Research Memo:
Condition of the Markets Across Classes, Regions and Sectors

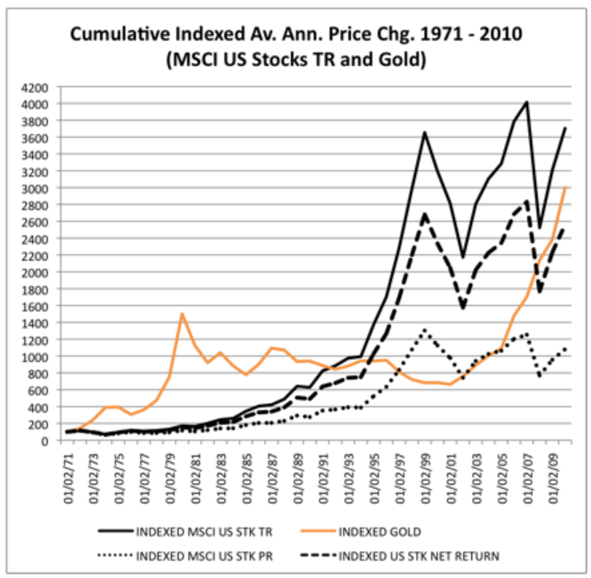
The world is swirling in negative events and pending negative events that are pushing and pulling on market prices, as well as investor emotions. Those negative forces are reasonably well known to most of you, so we won't try to enumerate them.

Our key point is that there is no calculus to sum and net all those factors, which have included an abundance of major surprises. However, all the while the markets are at work, providing in their own way, a net redux of the myriad forces that are pushing and pulling at the world's economy, influencing the level of interest rates and the fortunes of companies.

Let's begin with a very long-term multi-decade look, and then bring the focus in to months over several years, weeks over a year and days over a few months.

Gold Versus US Stocks:

Given the extraordinary attention that gold has in the past few years, whether in the securities markets, or on the radio and TV, let's start with gold.



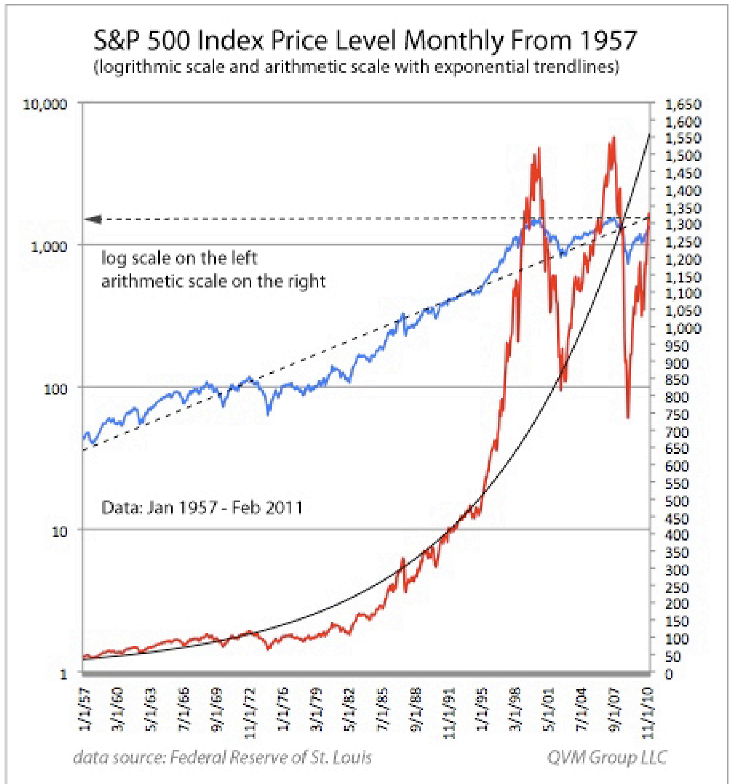
The chart to the right plots the price of gold since 1971, the year the United States went off the gold standard. It is plotted annually against the price return, total return, and hypothetical net of tax return for the MSCI US stock market index.

Gold is up 32 times, and stocks are up 26 times in the hypothetical net calculation (up 37 times gross and 11 times on a price basis only). Gold walloped stocks for the first 20 years, then massively underperformed stocks for the next 10, and finally finishing ahead or behind, depending on the tax status of the investor (fully taxable, tax deferred, well sheltered or tax exempt).

For those other than tax exempt organizations, there were tax timing differences between the two, as stocks paid cash dividends along the way, whereas gold did not and was not taxed, but is nearly entirely gain after 40 years. Gold also has storage and insurance costs of carry not shown in this chart.

We'll leave it up to you to estimate which would have worked out better for you. Gold probably has a pretty good future for the next few years the way things look at the moment.

Long-Term S&P 500 Stocks Price History:



This chart of the S&P 500 index price level from 1957 plots the index two ways.

The red line price chart (right-side scale) is an arithmetic plot though which an exponential best fit trend line is drawn.

The blue line price chart (left-side scale) is a logarithmic plot beginning with an indexed value of 100 (keeping all price changes proportion -- e.g. a 10 point rise from 100 has the same vertical rise on the chart as a 100 point rise from 1,000 -- each 10%). An exponential best fit trend line for the log plot is also drawn as a dotted line, with a dotted line horizontal reference back the left-side log scale.

The principal take-away here is that in spite of the extreme up and down moves of the past 10+ years, the best fit trend line over the past nearly 55 years, terminates above the current S&P 500 price level, in the vicinity of 1325.

The index closed last week at 1314, which suggests that on a very long-trend basis (history only), the index is broadly where it would be expected to be at this time.

Obviously, a trend line through historical data cannot "see" the current environment, or evaluate the implications of the current situation, or account for surprises such as rebellions, wars, nuclear disasters and sovereign bankruptcies. However, there may be some small comfort taken in the current index price resting effectively on a half-century trendline.

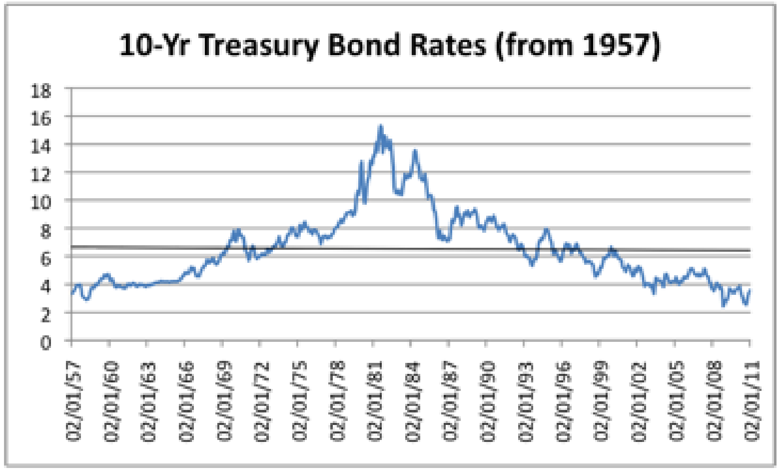
At least it is good to know that the price is not substantially above the very long-term trend line.

We also acknowledge that overvaluation in recent time periods would have "bent" the best fit curve upward, which may be giving too much credit to the recent past.

Nonetheless, it's a data point among many to put into the evaluation process.

Long-Term Interest Rates History:

The 10-year Treasury rate is widely used as benchmark for rates in the US. From 1957 when the rate as about 4%, it rose to the 6% to 8% range where it resided for about a decade from the late 1960's to the late 1970's, but then rose to a peak of over 15% in 1981.

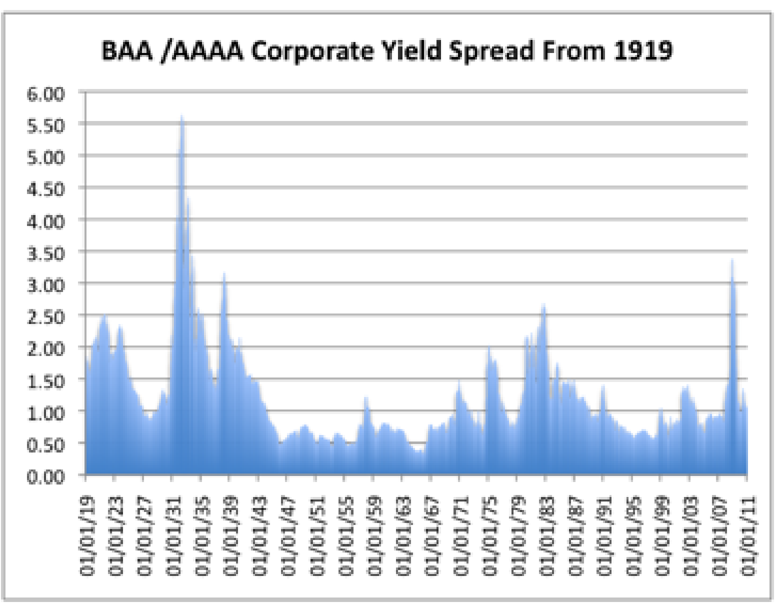


After a steep drop to about 10%, it rose again to nearly 14% a few years later, then from the mid-1980's has been in a period of overall decline.

