



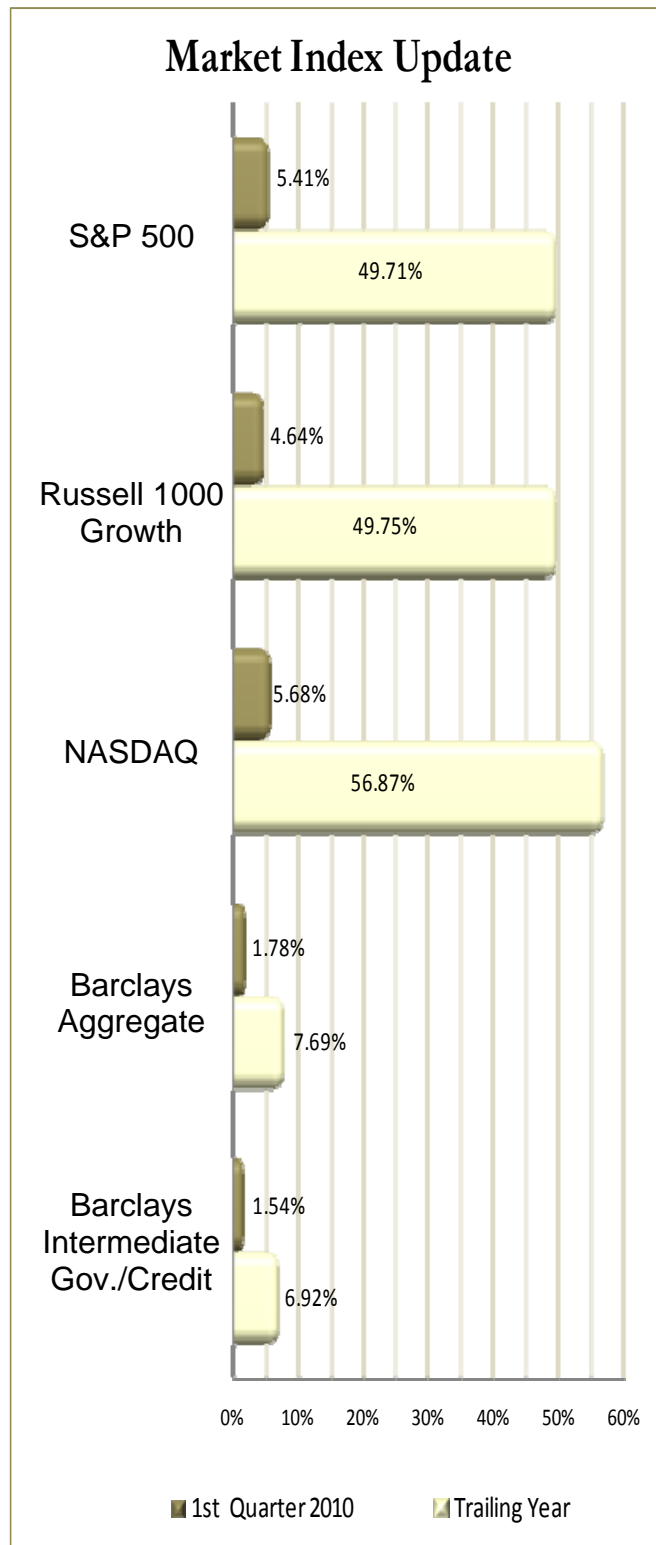
Recovery on Main Street

The huge Wall Street rally since last March has been met with skepticism for much of the past year. Many pundits have questioned the sustainability of higher stock prices given the pervasive sense of gloom in the "real economy." However, as we have noted repeatedly over the past several quarters, the capital markets are *discounting* mechanisms – and as such, markets attempt to price in *future* events.

Happily, emerging strength in a variety of economic data appears to be validating the recent strong stock market performance:

- March Jobs Report. With the unemployment rate hovering near 10%, the employment situation in the U.S. remains far from optimal. After all, unemployed workers are not in a position to buy houses, pay taxes, or purchase goods and services. So it came as good news that the most recent jobs report showed that employers added 162,000 jobs in March (the highest number of monthly jobs gains since March 2007 when 239,000 jobs were added). While it will likely take years for employers to rebuild their payrolls to pre-Great Recession levels, the tide appears to be turning for the better on the jobs front.
- March Manufacturing Sector Activity. The ISM Purchasing Managers Index for the U.S. manufacturing sector posted an eighth consecutive month of growth, and the Index reached its highest level since July 2004. It is also interesting to highlight that the Inventory component of this report showed that manufacturers actually *expanded* their inventories last month, for the first time in 46 months. (Chart 1)
- March Non-Manufacturing Sector Activity. The ISM Non-Manufacturing Index posted its third consecutive month of growth, reaching its highest level since June 2007. Taken in conjunction with the Manufacturing report, the Non-Manufacturing report buttresses the notion that the broader economy is firming. (Chart 2)

