

PELTZER CAPITAL

MANAGEMENT, LLC

2010 Market Return Summary

	Current Month (APRIL)	YTD 2011 Change
S&P 500 Index (Large Stocks)	3.0%	9.1%
Russell 2000 Index (Small Stocks)	2.6%	10.8%
Nasdaq Index (Tech Stocks)	3.4%	8.6%
MSCI EAFE Index (Int'l Stocks)	6.0%	9.6%
3-year Treas. Notes	1.0%	0.7%
5-year Treas. Notes	1.6%	1.6%
10-year Treas. Notes	1.1%	0.7%
High Quality Corp Bonds	1.8%	1.1%
20-year Muni Bonds	1.1%	0.2%
Gold	8.6%	10.8%

March Market Highlights


Overall Comments:

The market continued its fall rally with the S&P 500 climbing another 5.9% during the first quarter of 2011. The market is up a cumulative 28% from the beginning of September 2010 and market strategists expect the run to continue through the end of the year. Solid corporate earnings growth is the main driver of the current bull market.

There is an old saying on Wall Street, "the market climbs a wall of worry." There are currently many issues to worry about in the world: Japan's nuclear accident, the turmoil in the Middle East, the U.S. budget and trade deficit, the poor U.S. housing market and the economic/debt problems in Europe. Until recently, these worries kept individual investors out of the stock market. That is now changing as these investors are starting to shun bond funds in favor of equity mutual funds. This is probably the beginning of the process and should be watched to see how excited individual investors get about stocks in the months ahead.

Gold continues to sparkle and is up 2% on top of the 27.7% rate of return in 2010. Bond prices have started to decline in the first quarter due to expectations of higher inflation creeping into the market. Long-term interest rates are now back at the top of their range for the past two years.

Developed international markets still appear inexpensive compared to U.S. stocks and have lagged behind the U.S. market over the past year and a half due to concerns over the PIGS (Portugal, Italy, Greece, and Spain), Ireland and now Japan. The European Central Bank just started raising interest rates which helped the European currency (EURO) rally back to 1.45 versus the dollar from the 1.20 level last summer. Due to our low relative interest rates, the U.S. dollar is declining against most of the other major currencies in the world.



The U.S. economy is improving from the slowdown last summer and is expected to grow 3.0% this year and another 3% in 2012. Recently this forecasted growth rate has come down from 3.5% due to higher oil prices and the economic uncertainty cited above. There are signs that a global slowdown may be underway. If the global slowdown worsens, it would cause me to rebalance portfolios back into bonds earlier than I had anticipated. Originally, I was looking for higher interest rates in the second half of the year and into next year to trigger rebalancing.

Equity Market:

The recent stock market rally was driven by four major factors. First, the Federal Reserve is continuing its current round of quantitative easing (QE2) causing the money supply to increase and encouraging investment flows into more risky assets such as stocks. Second, Obama wants to get reelected and has moved toward the center politically in anticipation of the 2012 election. ISI, an economics firm in NYC, has counted approximately 56 steps Obama is taking toward a more centrist stance on policy since the mid-term election. This has helped remove a great deal of uncertainty regarding more government regulation stifling the U.S. economy. Third, investors have started to put new money into equity mutual funds. For most of this current bull market, investors were putting the majority of their new investment flows into bond mutual funds. This new trend should be watched since historically, when individual investors start pouring huge amounts of their money into stock funds, it is a sign that the stock market has reached the peak. Since this change has just begun, it would seem like investors have time before this indicator tells us that the top has been reached. Fourth, the global economy improved from the slowdown last summer.

Economy and Market Cycle:

I believe one of the most important factors to monitor now is where the economy is in the current economic cycle. I will use a few charts to highlight why I think this is so important.

Exhibit 1 on the following page highlights the relationship between the ISM Manufacturing Index in red and the S&P 500 Index in blue. This chart clearly shows these two factors are highly correlated. In the summer of 2010 as the ISM Index declined, the stock market headed lower until the ISM Index turned back up in the fall. Currently, the ISM Index has increased from the lows of last summer and just surpassed the peak reached for this economic cycle. The historic readings for this variable are shown directly below the two charts. Investors need to watch whether the ISM index has started to permanently roll over for this cycle or whether it is going through another slowdown similar to last summer which would indicate the stock market is starting a needed correction or something worse. The recent ISM report for March showed a slight down tick to a level of 61.2 from the February reading of 61.2. If this pattern of decline continues, the stock market would be prone to at least a correction similar to last summer.

