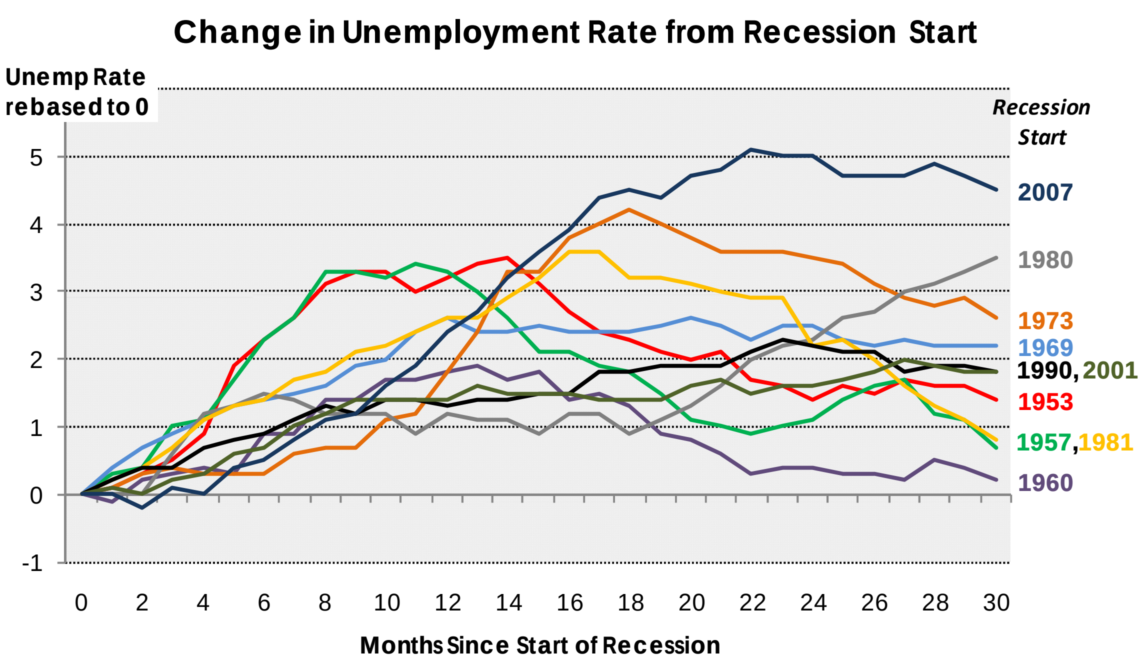
Mixed Messages

Following the markets on a daily basis is enough to flummox the most rational of investors. One day's only-slightly-better-than-expected economic report can send the S&P 500 tumbling as the talking heads declare the "double dip" a reality; meanwhile, the following week, a downright data disappointment may be interpreted as a "bottom" and spark a relief rally. Huh?

As we have discussed many times before, psychology and sentiment are playing huge roles in market movements today. Some investors are very entrenched in their "bullish" or "bearish" camps, but many are uncertain and feel whipsawed by the disparate data. We don't blame them. We are not in a "typical" recovery. The aftermath of a recession caused by the bursting of a credit bubble can behave very differently than that of a typical, cyclical overheating. The territory is relatively unfamiliar, and the high level of government involvement throws even more of a wrench into the picture. Below we examine some of the mixed messages investors face.

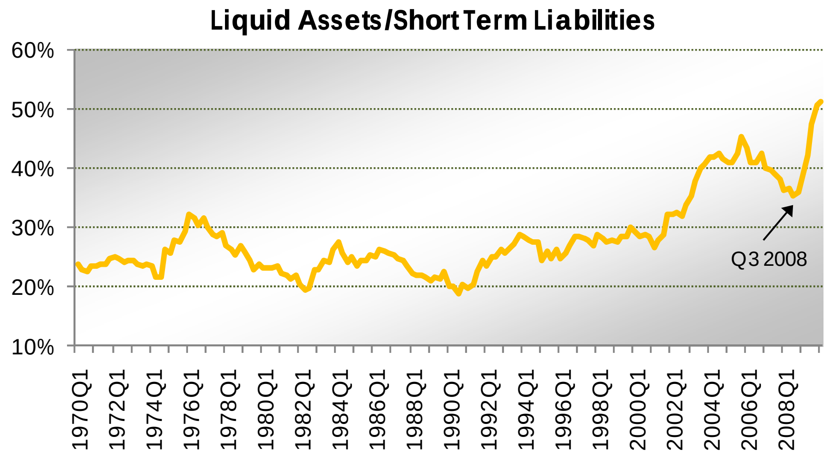
The Chicken (Spending) and the Egg (Employment)

