LADENBURG THALMANN
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Ladenburg Thalmann Asset Management
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Overview

Despite the volatility in 2010, the economy continued on its path towards recovery. Global profits rose and US household incomes and debt burdens improved. The personal savings rate has been trending downward from 6.3% in June to 5.3% in November positively impacting consumer spending which is a critical component for further economic growth as it comprises approximately 70% of the US economy (measured by GDP). Corporations who had maintained record levels of cash on their balance sheets began putting it to use in the second half of the year. The Bush tax cuts were extended in December which are estimated to add $100 billion in new net stimulus to the financial system in 2011. While much of this news is positive, there are still causes for concern which may lead to volatility in the New Year. Unemployment resides at 9.4% and will act as a road block to a robust recovery if not improved. The ballooning federal deficit, now at $14 trillion, has raised concerns that it is unsustainable and may ultimately lead to a period of high inflation. Issues surrounding the European Debt Crisis and the municipal bond market in the US are still highly prevalent. With all of the volatility experienced in 2010, it was extremely important to not let emotions get involved in investment decisions by sticking to a disciplined diversified investment approach. This approach allowed us to ride out some of the market pullbacks, in most cases losing less than the market, while still offering exposure to the upside.

Domestic Equities

The S&P 500 returned 15.06% for the year and outperformed both international developed equities and the broader fixed income market. Small and mid cap stocks outperformed large caps, benefiting from the additional round of Federal Reserve stimulus which led to the outperformance of riskier assets. Domestic equities are trading at discounted valuations compared to their 20 year historical averages and corporate cash on the balance sheets have hit their highest levels in half a century. Firms have recently begun deploying capital in the form of mergers and acquisitions, as well as stock buybacks and dividend increases which should help to drive growth, and specifically mid cap stocks. We added an overweight allocation to mid caps in the spring of 2010 and expect to see continued risk adjusted outperformance in this sector going forward.

International Equities

2010 was a strong year for most emerging market equities, rising 18.88% (measured by the MSCI Emerging Markets Index) accounting for two thirds of global economic growth. As discussed in past commentaries, we expect the growing middle class to be a strong driver of emerging market growth with expectations of an 8% annualized increase in spending in developing countries such as China, India, and Brazil over the next 10 years. We recently added an allocation to Frontier markets in our portfolios, which are considered less established versions of traditional emerging market countries. These markets are trading at much cheaper valuations and also provide additional diversification benefits to our portfolios as they are less in sync with global equity markets. Examples of Frontier markets include Bulgaria, Kenya, and Vietnam. While performance of both Emerging and Frontier markets were strong in 2010, international developed markets proved to be a bit more challenging, as the MSCI EAFE Index returned 7.75% due to concerns over their sovereign debt issues.

Fixed Income
We have begun to reduce our exposure to both domestic and international government bonds, due to the massive amount of debt on their balance sheets. Since the Federal Reserve began its latest round of treasury purchases in order to inflate the US economy, government related fixed income investments have experienced a significant pullback. Municipal bonds have felt the brunt of this pullback, mainly due to fears of high state deficits. Therefore we recently added an allocation to floating rate debt to our more conservative portfolios to hedge against possible inflation down the road. Unlike traditional bonds, coupons on floating rate bonds reset with increases in interest rates, limiting the effects of a rising rate environment. We favor corporate debt due to their cash on hand, high yield debt based on the improving economy and emerging market debt which have stronger economies and less debt compared to the developed world.

Natural Resources
Natural Resources outperformed most equity and fixed income securities, rising 21.94% (measured by the S&P North American Natural Resources index) in 2010**.** This performance can be attributed to strong investor demand, a weakened dollar, and emerging market growth. We continue to see opportunities in natural resources as countries continue to devalue their currencies in an attempt to increase exports. Rising prices in natural resources, specifically oil, act as a double edged sword hampering consumer spending since every 1 cent increase in gasoline decreases US consumer disposable income by about $600 million per year. We will continue to monitor the price of oil as it will be a key indicator as to the health of the economy.

Real Estate
There are signs of further deterioration in the real estate market and therefore, we do not have an allocation to the asset class. The unsold existing inventory of homes is 80% above the historical norm, and the annualized sales rate in November was roughly a third lower than after the expiration of the homebuyer tax credit. In addition, the real estate market continues to be uncharacteristically correlated to global equities and no longer offers the diversification benefits that it did in the past.

Conclusion
In 2011, we expect the economy to continue moving in a positive direction with an improving consumer leading to moderate GDP Growth. The first quarter's earnings reports could be a telltale sign if the S&P 500 returns are sustainable and if the economy will continue to expand. We will monitor the profound impact of the emerging market consumer on worldwide economies and the ability of the leading nations to reduce their sovereign debt. As we look forward to 2011, we expect the volatility to continue, but through our diligent process of risk management and prudent investing, we believe we will be able to manage this new era of global uncertainty.