Exhibit 2 on the next page, shows four distinct periods of a typical business/market cycle; early expansion, late expansion, early contraction and late contraction. The bell curve shown on this chart represents the change in the growth rate of the economy. This chart also shows the corresponding average stock market returns for the various stages since 1950. As seen in the blue bar chart, the average stock market return coming out of a recession in the “Early Expansion Phase” is 34.5%; the average return for the second phase of an economic recovery, called the “Late Expansion Phase” is 15.8%. When the growth rate of the economy starts to slow from the peak, the economy transitions into the third phase called “Early Contraction”. Equity market

returns in this phase are paltry at 1.2%. Finally, the growth rate of the economy turns negative in the “Late Contraction Phase”. This phase has average returns of -14.3%.

Market Returns Continue To Ebb and Flow With The Business Cycle

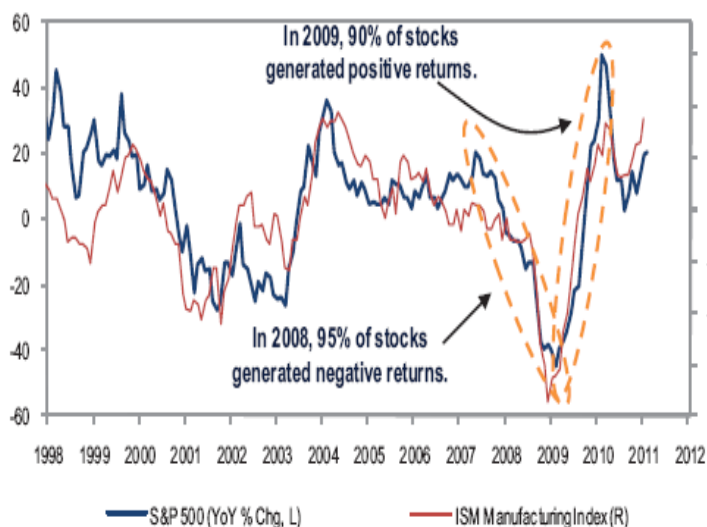


Exhibit 1

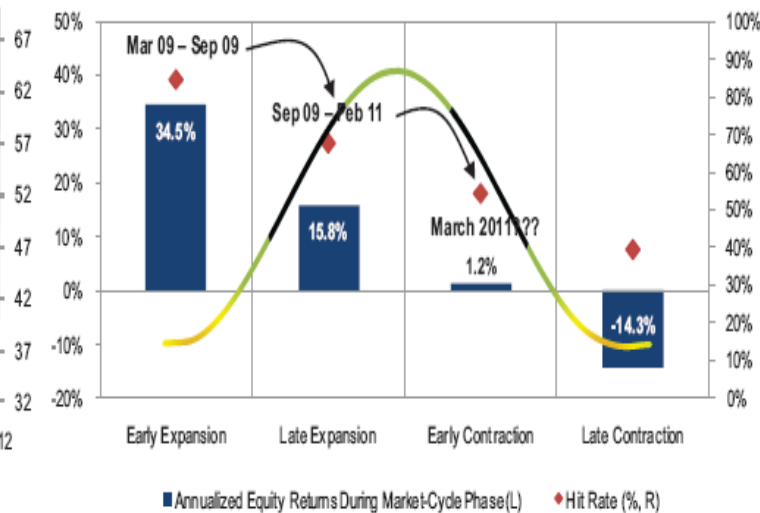


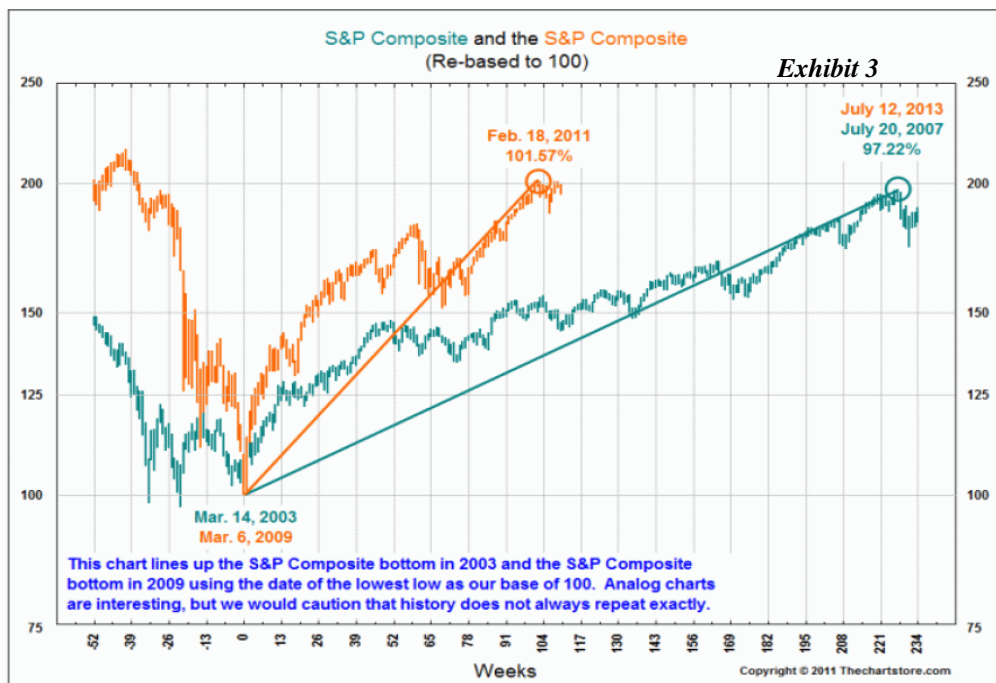
Exhibit 2

When the growth rate of the economy peaks and then starts to slow, this usually corresponds quite closely to the top of a bull market. It does not mean the economy has stopped growing but the growth rate has peaked and is starting a gradual decline to low or negative growth. To put this into context, if the economy is expected to grow 3.0% this year down from its faster pace this fall, it might indicate the economy is moving from the late expansion to the early contraction phase of the economic cycle. If such a transition is under way, the chart advocates the majority of the stock market’s return for the current bull market is behind us and smaller returns should be expected going forward. For this reason, it is important to monitor where the economy is in the economic cycle.

ISM Index

Apr 10	May 10	Jun 10	Jul 10	Aug 10	Sep 10	Oct 10	Nov 10	Dec 10	Jan 11	Feb 11	Mar 11
59.6	60.4	56.2	55.5	56.3	54.4	56.9	56.8	57.0	60.8	61.4	61.2