The employment situation, or the *unemployment* situation, rather, is the top headline these days. In most recessionary periods, an improvement in employment typically lags a recovery in the markets, but the wait this time around seems particularly long. Looking back at the past 10 recessions, the current downturn wins hands down for the biggest jump in the unemployment rate as well as the flattest recovery. Only the 1980 recession exhibits a weaker "recovery" trajectory 30 months after the beginning of the recession, and that was because a new recession had already begun in 1981.



Source: Bls.gov

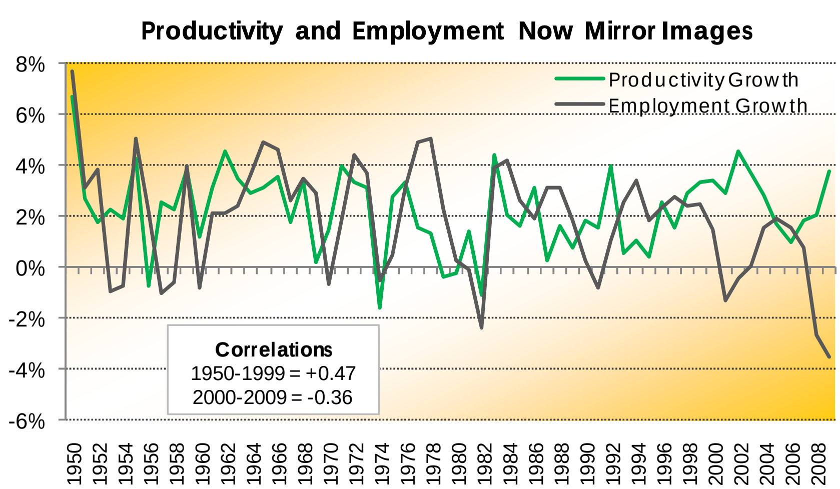
Meanwhile, corporations' balance sheets are looking good even if consumers' are not. Earnings reports have been solid in the last several quarters, and many companies have been rewarded with higher stock prices. Despite some recent weakness, the U.S. equity market is more than 60% above its March 2009 low. How can the corporate sector be doing so well if jobs are so scarce?



Nonfarm nonfinancial corporate business
Source: Federal Reserve flow of funds

Much of the growth in earnings is coming from cost reductions, not top line revenue growth. Corporations are becoming leaner and meaner, doing more with less, while they wait for consumer spending to pick up and drive revenues. The catch-22 is that spending is unlikely to accelerate while the employment picture remains weak. Record levels of cash helped many corporations weather the recent (*current?*) recession and they are reluctant to loosen the purse strings just yet. Liquid assets relative to liabilities are climbing once again after bottoming in the eye of the crisis. With so much dry powder, the capacity is huge for investment and hiring once the picture clears. Balance sheet liquidity means companies are in an excellent position to make acquisitions, especially given the very low cost of borrowing, which could be a boost for the equity market. One of the more near term results of flush balance sheets could be companies reinstating or raising their dividends – a very positive development for high net worth investors who may be giving up a higher percentage of their dividends as tax rates are expected to increase.

