Ladenburg Thalmann Asset Management
LAMP Market Commentary
October 2010

Introduction

The past month represented the best September performance for the S&P 500 in over 70 years, returning 8.92%. Our continued allocation to equities helped drive performance for the quarter reiterating why we maintain our disciplined investment approach by staying fully invested and diversified. Corporate profits continued to surprise on the upside, as profits were up 37% over the past 12 months. Mergers and acquisitions activity increased 59% in the third quarter 2010 compared to the same time last year signaling restored corporate confidence. The current low interest rate environment continues to encourage economic growth by allowing for cheap access to capital which has been aided by the Fed's recent round of quantitative easing through the purchase of treasuries. While these factors lead us to believe markets will continue to grow, the pace of growth has been and should continue to be at a slower rate. Consumers, which have historically accounted for 70% of GDP, are still burdened by the most recent recession and have continued to save at an above average rate of 5.9%. We see no indication that their spending habits will revert to levels seen prior to 2008 with unemployment currently at 9.6%. Despite concerns remaining in the market, we have an optimistic outlook for the remainder of 2010.

Domestic Equities

The S&P 500 returned 11.29% for the third quarter, and 3.89% year to date. Abundant liquidity provided by the Federal Reserve and the unattractive fixed income yields should sustain equities at their current levels. As investors look to equities for income, there are 68 companies in the S&P 500 with yields above the average rate of 3.8% in taxable bonds (Bloomberg). Our increased Midcap exposure this spring has benefitted the portfolio as Midcaps have outperformed large cap stocks by 6.55% and small cap stocks by 1.85% year to date. Increased M&A activity has positively affected mid cap stocks, which are nimble enough to make smaller purchases, and large enough to receive favorable loans. Although value stocks and growth stocks have had nearly identical returns year to date, we continue to favor value over growth based on their historical performance coming out of recessions and the increased need for yield in this low interest rate environment. For the equity market to continue to rise, we will need to see increased revenue and not just cost cutting methods which was a major driver of earnings growth earlier in the year.

International Equities

Emerging markets have fared much better than most equity markets, returning 10.75% year to date. We continue to be impressed by the changing emerging markets economies which used to be driven by large cap exports to developed market consumers and is now increasingly driven by their own growing middle class consumer. Within our portfolios, we have shifted our emphasis to emerging market small caps, which are better suited than large caps to take advantage of the trend towards consumers within the emerging world which has driven outperformance compared to the EM index this year. We continue to favor emerging market equities over all developed market equities. International developed equities have underperformed the S&P 500 due to concerns involving the health of the Euro, returning 1.07% year to date. While current prices on international developed equities are fairly valued, we are looking for a buying opportunity if prices fall further.

Fixed Income
Concerns over the European sovereign debt situation led to a widespread flight to quality starting in May which contributed to Treasuries being up 8.7% year to date measured by the Barclays Capital U.S. Treasury Index. Despite their recent strong performance, treasury yields are near all time lows, leaving more attractive opportunities in corporate investment grade and high yield debt. We have increased our allocation to Corporates due to the quality of US Corporate balance sheets which have ample cash set aside mitigating their increased risk over Treasuries. We also see opportunities in emerging market bonds which compared to the US, emerging markets have much lower levels of sovereign debt compared to their respective GDP outputs. The level of US debt has more than doubled in size since the start of 2008 and expectations are that it will continue to grow eventually resulting in inflation. In preparation of this scenario, we have positioned our fixed income allocations with moderately short durations which should help protect our portfolios in a rising rate, inflationary environment.

Real Estate
We do not hold an allocation to real estate in the portfolios due to the continued weakness and uncertainty of this sector. An astounding 14% of mortgages are in foreclosure or delinquent, and there will be an estimated one million foreclosed homes this year. Despite this weakness in the market, there have been some recent signs of improvement. US housing starts increased by a better-than-expected 10.5% in August to a seasonally adjusted annual rate of 598,000 on strength in multifamily construction (from the Commerce Department). We will continue to monitor this asset class for sustained fundamental improvements.

Natural Resources
Returns of natural resources have been uncharacteristically correlated to equities, and until investors are confident that strong global growth will return, this asset class should trade similarly to the equity market. Over the long run, increased demand for hard assets driven largely by flourishing emerging markets will put upward pressure on prices and drive returns in this asset class. The natural resources sector, and more specifically the exposure to precious metals and oil, continues to provide the portfolios with inflation protection by acting as a hedge against paper currencies, especially when many governments around the world have taken on high levels of debt.

Conclusion
Looking ahead to Q4, mid-term elections have historically had a positive effect on the markets. In the past 17 mid-term elections (since 1942) the stock market has gone up 100% of the time in the 200 days following the election, with an average gain of 18.3%. We expect the upcoming elections to have a similar positive impact on the market, regardless of the outcome. The election should provide clarification on many critical issues including future monetary policy, additional quantitative easing, the Bush tax cuts, and other laws. We will continue to monitor the state of US employment, business and consumer spending, housing, inventory restocking, revenue growth, and changes in interest rates to determine where we are in the economic cycle and we will rebalance accordingly as conditions continue to improve. As always, our goal is to position the portfolios to be able to benefit from positive returns in the equity markets while offering downside protection through the use of alternatives.