LADENBURG THALMANN

ESTABLISHED 1876

Ladenburg Thalmann Asset Management
Market Commentary
January 2012

Overview

2011 can be characterized as a year of slow economic growth, high unemployment, and heightened volatility. Concerns over the European sovereign debt crisis and uncertainties over policy decisions coming out of Washington were the driving forces that led to volatility throughout the year. As we look ahead to 2012, there are optimistic indicators that the economy will expand, albeit at a continued lethargic pace. Inflation remains subdued and interest rates are at historically low levels which should help to spur economic activity. Corporate profits are near all time highs and consumer spending has shown signs of improvement as of late. One of the most encouraging indicators is that the high unemployment rate, a major drag on the economy, has dropped from a peak of 10.1% in October 2009 to 8.5% in December 2011. These factors should help to drive economic growth in the New Year, but the unsolved debt issues in Europe may lead to continued turmoil in the markets and a possible global economic slowdown. We will continue to monitor the economic indicators for signs of sustained improvements, but hold a conservative stance in the portfolios to help weather swings in the market for what will most likely be another volatile year.

Domestic Equities

US equity markets saw large pullbacks in the third quarter, but managed to finish the year positively returning 2.11% after a 15% run from the year's low on 10/3/11. Although almost flat for the year, US equities significantly outpaced investments in international developed equities and emerging market equities due to fears of a global recession. In 2012, we expect domestic equities to grow faster than other developed countries due to the health of US corporations and moderately improved fundamentals relative to other nations. US Company balance sheets have a record $2 trillion-plus in cash, and profit margins are at or near all-time highs. The U.S. manufacturing sector continued to expand in December, hitting a six-month high and regaining much of the ground lost over the summer. Consumer spending, a key component in GDP growth is projected to grow at approximately 2.6% in the fourth quarter, its fastest in over a year. These factors could lead to positive momentum in the equity market, but volatility stemming from the European debt crisis, as well as other factors such as a backlash over the possible end of the Bush tax cuts, may lead to muted gains in 2012. Our shift from small caps to more defensive large caps and from a value tilt to a growth tilt earlier in the year benefited the LAMP portfolios. Large caps outperformed small caps by 5.58% and growth stocks outperformed value stocks by 2.28% in 2011. We continue to hold an overweight in larger growth-oriented companies within our strategies due to their ability to better withstand a volatile environment.

International Equities

International developed equities (MSCI EAFE Index) returned -11.53%, emerging markets equities (MSCI EM Index) returned -18.36%, and frontier markets (MSCI Frontier) returned -19.03% for 2011. A strong contributor to the underperformance of foreign stocks was the strengthening dollar stemming from concerns that the European Union cannot resolve their debt issues and will collapse resulting in a severe global recession. We do not believe that this will be the fate of the Eurozone, but do realize that there are serious obstacles to overcome for economic stability to return to this region and as a result expect further volatility in the global markets until a resolution is in sight. The Euro closed 2011 at $1.29 touching an eleven and a half month low against the dollar and a 10-year low against the yen. We continue to hold an allocation to international developed equities, although we have the lightest exposure to international developed equities since 2005 in the LAMP strategies. We continue to believe that emerging markets, despite the recent pullback are in a secular bull market. When compared to the developed nations, EM debt levels are relatively low and the rapidly expanding middle class in these nations will be a key driver in global consumption and GDP growth. Emerging markets currently account for 49% of global GDP and have expected growth rates that are double those of developed markets. Due to the strong positioning of emerging markets, we believe our allocation to this sector will benefit the portfolios over the longer term.

Fixed Income

With the Fed committed to keeping short term interest rates at near zero levels in the face of economic uncertainty, U.S. Long Treasury bonds were the strongest performing fixed income asset class last year returning 21.64% as investors flocked to "safe haven" investments. The credit risk (possibility of default) difference between non government bonds and "risk-free" government bonds are at their widest spreads since July 2009 when the market was recovering from the mortgage crisis. The risk of default in corporate bonds continues to decline, which has lead to attractive opportunities in high quality corporates, high yield bonds, and emerging market debt. The LAMP portfolios are structured to provide an attractive level of yield while keeping the duration of the portfolios relatively short.

Commodities

2011 was a tumultuous year for commodities with the prices of hard assets whipsawing up and down over speculation surrounding market demand coupled with a strengthening US dollar. We continue to believe that we are in a long term secular bull market for commodities despite the short term gyrations in prices stemming from negative headline news out of Europe and Washington. The emerging market middle class is expanding at a rapid pace which will ultimately lead to increased demand for commodities and price appreciation of the underlying assets. In addition, natural resources act as a hedge in the portfolios by offering inflation protection if the US dollar begins to weaken. The success of our allocation to managed futures depends on being able to track trends in the market, both on the downside and upside. Accordingly, this has been somewhat of a trendless year for commodities and therefore a challenging year for this asset class. We continue to believe that managed futures will benefit the portfolios over the longer term due to its low correlations to equities and fixed income as well as its ability to profit in up or down market environments.

Real Estate

The devastated real estate market has shown some signs that it is beginning to recover with inventories at the lowest level on record and new single-family home sales increasing by 1.6% in November. But falling home prices and high unemployment rate across the U.S. suggest recovery in the sector will be slow. The huge number of distressed houses in the market will continue to put downward pressure on home prices and limit the uptick in home construction.

Conclusion

We welcome 2012 to provide a fresh start to what has been an extremely difficult market to navigate. We expect that there will be many challenges ahead, but continue to believe that a diversified approach to investing will benefit the portfolios over time. We often speak of the importance of the consumer for the US economy, making up 70% of GDP, and have seen increased spending as of late. It is important to note that the majority of this has come from decreased savings, and not from significant wage increases. Since June 2008, the savings rate has declined from 8.3% to 3.5% in November 2011. The recent decline in unemployment should continue to power consumer spending growth, but will have to do so without the help of consumers further depleting their savings for the purpose of consumption. We expect the positive employment data to have a greater effect than the savings rate, which is one of the reasons we have a positive outlook on the US economy. LTAM believes that planning for financial success includes applying core investment principles, portfolio diversification, risk management, and disciplined long-term investing. Timing the market has proven to be almost impossible and historical analysis has shown that true diversification leads to outsized risk adjusted returns over the long run.