If Being Long is Wrong I Don't Want to be Right

We've all been there. Things are good, but not great. We worry about the problems over and over again throughout the night; but in the light of day we see how things could get better. After all, nothing is ever perfect. As long as the good outweighs the bad, we stay in it and ride out the ups and downs.

We are discussing, of course, being invested in the equity market. As we celebrate the one year anniversary of the current rally, it is natural to question if the good times can last. Our emotions tell us one thing, but our brains another. Looking at the hard facts, we have already had a longer run than almost anyone expected. We have been hurt before – maybe we should play it safe and get out while we're ahead? But why walk away when things are going so well? We turn to others for advice and guidance only to find an array of differing opinions: get out, give it more time, up your commitment. Although we are always looking for better opportunities, we believe that there are a few reasons to give equities the benefit of the doubt for a little longer.

Stand by Me

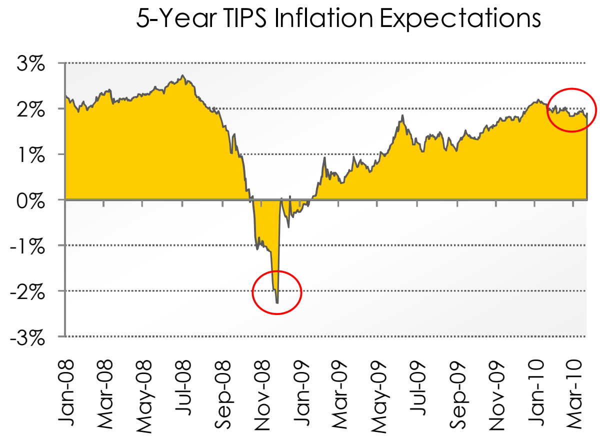
Any time Fed Chairman Bernanke reiterates the Fed's commitment to keeping interest rates low, the equity market's Pavlovian response is to rally. We cannot overemphasize the importance of the safety net put in place by the Fed's implicit "*low interest rate guarantee*". It is clear that the risk of a double dip is not one they are willing to take. As Treasury Secretary Timothy Geithner said in a speech earlier this month, "*We're not going to make the mistakes that many other countries have made in the past, which is to, at the first signs of life and hope, step on the brakes.*"

The trepidation over raising rates is rooted in the employment picture. Despite signs of stabilization in the unemployment rate and payrolls, the economy is not sustainably creating new jobs. The U.S. has lost nearly 8.5 million net jobs since the beginning of 2008. That puts us back at the same total employment level as late-1999, yet today there are over 30 million more people in this country. That level of slack in the job market has permitted interest rates to remain near zero without (yet) stoking excessive inflation. Analysts are predicting that this week's employment report will show nearly 200,000 jobs were added in March. While an improving job market is good news for the average American, it is a double-edged sword for companies. If employment does consistently gain ground, the markets would prepare for higher interest rates, which would mean higher borrowing costs for companies. Also, during the downturn, companies slashed payrolls and are now operating at very lean levels. A tighter labor market could take a bite out of corporate profits in the form of higher wages. Several months of strong gains on the jobs front could take a toll on equities.

Interest rates are not the only tool at the Fed's disposal for managing liquidity. Stimulus measures, both past and present, continue to flow through the economy: TARP funds are a part of the new administration proposal to stem foreclosures, and the year-old Build America Bond program is growing with greater interest from foreign buyers. Officials can also wind down stimulus already in place to shrink liquidity. The Fed will wrap up its purchases of $1.25 trillion of mortgage-backed securities at the end of March, and eventually will begin to sell those securities on the open market. As long as Fed officials continue to manage expectations and adequately broadcast their intentions, they may be able to reign in loose policy conditions without scaring investors.

Smooth Operator

We have argued for many months that actual inflation would be higher than investors' expectations. We were correct. When the equity decline accelerated in 2008, most investors thought a prolonged deflationary period was inevitable. In November 2008, Treasury Inflation Protected Securities were pricing in a greater than –2% deflation rate over the following five years. These deflationary expectations were highly detrimental to equities. We knew that -2% was excessive, and that expectations would have to rise. That has happened, and now they hover near a moderate +2% rate.



Inflation expectations are the difference between the 5-yr nominal and real Treasury yields

An environment of low, moderate inflation is very supportive for equities. Right now U.S. housing prices and wages are stagnant and helping to subdue inflation, but eventually we may import higher prices. Though some investors scoff at the idea of inflation becoming an issue in the U.S. any time soon, there are forces at work in emerging countries that point in this direction. Despite a population of 1.3 billion people, China may be short of workers, particularly in the eastern coastal provinces which include Shanghai. Employers are offering higher wages, health benefits and housing subsidies to attract more labor away from the interior provinces where stimulus-funded infrastructure projects are keeping local workers closer to home. Minimum wages, though they vary by local area, are predicted to grow around 10% this year. If Chinese companies are able to pass on wage increases to the end consumer, they could be shipped to the U.S.