Productive to a Fault



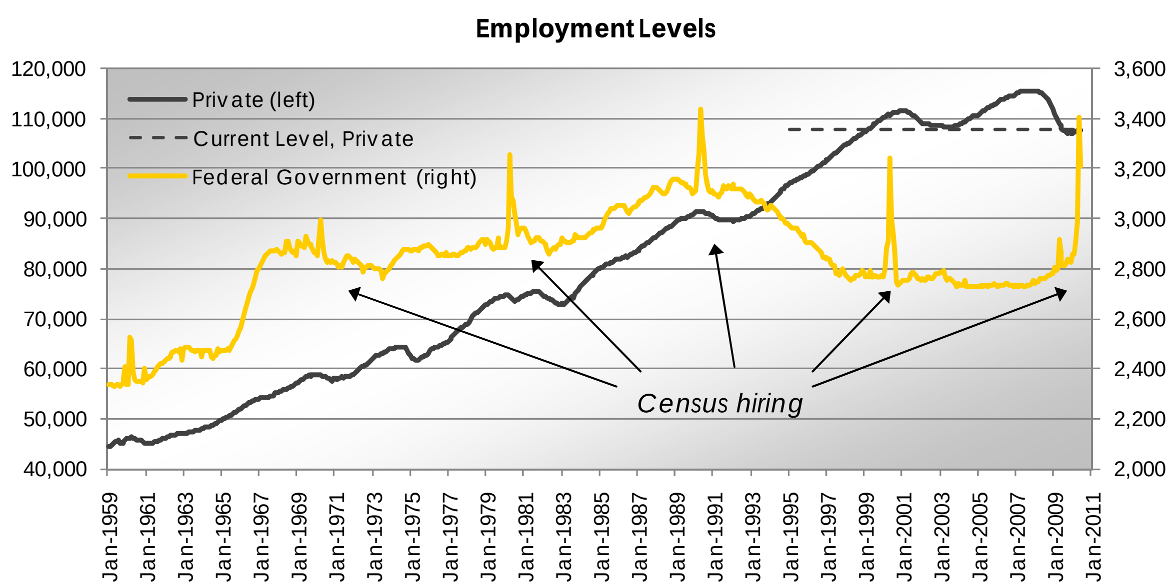
Source: Bls.gov

Although the current environment has helped suppress hiring, the reality is that the trend toward productivity to the detriment of employment has been in place for some time. From 1950 through 1999, the correlation between the growth of productivity and employment was strongly positive (+0.47). During the 2000's this relationship reversed, and the two series are now negatively correlated (-0.36). Technology and globalization have placed companies on a secular path toward cost cutting and efficiency, much to the dismay of the American worker.

Harley-Davidson is the poster-child for productivity gains. The company recently reported profits triple those of a year ago despite lower sales revenues. They accomplished this through a workforce reduction of 20%, and announced additional cuts expected in the next year. In fact, of the companies that have reported second quarter earnings, one in ten have had higher profits on lower sales. The upside to this trend is that the U.S. could become a more competitive manufacturing force and eventually *increase* the number of jobs in the sector. Slack in the labor market should keep wages in check in the U.S. while China is experiencing upward pressures on wages. A rising yuan and (eventually) weaker dollar would reinforce this trend as we gradually move beyond the recession.

Con-Census

The jobs picture actually is improving, albeit slowly. A major distortion this year is the hiring of census workers. Every ten years, the federal government hires hundreds of thousands of people temporarily to help canvass neighborhoods for the census. This year the hiring largely occurred in May with the Labor Department reporting that 433,000 new jobs were added in the month. The markets digested this good news, only to be disappointed a month later when 125,000 jobs were lost. Digging deeper we see that those swings were completely due to federal government jobs. Looking only at private sector employment, the economy added 33,000 jobs in May and 83,000 jobs in June. In fact, every month in 2010 has shown positive changes in private payroll data. Unfortunately, these gains are not yet making up for the huge losses that occurred during the height of the recession. After two downturns in the 2000's, the private employment level is back to where it stood in January 1999.