The rate is now lower than at any time in the past 5+ decades, although is was often about 1 to 1.5 points lower in period from the depression though WWII and until a couple of year after the Korean War.

Prognosticators today are looking at a rate between 4.5% and 5% within 6-12 months, from the current rate of about 3.45%. Remember that bond prices go down when rates to up.

There were some big gains made after 2008 by investors who owned high yield (below investment grade bonds). When the credit markets fell apart, investors sold high yield bonds, driving the price down and the yield up. The rate spread between investment grade and below investment grade bonds widened greatly. As credit markets improved and corporate profits and solvency improved, the rate spread narrowed, as below investment grade bond prices recovered.

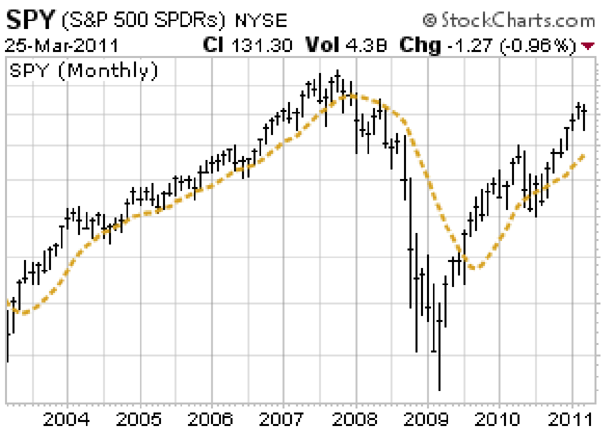


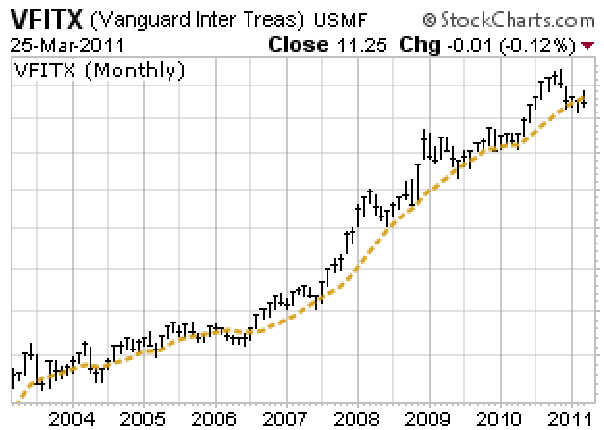
This chart shows the history of the yield spread between AAA corporate bonds and BAA corporate bonds from 1919.

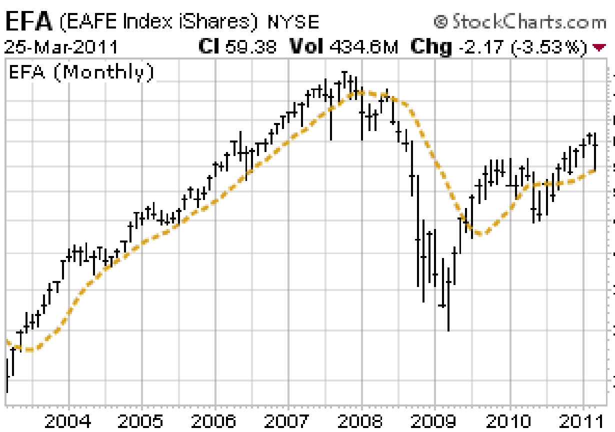
The spread was at its highest during the depression years, very high in the period of high interest rates in the early 1980s' and in 2008 the spread was second only to the spreads in the great depression.

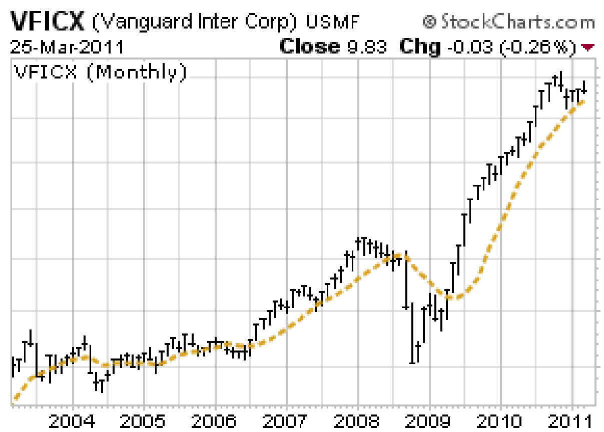
The take-away from this chart is that the high yield bond party is essentially over. The spread is mostly back to roughly normal level for recent times. High yield bonds are not likely to provide the level of total return that they did over the past 3 years.

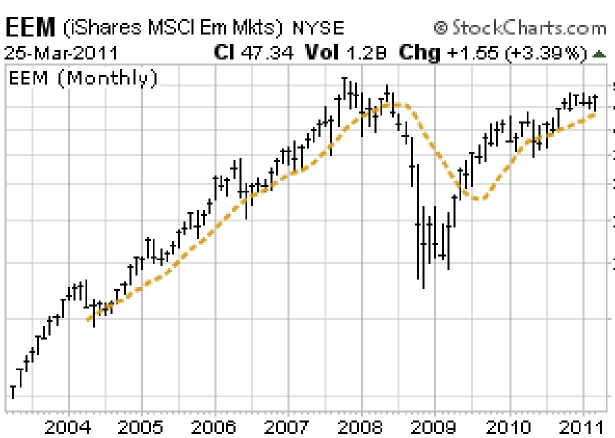
Eight-Year Monthly View of Stocks and US Bonds: US stocks (SPY) are in a clear up trend at this level of inspection. The are ascending nicely and are well above their 12-month average (dashed gold line). Non-US developed stocks (EFA) are struggling a bit and emerging market stocks (EEM) are flattening as the reach the level of the prior 2007 peak. Intermediate-term Treasuries (VFITX) are up and did well in the 2008 crash. Intermediate-term investment grade corporates (VFICX) were hurt in 2008, have done well since. High yield bonds (VWEHX) have done the best and are still staying above their 12-month average. All bonds are at risk of rate increases now.