You've Lost That Loving Feeling

Reversals tend to occur when investor sentiment overwhelmingly lines up on the side of the current trend. In the spring of 2009, the dismal environment did not inspire much hope for an equity rally. The S&P 500 had declined nearly 60% from its peak in October 2007, and there were a multitude of reasons it could go lower. Just days before the index bottomed on March 9th, 2009, the American Association of Individual Investors Sentiment Survey posted some of the most pessimistic readings ever recorded. In the March 5th survey, over 70% of respondents indicated a "Bearish" feeling toward the stock market over the following six months, while only 19% felt "Bullish" and 11% "Neutral." This overwhelmingly negative response came not even a week before the current rally was born. Today, despite improving economic data and a year of equity gains, most investors still do not feel bullish on the market. The March 25th survey shows just over 33% of respondents indicate a "Bullish" sentiment, well below the historical average of 39%; nearly 35% are "Bearish", which is above the 30% average.

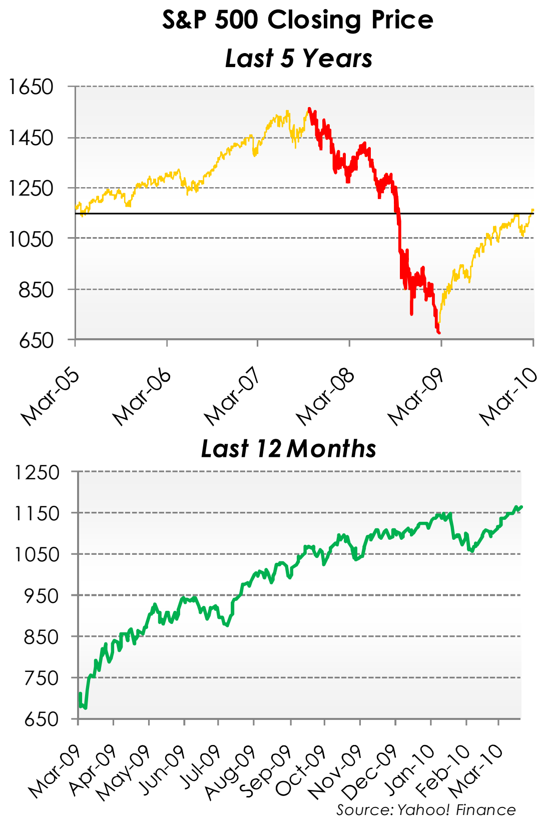
Even faced with hard facts, most Americans are overly pessimistic. A recent poll conducted by Bloomberg found that among those that own stocks, bonds or mutual funds, only 3 out of 10 people say the value of their portfolio is higher than it was a year ago. This seems out of line with reality. The table at the right shows that the 12-month price return through February was positive for ***all but one*** of the industries in the S&P 500. Even if most equity investors were late to the game and did not jump back in until September, only 8 of these industries posted negative returns in that shorter period. Bonds, both taxable and municipal, also posted single-digit positive returns February to February. We think that this poll shows that investors' negative perceptions are still very entrenched. Survey numbers like these do not indicate a top-end capitulation point in sentiment.

S&P 500 Industry Price Returns February 28, 2009-Februrary 28, 2010	
S&P 500	**50.3%**
Industry Index	**Price Change**
Real Estate Mgmt. & Devel.	356.7%
Automobiles	314.2%
Consumer Finance	199.4%
Auto Components	177.8%
Building Products	159.6%
Paper & Forest Products	145.0%
Diversified Financial Services	121.8%
Airlines	113.6%
Household Durables	107.4%
Commercial Banks	105.5%
Personal Products	102.4%
Internet & Catalog Retail	100.2%
Insurance	89.6%
REITS	88.3%
Machinery	88.2%
Elec. Equip., Instrus. & Comps.	87.8%
Industrial Conglomerates	85.6%
Multiline Retail	82.5%
Textiles, Apparel & Luxury Goods	81.7%
Office Electronics	80.9%
Road & Rail	77.6%
Electrical Equipment	76.9%
Media	76.8%
Metals & Mining	76.3%
Health Care Technology	75.6%
Computers & Peripherals	75.4%
Leisure Equipment & Products	75.3%
Indep. Power Prods. & Energy Trdrs.	72.8%
Energy Equipment & Services	72.0%
Software	67.0%
Health Care Providers & Services	62.7%
Semiconductor & Semi. Equip.	62.5%
Aerospace & Defense	62.1%
Containers & Packaging	61.4%
Capital Markets	59.3%
Specialty Retail	56.8%
Internet Software & Services	54.4%
Chemicals	53.5%
Hotels Restaurants & Leisure	53.5%
Life Sciences Tools & Services	51.8%
Air Freight & Logistics	51.0%
Trading Companies & Distributors	50.7%
Communications Equipment	50.5%
IT Services	44.7%
Distributors	43.4%
Gas Utilities	42.6%
Professional Services	40.7%
Tobacco	40.7%
Health Care Equipment & Supplies	39.1%
Pharmaceuticals	34.3%
Commercial Services & Supplies	33.6%
Beverages	33.2%
Household Products	31.9%
Food Products	31.3%
Food & Staples Retailing	23.2%
Multi-Utilities	22.5%
Construction & Engineering	21.6%
Oil, Gas & Consumable Fuels	21.6%
Wireless Telecomm. Services	17.5%
Biotechnology	13.0%
Thrifts & Mortgage Finance	9.3%
Electric Utilities	6.2%
Diversified Telecomm. Services	5.4%
Construction Materials	4.8%
Diversified Consumer Services	-8.7%