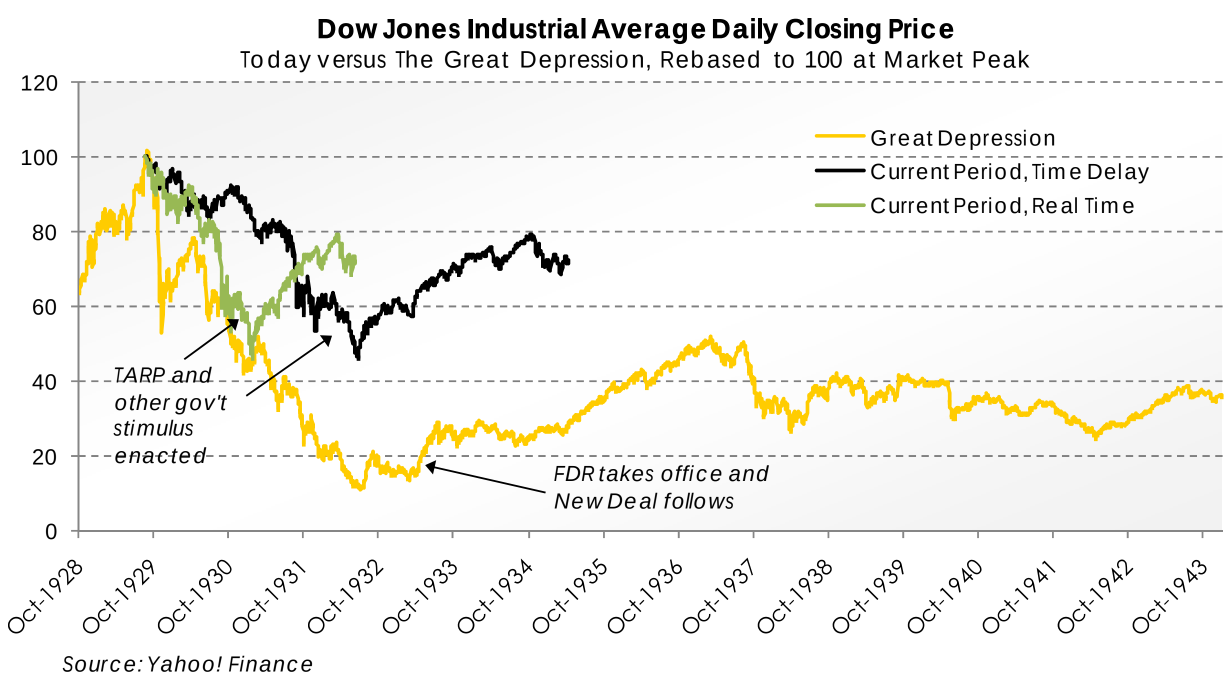


Source: BLS.gov

Depression Obsession

Once again, comparisons to the lean years of the 1930s are rearing their ugly heads. Are we or aren't we in another deflationary depression? According to the equity market, the answer is we are *not*. The chart below shows the Dow Jones Industrial Average for the Great Depression era (**yellow** line) compared to the current recessionary period. The **green** line shows the DJIA in "real time" since the peak of the market in October 2007. The **black** line also shows the current period DJIA, but accounts for technological advances and speed of information flow today versus the 1930's: this line doubles the amount of time it took for the DJIA to cover the same ground it did in the last two years. All series are rebased to 100 at the market peak.

If we compare "real time" lines, then we do not exhibit the same pattern as the Depression era. Once the government stimulus programs took effect in late 2008 and early 2009, the DJIA began to turn around. This period equates to 1931 on the Depression time line. It would not be until 1933 when FDR took office and began enacting the New Deal stimulus measures that the DJIA would rally. Take a look at the black line expanded to approximate the timing of 80 years ago. Counting every day today as two days back then, the timing of the stimulus measures almost line up. The conclusion we draw is that the liquidity measures taken by the federal government in the present day were done much sooner than during the Depression. Once this occurred, the DJIA began to recover. Now many of the stimulus programs such as home buyer's tax credits and Fed purchases of mortgage backed securities are wrapping up and we believe that the market is trying to digest how the private sector will pick up the slack. At this point, it is possible we could experience a sideways market, similar to the late 1930's and early 1940's, as the readjustments occur.