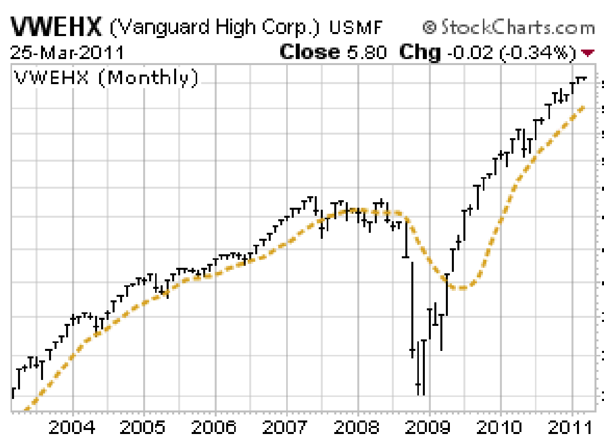




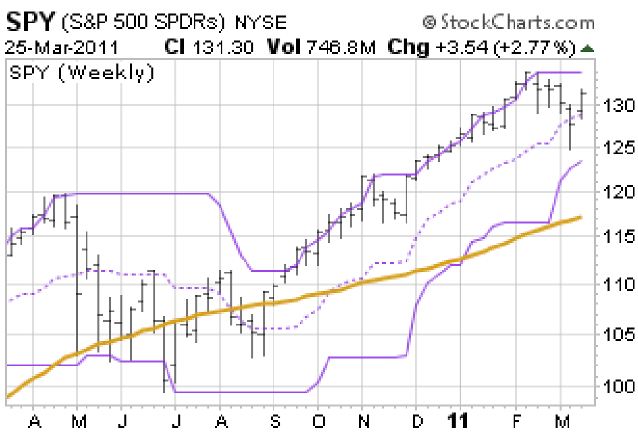


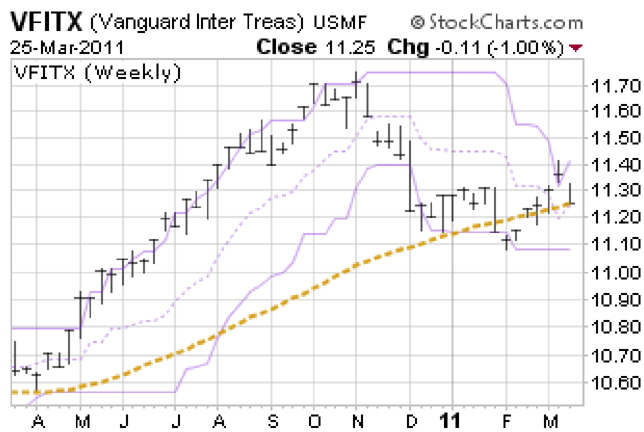


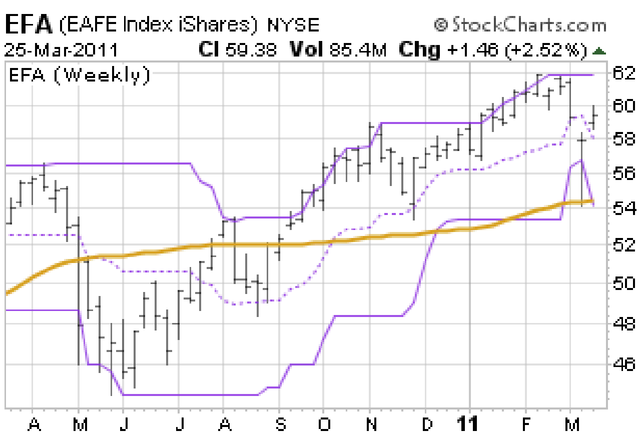


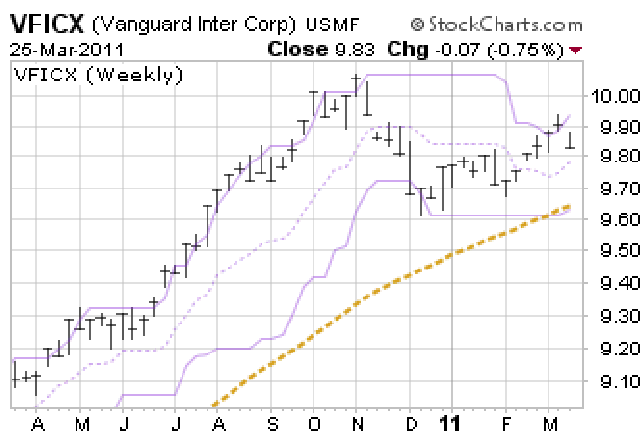


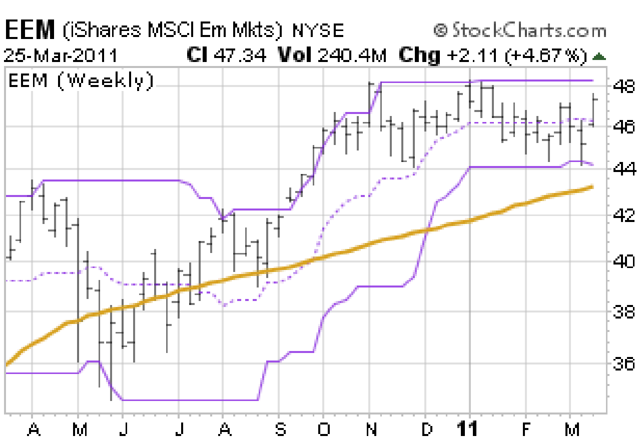
One-Year Weekly View of Stocks and US Bonds: SPY as of last week are back above the mid-point (the dotted purple line) of its 13-week price range, which itself is still rising and well above the 52-week primary trend line (gold line), which is also in an up trend. EFA took a larger dip than SPY or EEM two weeks ago due to sovereign debt issues. EFA is coming back but not as strongly as SPY. EEM is above its 13-week mid-point, but is flat since October. Treasuries are on their primary trend line exposed to rate increase concerns. Investment grade corporates are doing better, and high yield are doing best, still rising.

