LADENBURG THALMANN

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Ladenburg Thalmann Asset Management
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INTRODUCTION

Imagine stock market returns represented as a giant pendulum, typically swaying slightly to the left, then slightly to the right, all while spending the majority of its time in the middle (or near its average return). If you pull that pendulum extremely far left (picture 2008), and let it go, before settling in the middle, it will fly past the middle (or average) and momentum will take it almost to an extreme on the right (picture 2009). We continue to see opportunities in equity markets but have maintained a rather defensive hedge as we expect markets to stay within a trading range as the pendulum settles on a new middle (or new average return). The US consumer has shown resiliency in recent months, with consumer spending numbers up 3% for the first quarter of 2010 (mainly due to a decrease in the savings rate). Nearly 70% of GDP is driven by consumer spending and any sustained market advances would likely be accompanied by continued growth in this area. Although we've seen positive economic indicators of late, they continue to be coupled with risks stemming from a 9.7% unemployment rate and a unstable dollar in the face of next to zero interest rates. We do not expect interest rates to increase this year, and when the Fed does begin raising rates we expect these increases to be gradual. The biggest factor which could result in the Fed raising rates sooner is not inflation, but rather an attempt to protect the value of our currency as the demand for US debt has decreased. For economic growth to further expand, it requires the continuation of improving employment, consumer spending, and top line revenue growth of companies rather than cost cutting methods to increase their bottom line. While we are not completely in the clear, there is evidence that a sustained recovery is underway which we will closely monitor.

DOMESTIC EQUITIES

The 2009 market rally has continued through the first quarter with the S&P 500 returning 5.39%. Most equity markets are now at 18 month highs lead by another quarter of stronger than expected earnings in which 72% of companies beat their fourth quarter estimates. In our rebalance last November we began unwinding our growth over value tilt which we held from early 2008 because value tends to outperform growth coming out of a recession. Our hedges, such as the previously discussed growth tilt, have allowed us to capture the majority of the market upside while leaving us better positioned for future pullbacks. Our current conservative risk posture towards equities will continue until we see corporate cost cutting replaced by increased revenue and higher quality equities outperform lower quality equities.

INTERNATIONAL EQUITIES

International developed and emerging market equities returned 0.87% and 2.41% respectfully for the first quarter. Most of the underperformance of international developed equities, measured by the MSCI EAFE Index, when compared to the S&P 500 can be traced to fluctuations in currency markets and a strengthened US dollar. Recent problems within the Greece debt market have weakened the euro and have raised questions on its structure. We continue to believe that emerging markets will be a growth driver in our portfolios as their debt in relation to GDP are at much lower levels when compared to those of developed nations, and the continued growth of their middle class has consistently created new business opportunities.

FIXED INCOME

The Fed Funds rate remains at record low levels at 0-0.25% and it is widely expected that it will remain unchanged for an extended period of time. As a result of the low Fed funds rate, the yield curve is sloping upward at a historically steep level which is a positive economic indicator of future growth. However, with the yields on Treasuries at such low levels investors are moving toward higher yielding corporate bonds and the debt of some international developed and emerging market countries. This is resulting in a reduction of demand for government backed bonds that has put downward pressure on their prices causing a rise in their yields. The rise in the 10-year treasury yield may dampen the recovery if higher borrowing costs for the government are passed on to consumers. While many were concerned that the end of the government's trillion dollar mortgage purchase program would lead to a spike in mortgage rates and be detrimental to the market, we believe the greater concern is the rising yields on the 10-year treasury. High yield debt continues to benefit our portfolios with the allocation returning 3.12% YTD. As we expected the uncertainty in the bond market, we have benefited from our shifts in the portfolio to shorter term maturities and higher quality bonds.

ALTERNATIVE INVESTMENTS

As the worldwide emerging market economies continue to flourish and populations continue to rise, the demand for hard assets will grow which will positively impact natural resources. Although relatively flat for the first quarter due to the rally of the US dollar, our long term outlook on natural resources remains strong and we continue to hold an allocation due to its inflation protection and diversification benefits.

Managed futures have yielded negative returns in 2010 due to relatively trendless commodity and currency markets. However, the allocation, which had positive returns in the midst of the 2008 recession (18% from the market peak in October 2007 to the market low in March 2009), still remains a good hedge in the portfolios due to its non-correlation. As previously mentioned, we expect strong demand for hard assets over the long run and this will bode well for alternative investments.

REAL ESTATE

Although we have seen some signs of stabilization in the real estate markets, the number of troubled mortgages continues to rise as foreclosed properties now account for roughly a fifth of all homes listed for sale nationally. Recent government initiatives targeted to sustain the recovery include reducing mortgage loan balances for some borrowers and temporary help for unemployed borrowers. We removed our allocation to real estate in late 2009 due to the poor overall fundamentals of the asset class but we will continue to monitor it for when we see sustained fundamental improvements in the sector.

CONCLUSION

On the one year anniversary of the current stock market rally, our commitment to our disciplined approach to stay invested for the long term benefited our portfolios. We focus on minimizing risk which we believe adds more value by protecting the portfolio on the downside rather than outperforming on the upside. We continue to hold a number of hedges in our portfolios such as allocations to ultra short fixed income, conservative high yield, and managed futures as we wait for the pendulum of the market to settle on a new normal range. We are closely monitoring the state of US employment, consumer spending, inventory restocking, revenue growth, and changes in interest rates to determine where we are in the economic cycle and we will rebalance accordingly as conditions continue to improve.