Ladenburg Thalmann Asset Management
Market Commentary
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Overview

In the first quarter of 2012, the economy improved leading to a rally in the equity markets with the S&P 500 returning 12.59% for an astounding 25.9% gain over the past 6 months. This was the first time since the post-World War II era that there has been such a rise in equity markets with such low volatility. Improved fundamental economic indicators including rising corporate profits, strong manufacturing levels, a healthy personal savings rate, improving retail sales, and a growing GDP (from 1.8% in Q3 2011 to 3% in Q4 2011) were behind the strong market returns. This is in stark contrast to the market behavior in 2011 that was largely news driven. We do not anticipate the same levels of returns in the next 9 months that we have seen in the previous six months. The unemployment rate has come down from a high of 10% to 8.3%, but still remains above historical levels. The housing market has shown signs of life over the last few months, but remains at very depressed levels. Energy prices have risen at an 8.1% annual rate with gas prices climbing a staggering 17% (CNN Money). Increasing energy prices will negatively impact the consumer, a key driver of GDP growth. Additionally, while no longer the center of attention, the European debt issues have not been resolved and the US national debt has ballooned to $15.5 trillion. Despite recent economic improvements, it is not the time to be complacent about risks in the market. We feel it is essential to focus on managing downside risks. We recently rebalanced the portfolios to secure gains from the strong market rally and to reallocate our portfolios back to a more conservative stance, while maintaining ample equity market exposure to capture upside returns.

Domestics Equities

Domestic equities experienced their best start to the year in over a decade. Investors were enticed to re-enter the equity markets by the plethora of reports on improving economic data. Record high corporate profits and manufacturing remaining at expansionary levels for the last 32 months were the key drivers of the strong equity returns. Some believe we are even in the midst of a US manufacturing renaissance, driven by a weakened US dollar, an increase in US energy competitiveness, and the ability to contain somewhat consistent labor costs. Typically during robust market rallies, small-cap stocks tend to outperform large and mid-caps stocks, however, they didn't in this instance. We continue to be underweight small cap stocks and value stocks in our strategies as we believe large and mid-cap stocks have the potential to capture most , if not all, upside that small-cap stocks provide, while significantly limiting downside exposure.

International Equities

After a grim 2011, international developed equities (MSCI EAFE Index) returned 10.86% and emerging market equities (MSCI EM Index) returned 14.08% through the end of the first quarter even in the face of a technical default in Greek debt. Like US equities, international equities benefited from reduced fears over the collapse of the Eurozone because of the actions taken by the European Central Bank (ECB) to essentially "bail out" Europe through measures such as the LTRO (Long-Term Refinancing Operation), which added liquidity to the European Banking system. This, in turn, gives them ample capital to purchase debt from some of the struggling countries in Europe. While a further equity rally would likely advance international developed equities, many of the outstanding global economic risks stem from this region and would likely be accompanied with higher levels of volatility. Although historically more volatile than developed markets, prospects for emerging markets and frontier markets are strong due to their flourishing middle class, higher GDP growth rates and healthier balance sheets compared to those of many developed nations.

Fixed Income

We continue to favor high quality corporate bonds due to their increased yields over treasuries and the strong health of their underlying corporate balance sheets. The 10-Year Treasury Index (iboxx $ Treasury Total Return 10 Year) was one of the strongest performing asset classes in 2011 returning 29.6%, but has unperformed in the first quarter down -5.62%. This is largely due to the diminished anticipation that the Fed would have performed additional rounds of quantitative easing though the purchase of treasuries, causing a reversal in the high demand for treasuries seen last year by many investors. Within international fixed income, specifically international developed debt, some of the previously experienced diversification benefits have decreased. Overall, our fixed income position has a short duration to protect against any future inflationary surprises.

Commodities
Commodity prices have bounced back with the market, and oil has risen above $100 per barrel. Natural Resources have become too correlated (moving in the same direction) with the overall market, and no longer show the diversification benefits they once had. We have recently removed that allocation in exchange for focused investments in gold and MLPs (Master Limited Partnerships). MLPs can lessen market volatility, as they are currently yielding 4.78% (measured by the Alerian MLP Index) and their increases in yields have historically outpaced the rate of inflation. Future growth expectations are strong for MLPs as it is projected that the US may require more than $200 billion in energy infrastructure investment over the next decade. Gold has shown its ability to perform strongly under a variety of market conditions and is the only asset class that has rallied in each of the past 10 years. Previous market conditions in which gold has performed well include periods when the U.S dollar has depreciated since it is priced in dollars; periods when the U.S. dollar has appreciated because of its risk-off attributes; and periods of inflation and deflation. Gold, which is widely considered a currency, is attractive compared to paper currencies because central banks cannot reduce the purchasing power of the asset by simply printing more gold. Gold has come down significantly since its high in September of $1900, making it again an attractive investment.

Real Estate
The devastated housing market which has been a major drag on GDP is slowly mending. Housing starts declined 1.1% in February, but were up 34.7% versus a year ago. Home sales also fell 0.9% in February but were up 8.8% from a year ago and near the highest level since November 2009. Although the data shows improvements, it is important to note that they are relative to very depressed levels. Home buyers still face very tight credit conditions and therefore we do not expect a huge increase in home sales any time soon. Accordingly, the slow rate of recovery will not likely lead to a large impact to GDP growth or major improvements in unemployment.

Conclusion
The rally the market experienced over the last 6 months leads us to believe that problems stemming from debt issues in the Eurozone have been largely contained. While markets are trading more on actual fundamentals, and not headline news from Europe and Washington, we do not believe the current market momentum is sustainable at its current pace. US and the emerging world economies have strengthened, but concerns remain that the pace of the rally may have gotten ahead of itself. We recently took profits in some of our equity positions, and made changes to our alternative allocations to more conservative investments with better diversification benefits with the goal of reducing the volatility of our portfolios. We expect equities within the US and emerging markets to continue to grow, but not without increased volatility. Beyond the risks of European Debt and a growing US deficit, we see potential risks in rising energy prices and increasing political uncertainty that comes with an election year. We maintain diversified portfolios with exposure to various equity, fixed income and alternative positions and rebalance accordingly to maintain their risk / reward balance.

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