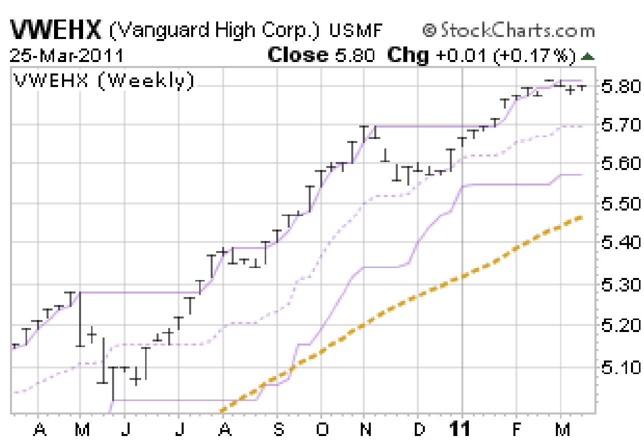




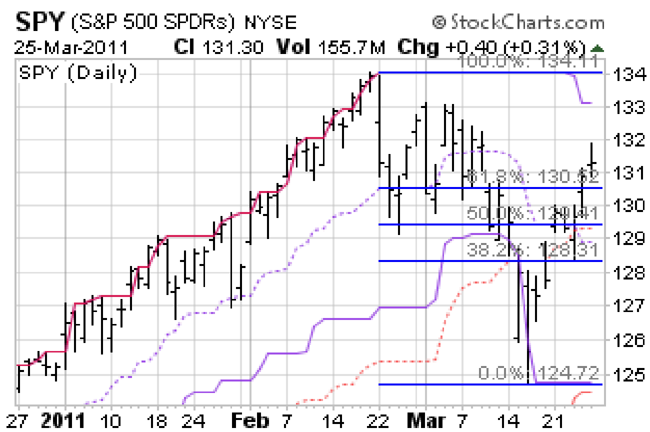


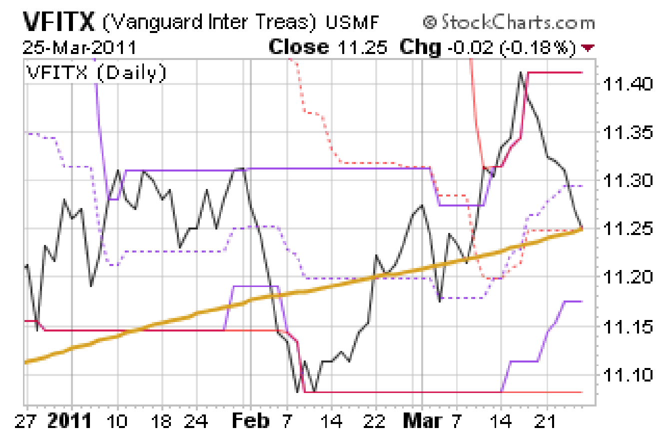


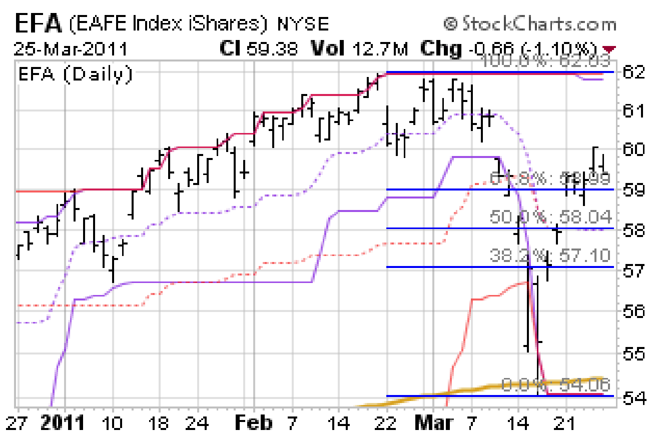


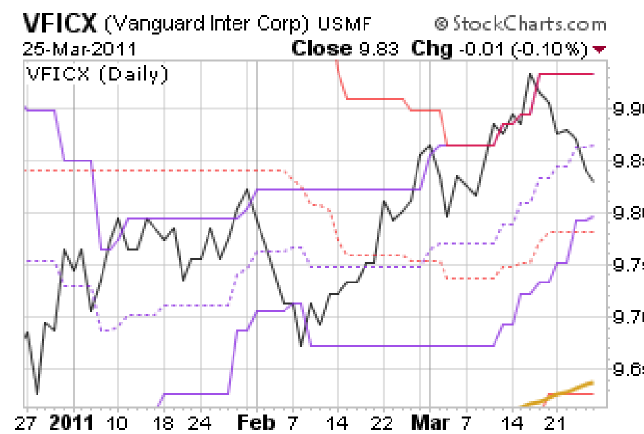


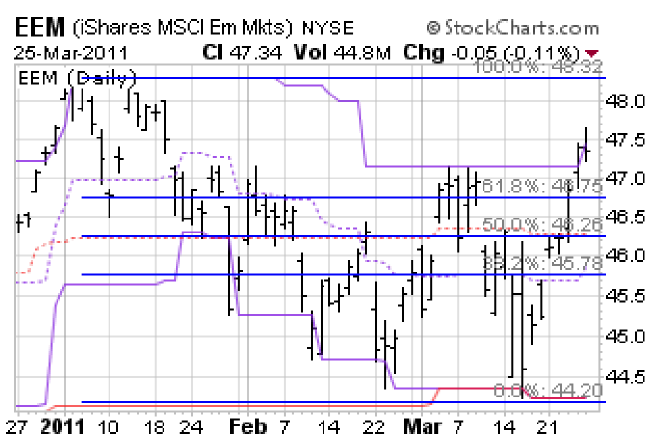
Three-Month Daily View of Stocks and US Bonds: For aggressive short-term investors, each of SPY, EFA and EEM have retraced more than 60% of the distance from late February high to the mid-March low. Those investors may be inclined to commit or recommit cash to those securities. However, conservative investors, cognizant of the myriad events unfolding in Japan, the Middle East, with European sovereign debt, and an approaching end to QE II, may wish to wait for the prices of those securities to exceed the February highs before believing the short-term trend is re-established. EEM is unconvincing, as it is simply oscillating within its recent sideways range. High yield bonds (VWEHX) are flat so far in March too.

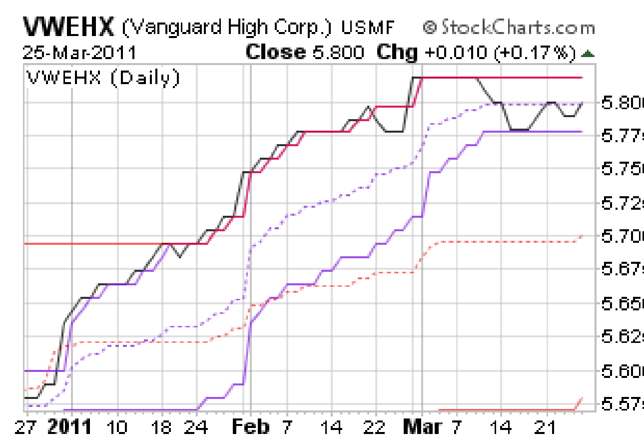




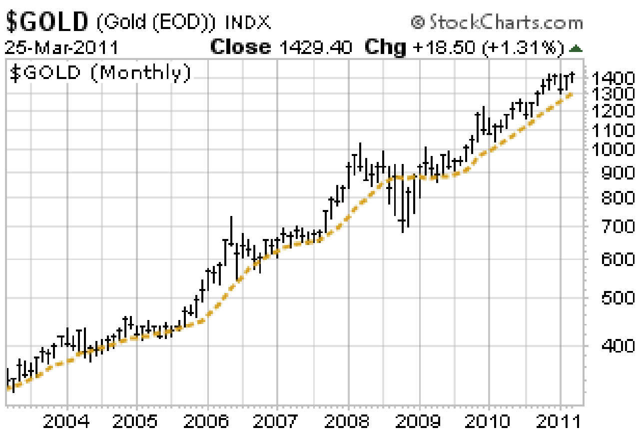


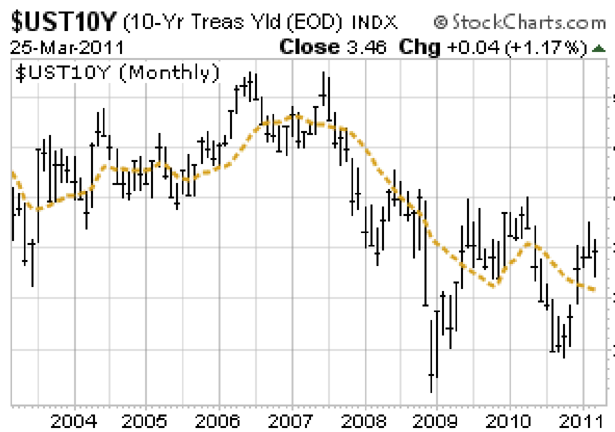


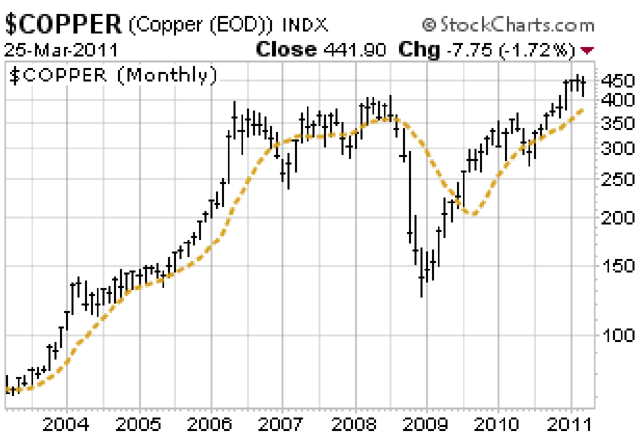


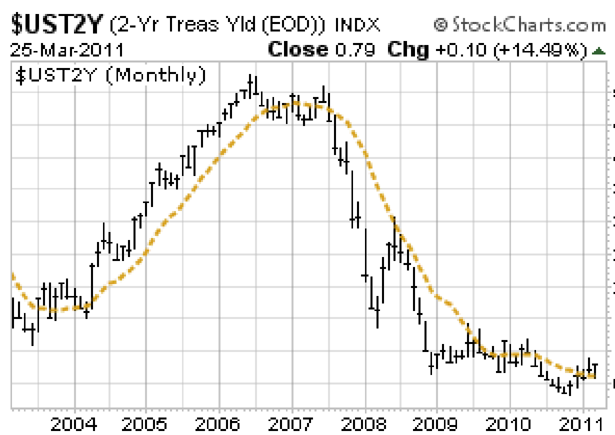


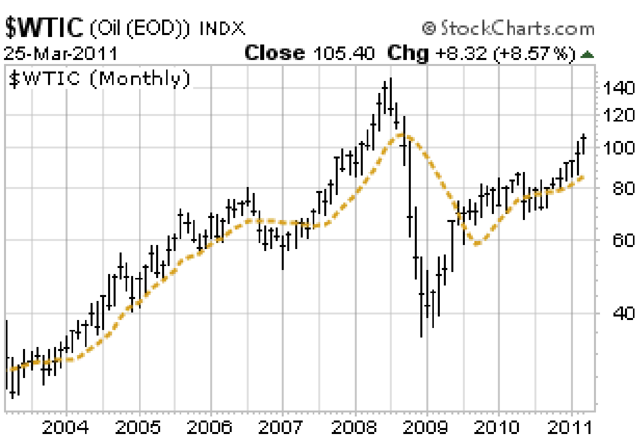
Eight-Year Monthly View of Commodities and US Interest Rates: Gold cruised through the past eight years in pretty good shape (although it did decline 30% peak to trough in 2008) -- so much for disaster protection. Copper, a general indicator of industrial production, is more than 10% above 2007 highs speaking positively for global GDP growth, but it declined more than 60% during 2008. Oil dropped more than 75% during 2008 from its bubble high in early 2008. Today it is above its 2007 pre-bubble spike high. Ten-year Treasuries are volatile, but still in a wide downward channel. Two-year rates are se-verely depressed and generally flat. Three-month Treasuries are dead flat and near zero for 2 years.