To help us understand where the stock market is in this market cycle, I have compared our current bull market with the two previous bull markets. The average market cycle normally lasts 3-4 years so we could be close to the half-way point for this economic/market cycle. *Exhibit 3* on page 4 shows the current bull market (orange line), which started in March of 2009, compared to the most recent bull market which started in March of 2003 (green line). Our current bull market already had a return (+101.57%) slightly above the entire previous bull market (+97.22%) and has done so in half the time.



As in the 1990's, it is possible to have slowdowns in the economic growth and have the economy reaccelerate. The chart below (*Exhibit 4*) shows the market cycle of the 1990's compared to the current market cycle. Obviously, an extended economic cycle would lead to an extended market cycle that could cause stocks to move much higher. Could this happen again? Of course the answer is yes. Is this likely? The answer is no. The 1990's bull market had some very powerful

tail winds which generated a very long, powerful bull market. A few of those historic factors were falling interest rates, spending for Y2K, a balanced federal government budget, low levels of inflation, dramatic increases in productivity, and dramatically expanding price earnings multiples. Hardly any of these factors are present today to help the current stock market.

I am getting concerned about the longevity of this bull market which is now in its third year. Valuations are not extended so there may be a little more upside. However, investors seem to be pinning their hopes on a longer than average economic cycle to continue to drive the stock market higher. This is possible but not probable since I believe both the Federal Reserve and the Federal Government are out of stimulus bullets. The Fed could generate another market bubble but the hangover would be worse than what the economy and stock market went through three years ago.