Spend or Save

The culmination of the Greek debt crisis brought the developed world's fiscal problems to the forefront. At first all eyes were focused on the PIGS (Portugal, Ireland, Greece and Spain), but then it became apparent that economic powerhouses such as the U.S. and the U.K. face similar crises down the road. There is a great divide between the camps that believe we should implement austerity measures immediately to prevent the debt levels from rising any higher, and those that believe continued low rates and spending are imperative to prevent a deflationary spiral. The correct answer to this problem is unfortunately unclear. The country's fiscal problems are severe and without a doubt need to be addressed sooner rather than later to maintain the safe haven status of our currency and the foreign backing of our Treasurys. We believe this will be the dominant issue for investing in the next decade, but today the relevant issues are much shorter term.

Investing with Uncertainty

First and foremost, we want to reiterate that the market is not the economy. Some pundits say the markets need a steady stream of good news to post positive performance, but this is not true. In fact, rising markets tend to climb a "wall of worry", just as they did throughout 2009. Although economic data have been less robust than we would like, there are other areas of good news, particularly in the corporate sector. Strong company fundamentals, rising dividends and attractive valuations provide a tailwind to U.S. equities, and extremely low yields incentivize investors to seek out better returns in risk-bearing assets. We couch this in a few caveats:

- Keep an eye on extremes in sentiment and do not pile on at the top or bottom.
- Credit conditions are improving but exogenous shocks are possible (probable).
- Midterm elections add uncertainty to the outlook, but if Democrats do end up losing Congress the gridlock could please the markets.

Despite the volatility, it is important for investors to stay invested in their long-term allocations so that they participate in the "up days." We are favorable on U.S. equities, in particular high dividend-yielding sectors, and continue to prefer high-quality municipal bonds for diversification and income.

July 30, 2010

Katherine Krantz | Brock E. Moseley

Katherine Krantz
Chief Economic Strategist

Brock E. Moseley
Chief Investment Officer

Miracle Mile Advisors, LLC | 201 North Robertson Blvd, Suite 208, Beverly Hills, CA 90211 | tel 310.246.1243
www.MiracleMileAdvisors.com | info@MiracleMileAdvisors.com

Disclosures

The views of Miracle Mile Advisors, LLC ("MMA") may change depending on market conditions, the assets presented to us, and your objectives. This research is based on market conditions as of the printing date. The materials contained above are solely informational, based upon publicly available information believed to be reliable, and may change without notice. MMA makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in this report change.

MMA shall not in any way be liable for claims relating to these materials, and makes no express or implied representations or warranties as to their accuracy or completeness or for statements or errors contained in, or omissions from, them.

This report does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. MMA recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives.

This report is not an offer to buy or sell any security or to participate in any trading strategy. In addition to any holdings that may be disclosed above, owners of MMA may have investments in securities or derivatives of securities mentioned in this report, and may trade them in ways different from those discussed in this report.

The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in your securities transactions. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

The information and analyses contained herein are not intended as tax, legal or investment advice and may not be suitable for your specific circumstances; accordingly, you should consult your own tax, legal, investment or other advisors, at both the outset of any transaction and on an ongoing basis, to determine such suitability. Legal, accounting and tax restrictions, transaction costs and changes to any assumptions may significantly affect the economics of any transaction. MMA does not render advice on tax and tax accounting matters to clients. This material was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

The projections or other information shown in the report regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results.

Other Important Disclosures

Physical precious metals are non-regulated products. Precious metals are speculative investments and, as such, their value can be subject to declining market conditions.

Real estate investments are subject to special risks, including interest rate and property value fluctuations as well as risks related to general and local economic conditions.

Foreign/Emerging Markets: Foreign investing involves certain risks, such as currency fluctuations and controls, restrictions on foreign investments, less governmental supervision and regulation, and the potential for political instability. In addition, the securities markets of many of the emerging markets are substantially smaller, less developed, less liquid and more volatile than the securities of the U.S. and other more developed countries.

This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of MMA.

Additional information on recommended securities is available on request.