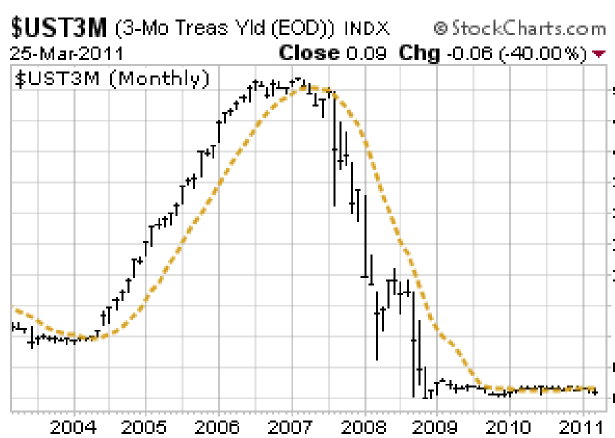




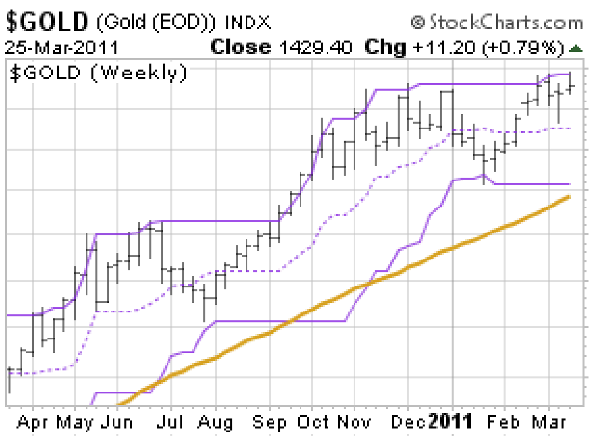


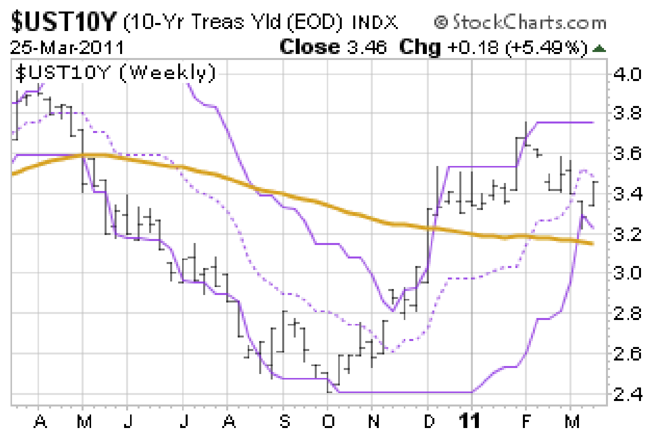


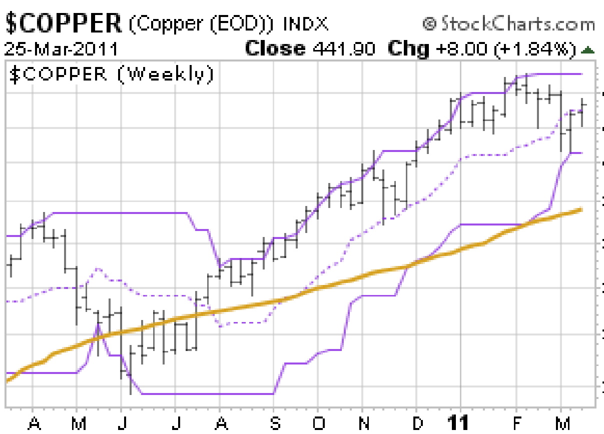


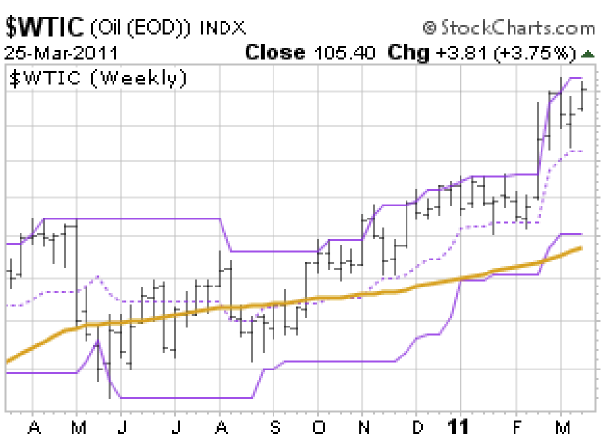


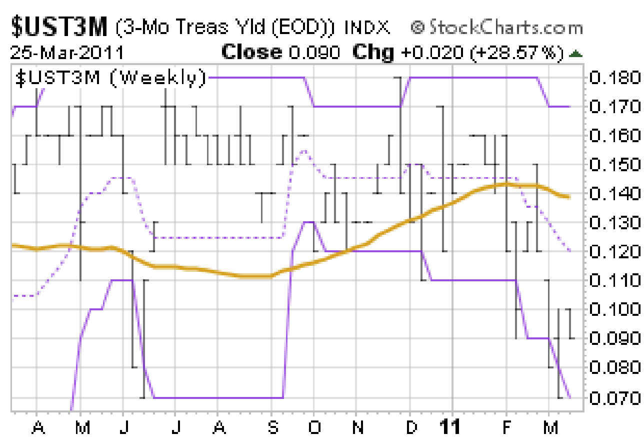
One-Year Weekly View of Commodities and US Interest Rates: Gold, copper and oil are all up for one-year. They are above the mid-point of their 13-week range and that range is above the 52-week average. This 1-year view shows the rising rate tendency in 10-year and 2-year Treasuries. The 3-month Treasuries rate are just showing some noisy variation within their flat, near zero rate range.



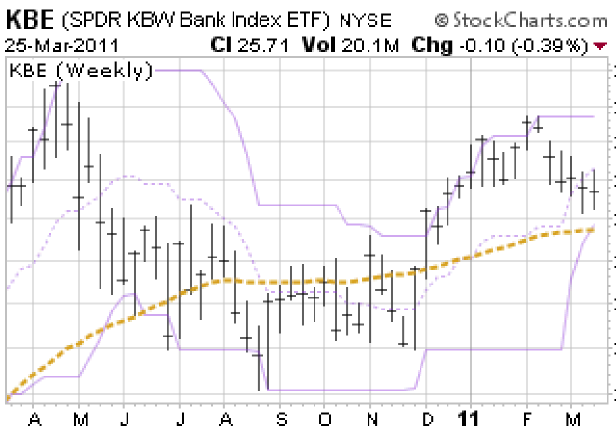


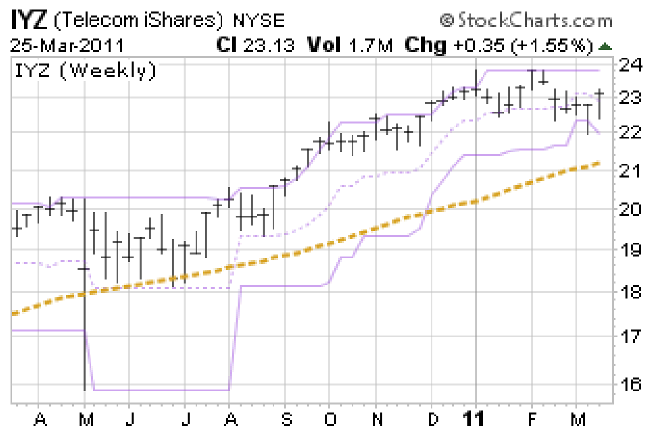


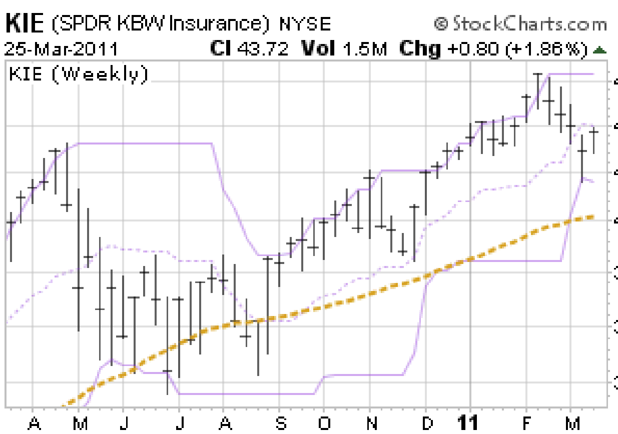


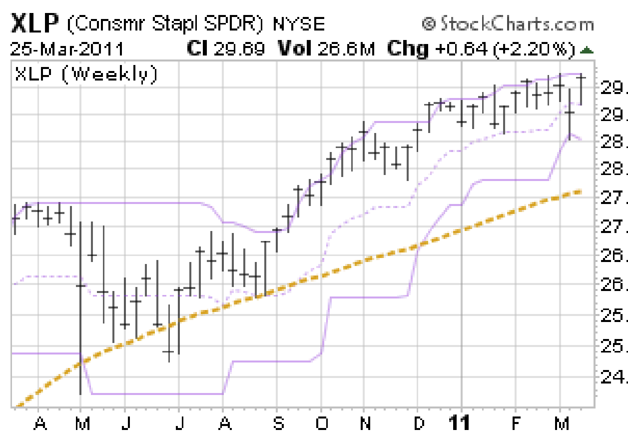


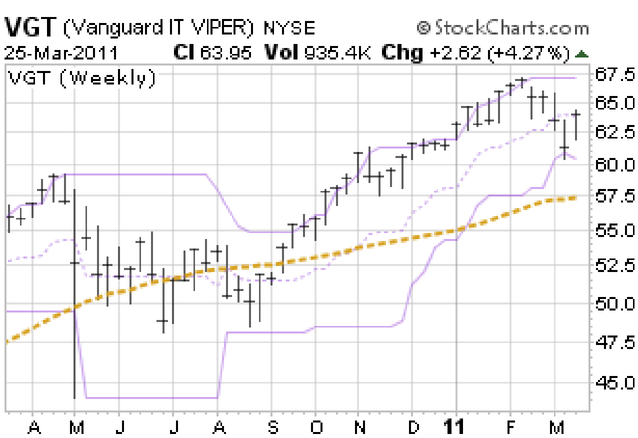
One-Year Weekly View of US Industrial Sectors: Large banks (KBE) are slightly negative for the trailing 1-year, but its 52-week primary trend (gold line) is positive. Insurance (KIE), on the other hand, is up for same period. The other sectors are up for the period and their primary trend line is also up. They are Technology (VGT), Telecom (IYZ), Consumer Staples (XLP) and Consumer Cyclicals (XLY). KBE, KIE, VGT and IYZ, however, have prices just at or just below the mid-point of their 13-week price range. We'd be more assured if they could clearly surpass those mid-points.