Smoke Gets in Your Eyes

One possible reason that Americans' perceptions do not lineup with reality is that they may not understand how easily the data they see can be manipulated. Today's world of 24/7 access to information provides us no shortage of opinions, and usually they are supported by some irrefutable data. Often, we even see the same data held up as support for opposing viewpoints. As the saying goes, *"if you torture data long enough, it will confess to anything."*

Context is an important point to consider when drawing conclusions from charts and tables. Take for example the two graphs presented at right. Both of them show the closing price for the S&P 500 index over the last 12 months, however the top graph presents it within a broader time horizon of 5 years. Someone trying to make a case for a continuation of the upward trend might use the 5-year chart to point out that the index is still more than 25% below its late-2007 peak, and barely back to levels from five years ago. This shows room to move. An analyst trying to make a case for a correction might choose the 12-month chart to highlight the swift and steady run-up, without the context of the previous twelve month's steep decline. Every picture tells a story, but it may be a very different story depending on the artist.



Ain't No Mountain High Enough

Statistically, history is on the side of the bulls. Looking at every instance since 1920 when the U.S. equity market posted a positive-return year following a negative-return period, the bull trend lasted an average of almost 4 years. Only twice did the market post only a single positive-return year (1933 and 1961). The most common length for positive-return runs was 2-3 years; the 8- and 9-year bull runs in the 1980s and 1990s were responsible for bringing up the average to four. However, in more than three-quarters of the 2-3 year bull runs, the largest gains were made in the first year of the rebound. If 2010 follows historical patterns, we will close the year with gains, but below those of 2009.

With that said, to quote Mark Twain, *"There are three kinds of lies: lies, damned lies and statistics."* The importance of what has happened during previous market cycles really lies in learning about the psychology of investors. We have stressed the importance of emotion in the continuation of a market trend in a few of our previous research publications (*"Market Therapy,"* June 2009 and *"Ceteris Paribus,"* August 2009). Momentum can easily catapult a market rally or decline beyond the fair value of the underlying assets. The market declines in 2008 and early-2009 were great examples. On the last trading day before Lehman's bankruptcy filing in September 2008, the S&P 500 closed 20% off its all-time high, already in bear market territory. By the time the index bottomed in March 2009, it had fallen an ***additional*** -46%. Though the S&P 500 index is up about 70% from that March 2009 low, the gain is only a little more than half of what is required to get back to its high. And, how much of that gain was just a reversal of the overshoot – the pricing in of "Armageddon" – after the collapse of Lehman Brothers? As markets have un-priced the possibility of another Great Depression, we have seen equities successfully shrug off potentially-bearish events. The S&P 500 ended in the black the day after the House of Representatives passed the health care bill, and the Dubai and Greek debt crises prompted only small, temporary pullbacks. Until we see signs that investors are "too" complacent, we expect equities to continue to climb the wall of worry.

Let's Stay Together

Certainly there are reasons to be concerned about the future of the equity markets, but in the short-term we believe there could be more room for gains. Low rates, mild inflation, transparent policy guidance, balanced sentiment and investor psychology seem to be on the side of the bulls. Even economic fundamentals are improving slowly but surely. Consumer spending rose for the fifth straight month in February, and labor markets are stabilizing. The "lost decade" for equity returns and employment will be difficult to erase from memory – and to reverse – but we doubt that a double-dip recession is still a real concern.

U.S. equities also look attractive relative to other investment opportunities. A strong dollar provides a headwind to international equities for U.S.-based investors, while over-bought bond markets are leaving investors starved for yield. We are maintaining our full strategic weighting in U.S. equities, while underweighting developed international markets.

March 29, 2010

Katherine Krantz	Brock E. Moseley
Chief Economic Strategist	Chief Investment Officer

Miracle Mile Advisors, Inc. | 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, Inc. ("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.