Ladenburg Thalmann Asset Management
LAMP Market Commentary
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Overview

As we expected, in the first half of the year the economy continued on its road to recovery but with slowed economic growth and market volatility. The recent pullback has raised questions over whether this is a "soft patch" or possibly the beginning of an extended downturn. On a positive note, manufacturing continues to expand and corporations are flush with cash and are reporting record profits, up 10.2% in the first quarter versus a year ago. The combination of these two factors is essential components of long term economic growth. GDP expanded 1.9% in the first quarter which is below the historical average of 3.30% (from 1947-2011), but it is still unclear how much of this can be attributed to slowed growth or market disruptions such as the natural disasters that hit Japan last quarter. The unemployment rate remains at elevated levels and has modestly increased as of late. The massive US debt level is unsustainable over the long term and is creating concerns regarding inflation, devaluation of the US dollar, potential spending cuts, and increased taxes. A default in Greece has been avoided for now, but European debt issues may resurface down the road which would have negative effects on global markets. Despite these factors, we believe the economy will continue its recovery finishing the year positively but know that there will be bumps in the road and therefore we are taking a more conservative stance in our portfolios.

Domestic Equities

Domestic equities (represented by the S&P 500) have returned 6.03% year to date, most of which was earned in the first quarter. The second quarter was volatile due to concerns about commodity prices, European debt, and Japan's disaster testing the US consumer's confidence and hampering the outlook for GDP growth. Despite these concerns, US corporate profits and manufacturing supported the economy. Small cap stocks outpaced large cap and mid cap stocks for the majority of the first half of the year, but gave up the lead in the later part of the second quarter. Small caps tend to have stronger performance over large caps in the early stages of the market recovery, but we believe we are in the later phase of the recovery. We are favoring growth and larger cap stocks since they have good defensive characteristics, perform better during slowed economic growth periods, and have greater access to international consumers which allows them to take advantage of a declining US dollar.

International Equities

International developed, emerging and frontier markets lagged domestic markets for the first half of the year. International developed markets returned 4.98% year to date, emerging markets returned 0.88%, and frontier markets returned -5.49%. We continue to see high growth prospects in both emerging and frontier markets, although we have some concerns regarding inflation issues in emerging markets. Much of the underperformance of frontier markets can be attributed to geopolitical events in the first quarter. Many frontier countries are leading producers of oil, gas, and precious metals, and they continue to invest in the infrastructure necessary to allow their economies to expand additionally enticing investments from emerging and developed countries. We are not as favorable on the growth prospects of international developed equities, as sovereign debt issues continue to plague the region.

Fixed Income
After a negative first quarter, Treasuries rallied, despite their record-low yields, as investors sought out risk adverse investments during the recent market pullback. While the near term prospects of government securities are uncertain due to the end of the quantitative easing program (QE2), US debt levels, and current yields, Treasuries are still essential for a diversified portfolio. We continue to hold various fixed income positions including international debt (both developed and emerging), a focus on short and corporate debt, as well as allocations to both high yield and floating rate debt. These allocations are meant to protect our fixed income allocations from the possibility of a declining US dollar and future interest rate increases.

Natural Resources
Natural resources declined in the second quarter as fears over a slowing economy resurfaced and the impact of geopolitical events subsided. Oil declined over 11% in the second quarter closing at $95.42 a barrel, wheat prices plunged 23%, and corn prices were down 20% from its high this year. Although we have seen significant swings in the prices of natural resources, we remain optimistic about the demand for commodities due to the expanding emerging market economies.

Real Estate
Although there have been modest signs of improvement, the real estate market has been a drag on the US economy, and it could take several years for the housing market to recover. Recently released reports showed that in April 2011, home prices increased for the first time in eight months and pending sales of homes rebounded by 8.2% in May. We remain unallocated to this space but continue to monitor both the residential and commercial real estate market to help gauge the strength of the overall economy.

Conclusion
Similarly to the second quarter, we expect to see volatility but feel the economy will continue to recover although as noted by Ben Bernanke, at a "frustratingly slow" pace. While the current interest rate environment would historically imply a bull market, the magnitude of the unresolved debt problem in our country leaves us in a unique setting, making historical comparisons to similar environments difficult. The main question investors have today involves the huge deficit our country faces and potential plans to unwind it. We fully expect the debt ceiling to be raised, but the consequences of such a raise are yet to be seen. The consumer, a key driver in GDP growth, has been strained by higher food and commodity prices, although lately there has been relief in that area. We expect increased spending at a modest rate in the next few months whereby summer going into early fall is generally a period of increased consumption. Our portfolios are currently positioned to take advantage of further advances in the market as well as navigate strongly through periods of further volatility.

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