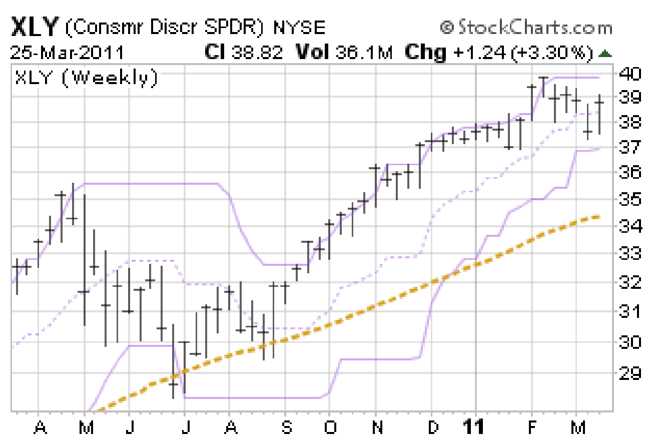




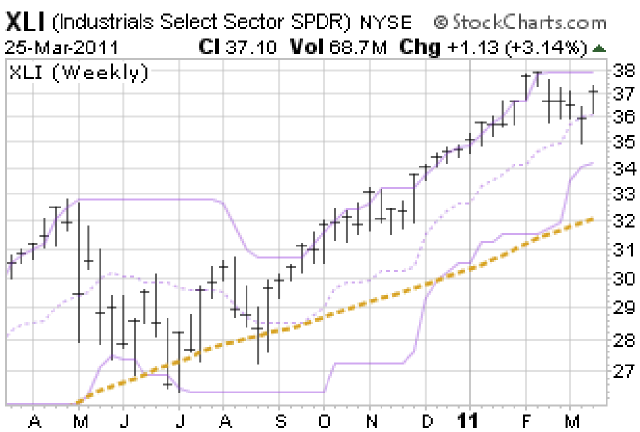


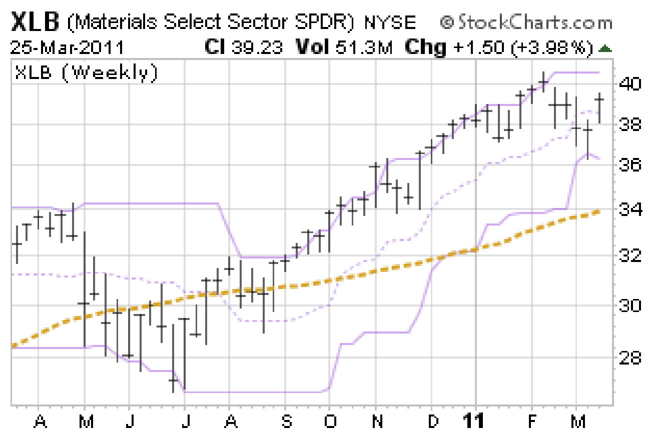


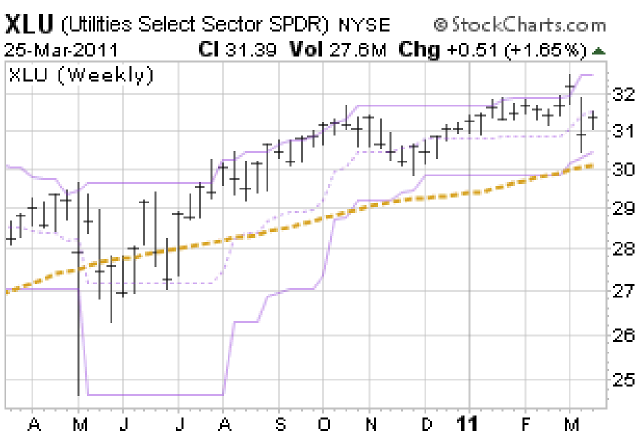


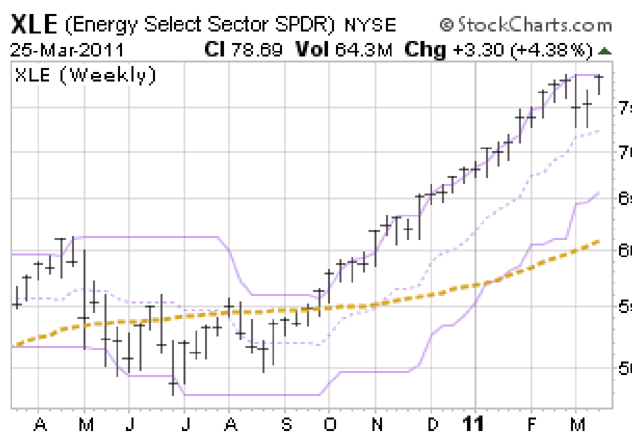


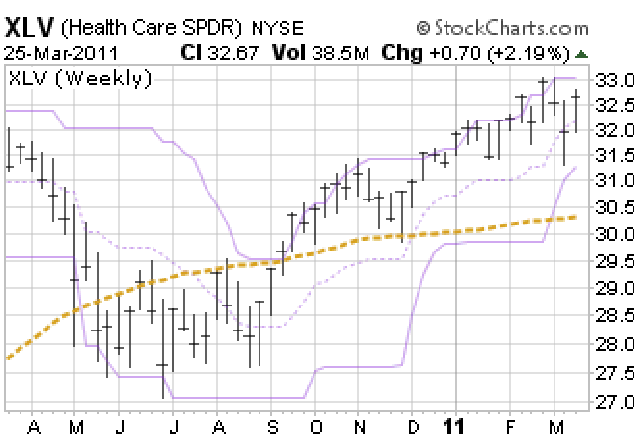
One-Year Weekly View of US Industrial Sectors (continued): Similar to the sectors on the prior page, all on this page are in primary up tends. Except for Utilities (XLU), they are in solid short-term condition with prices above the mid-point of their 13-week price channels, which in turn are above their primary trend lines. The 13-week range for utilities is hugging the primary trend line and the price is just below the mid-point of the 13-week range. Industrials (XLI), Energy (XLE) and sub-sector Oil & Gas Producers (XOP) have the strongest looking charts. Healthcare (XLV) and Basic Materials (XLB) are doing OK.

