up at an annual rate of 5.4%, although recently has slowed due to inflationary pressures. Consumer spending is a key factor in stimulating GDP growth and has been a pivotal indicator that we have been monitoring closely for signs of a sustained recovery. Real GDP growth was strong in the fourth quarter of last year reporting an annual rate of 3.1%. Although there are signs of improvement there are still aspects of the economy that are weak. For example, housing is still lagging and food and energy prices continue to rise which hurts the consumer's purchasing power. Consumer sentiment now stands at its lowest levels since November 2009 partially due to decreasing average weekly wages. It is also unclear whether or not corporate earnings can continue to grow at the same pace seen over the past two years which has been a strong driver in performance. The question we will focus on going forward is, will further signs of improvements in the economy such as increased employment and an expansion in manufacturing offset the consumer burdens of lower home prices, higher food and fuel prices, and minimal wage growth? While there are continued headwinds against this market and further volatility expected similar to 2010, we expect the economy to continue improving throughout 2011, but at a slower pace.

Domestic Equities

The US stock market had its strongest first quarter gain in over a decade returning 5.9% measured by the S&P 500. Our diversification benefited the portfolios with exposure to small cap stocks being the leading domestic asset class at 7.94%. Corporate profits were up 18.3% versus the prior year supported by expanding manufacturing. Over the next few months domestic manufacturing could increase further pending the impact of Japan's earthquake on their ability to recover and maintain their global supply. The strength in the equity market has been fueled by strong corporate profits, high levels of cash on the balance sheets, relatively low borrowing rates, and a recent rise in lending. Going forward, we will monitor the sustainability of these market highs as corporate profits will be negatively impacted by reduced consumer spending and rising energy costs.

International Equities

Unlike the strong performance in domestic equities, international equities including emerging and developed markets underperformed due to inflation fears, European debt issues, the earthquake in Japan, and conflicts in Africa and the Middle East. We believe the growing strength of the emerging market consumer will be a driver in global consumption growth over the next 10 years, which may lead to excess returns in this asset class. Last quarter we added an allocation to Frontier markets (examples of which are Bulgaria, Kenya and Vietnam) in our more aggressive portfolios, which are considered less established versions of traditional emerging market countries. Despite recent volatility, we expect Frontier markets to outpace global equities due to lower valuations and additional diversification benefits. We continue to be under allocated to international developed equities, even though they are trading at attractive valuations due to concerns regarding sovereign debt issues and global inflation.

Fixed Income
Much like in the equity markets, fixed income investments experienced a number of rallies and pullbacks in the first quarter. The end of the quantitative easing program in June will put downward pressure on fixed income prices resulting in higher treasury yields which may slow lending and potential GDP growth. There are more attractive opportunities in corporate debt, ranging from short term high quality to high yield, as well as floating rate debt, which was recently added to our portfolios as a hedge against potential increases in interest rates.

Real Estate
The real estate market continues to suffer despite improving economic conditions. New home sales fell to the lowest level on record in February and home prices dropped again in January for the 6th straight month. Despite low mortgage rates, credit conditions still remain very tight which puts stress on the real estate market. Foreclosure rates decreased by 27% from February 2010 which is a positive indicator that consumer finances are improving. However, due to the excess inventory of homes on the market, it may take years for the sector to recover therefore we do not hold an allocation to real estate.

Natural Resources
Increased economic activity coupled with the geopolitical unrest in Africa and the Middle East has caused commodity prices to soar, especially gasoline increasing 21% in the first quarter. According to BoA Merrill Lynch, every sustained $10 rise in oil prices translates into a $35 billion hit to consumer wallets. US household energy bills are up 17% and food bills are up 25% in the last 12 months resulting in approximately 22% of the US consumers total income dedicated to these expenses. The acceleration in the price of oil, grains, and other hard assets may lead to slowed economic growth due to inflation in the US and abroad if not stabilized. Our allocation to natural resources is intended to act as a hedge for our portfolios in periods of increased inflationary pressures and has benefited from the recent rise in prices returning approximately 10% this year.

Conclusion
Similiar to 2010, we expect to see continued volatility in the market throughout the rest of the year driven by catalysts such as the end of the quantitative easing, geopolitical events, and potential higher inflation, but feel that the recovery has taken root. Historically, there is about an 88% correlation between stocks and the movements in the Fed's balance sheet, therefore many investors fear a potential pullback in equity markets with the end of QE2. We believe the pullback will be minimal since unemployment is improving, corporate profits are strong and inflation is currently limited to food and energy. Our portfolios are positioned to take advantage of further advances in the market as well as navigate strongly through periods of further volatility.