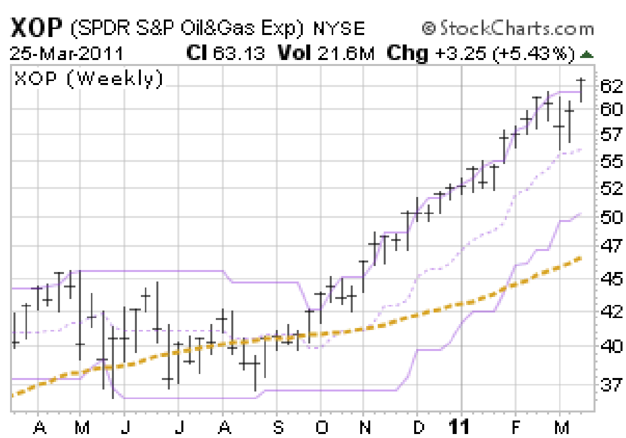




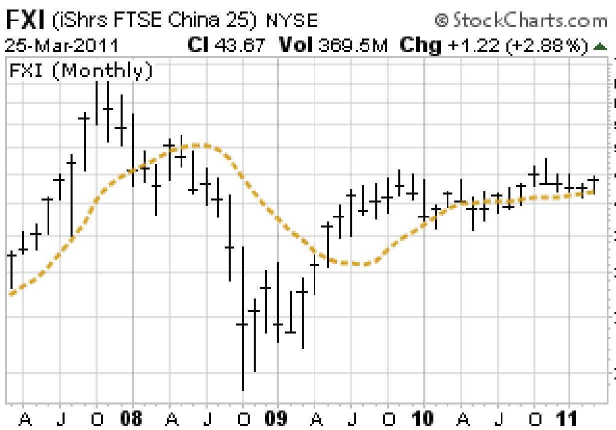


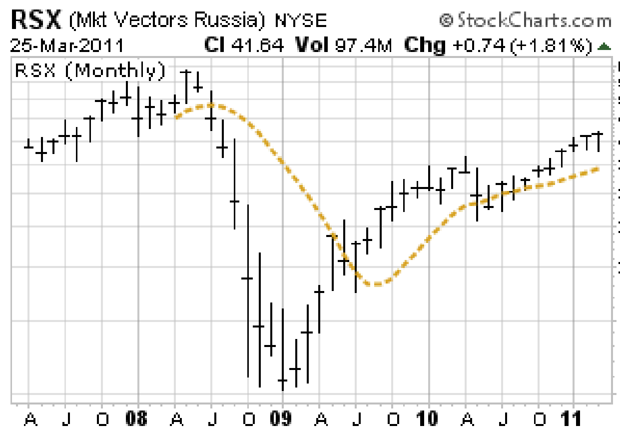


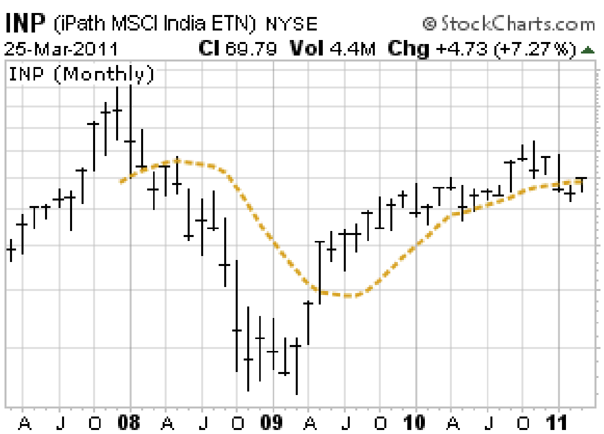


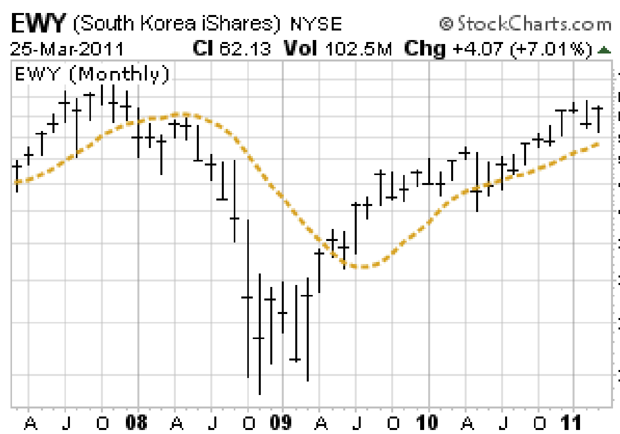


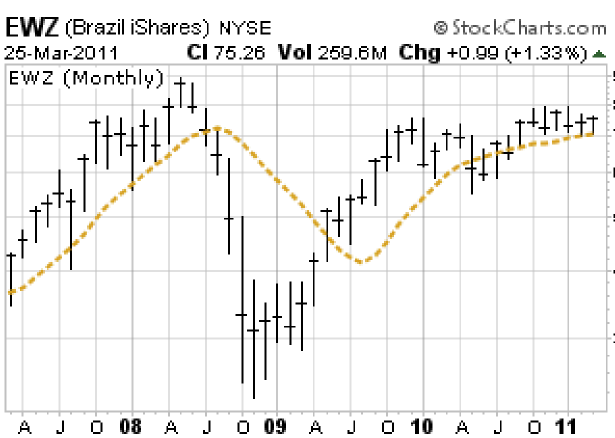
Four-Year Weekly View of Country Index Funds: Not enough of the country funds have 8-years of history, so we use 4-years here. Shown below are China (FXI), India (INP), Brazil (EWZ), Russia (RSX), Korea (EWY) and Taiwan (EWT). China has been flat for more than a year. India and Brazil are flat. Russia had been flat, but has picked up slope as its energy export dominated economy became more attractive. Taiwan and Korea are rising.

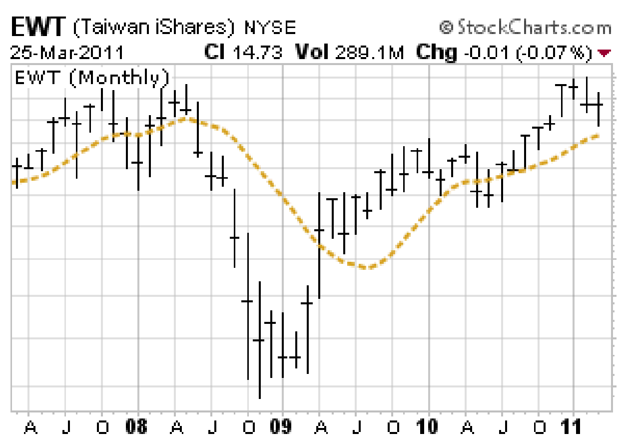




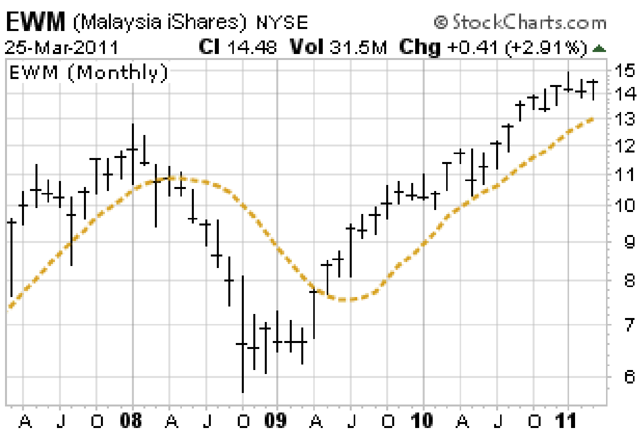


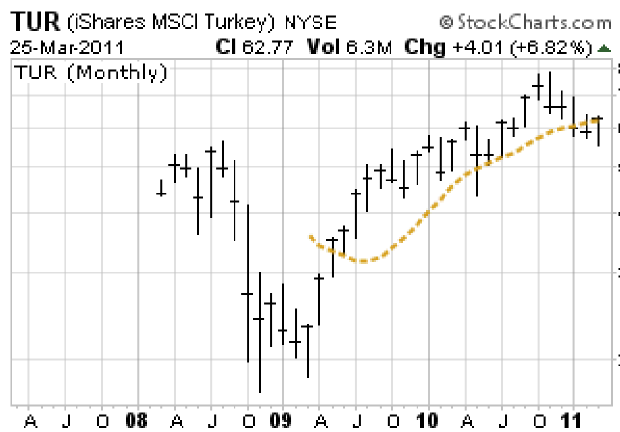


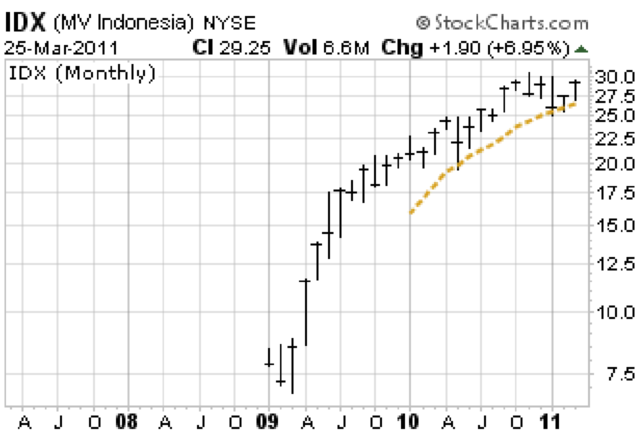


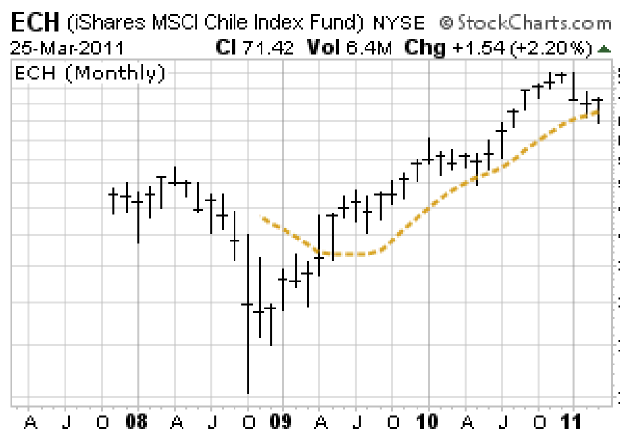


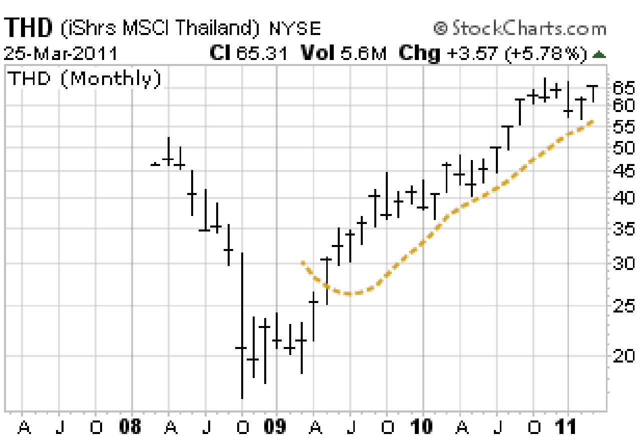
Four-Year Weekly View of Country Index Funds (continued): Country funds on this page are Malaysia (EWM), Indonesia (IDX), Thailand (THD), Turkey (TUR), Chile (ECH), Mexico (EWW). Malaysia is in a clear up trend. Indonesia and Thailand are in an up trend, but each has had some 10+% adverse moves along the way. Turkey was in an up trend but is currently down more than 20% from its high. Chile is also in a 10+% correction, which is a little surprising given it's heavy linkage to copper mining, while copper is up -- unless it is forecasting a possible slowdown in copper demand. Mexico is in an up trend, substantially pulled along by the US markets it serves.

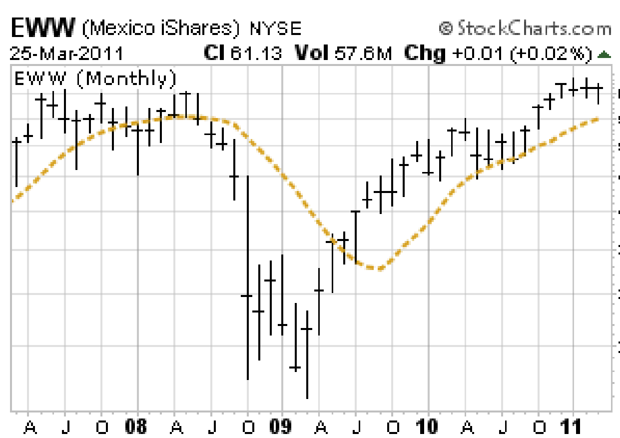




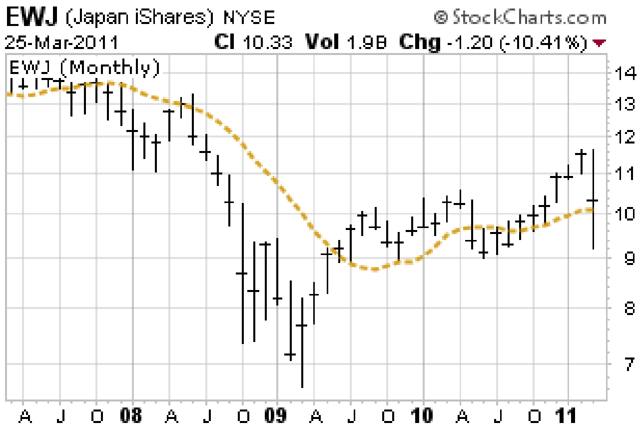


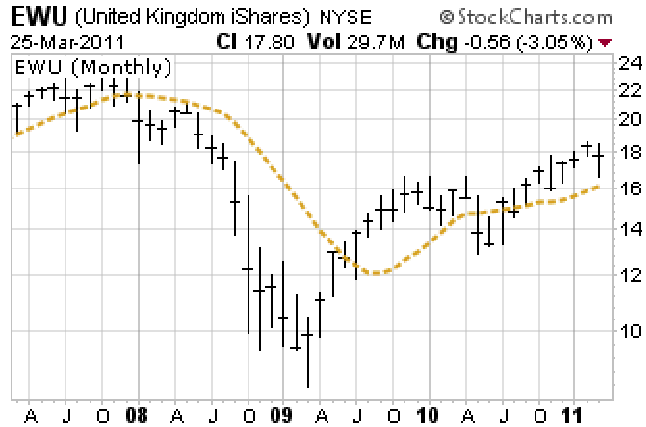


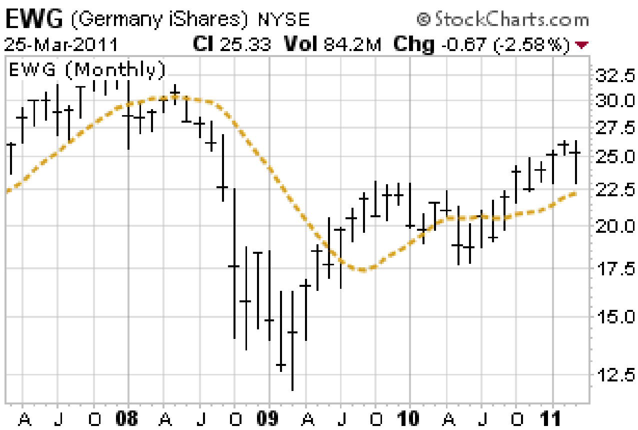


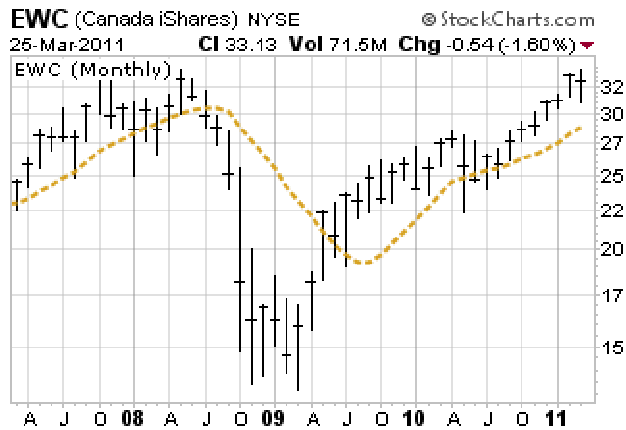


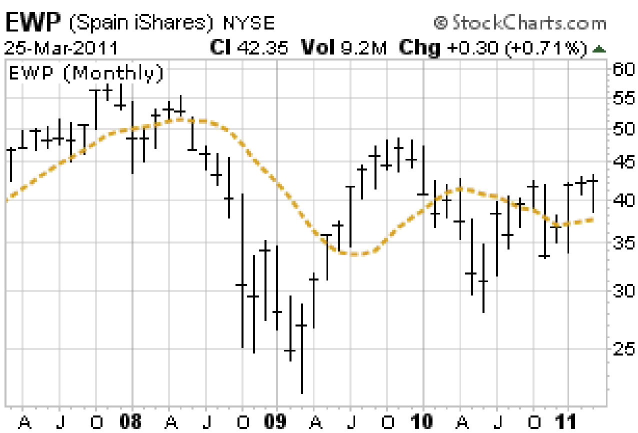
Four-Year Weekly View of Country Index Funds (continued): Country funds shown are for Japan (EWJ), Germany (EWG), Spain (EWP), United Kingdom (EWU), Canada (EWC) and Australia (EWA). Japan was recovering moderately from its 2009 low, but was hit hard by the earthquake, tsunami, nuclear triple event. All of the other developed markets on this page dipped significantly in the April-May correction period, and are otherwise in up trends to varying degrees, except for Spain. Spain is one of the PIIGS (Portugal, Ireland, Italy, Greece and Spain) that are in sovereign debt difficulties. Spain was recovering from the 2009 bottom until 2010, when the debt concerns arose. It is essentially flat since then. It's near-term fate is highly dependent on the outcome of the EU bailout program, and the success of austerity

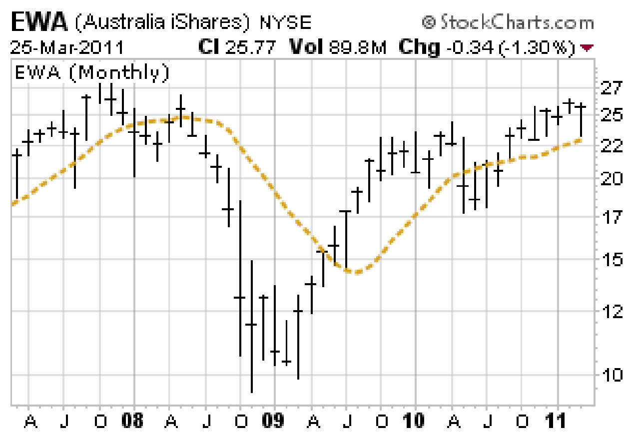












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