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Chart 1

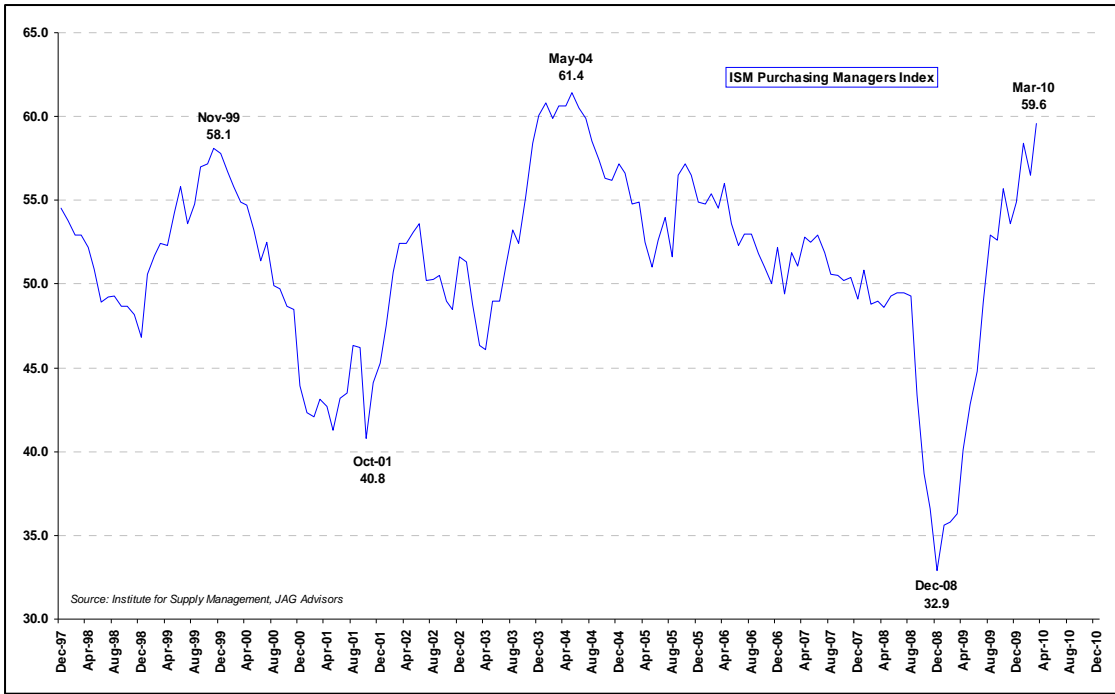
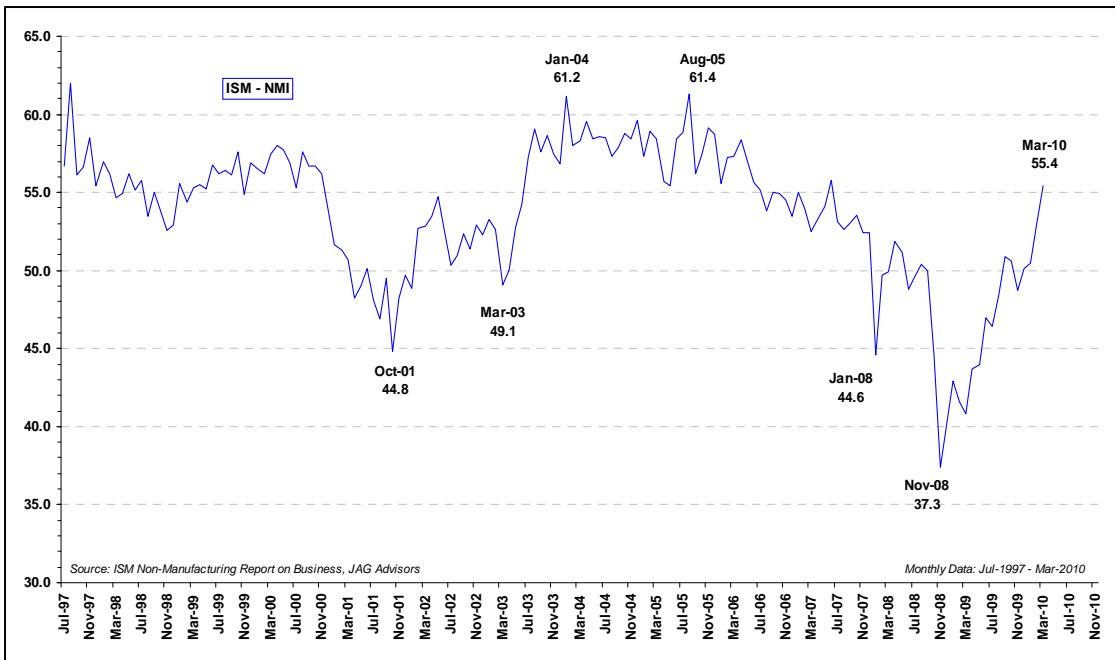


Chart 2



PMI & NMI reach multi-year high's

- Commodity Prices.** Commodity price movements are a “good news, bad news” story. *Moderate* increases in prices speak to healthy global economic growth. But rapid and prolonged spikes in prices (think 2007) signal a global imbalance and/or an inflationary bubble. At the other extreme, full-blown collapse in commodity prices (think 2008) indicates a significant economic slowdown. So far in 2010, economically-sensitive industrial metal prices are up an average of 7.7% for the year, which reflects a healthy (but not yet bubbly) sign of economic growth.

Outlook Through Year-End 2010

We remain solidly bullish on the outlook for equities over the coming several quarters. Valuations are still not stretched, earnings growth should exceed expectations, and investor sentiment remains subdued. All of these factors should support modest to moderate equity price appreciation through the end of 2010.

Bonds are a more difficult call. While there is still room for credit spreads to improve, we believe that the spread-contraction story is mostly played out.

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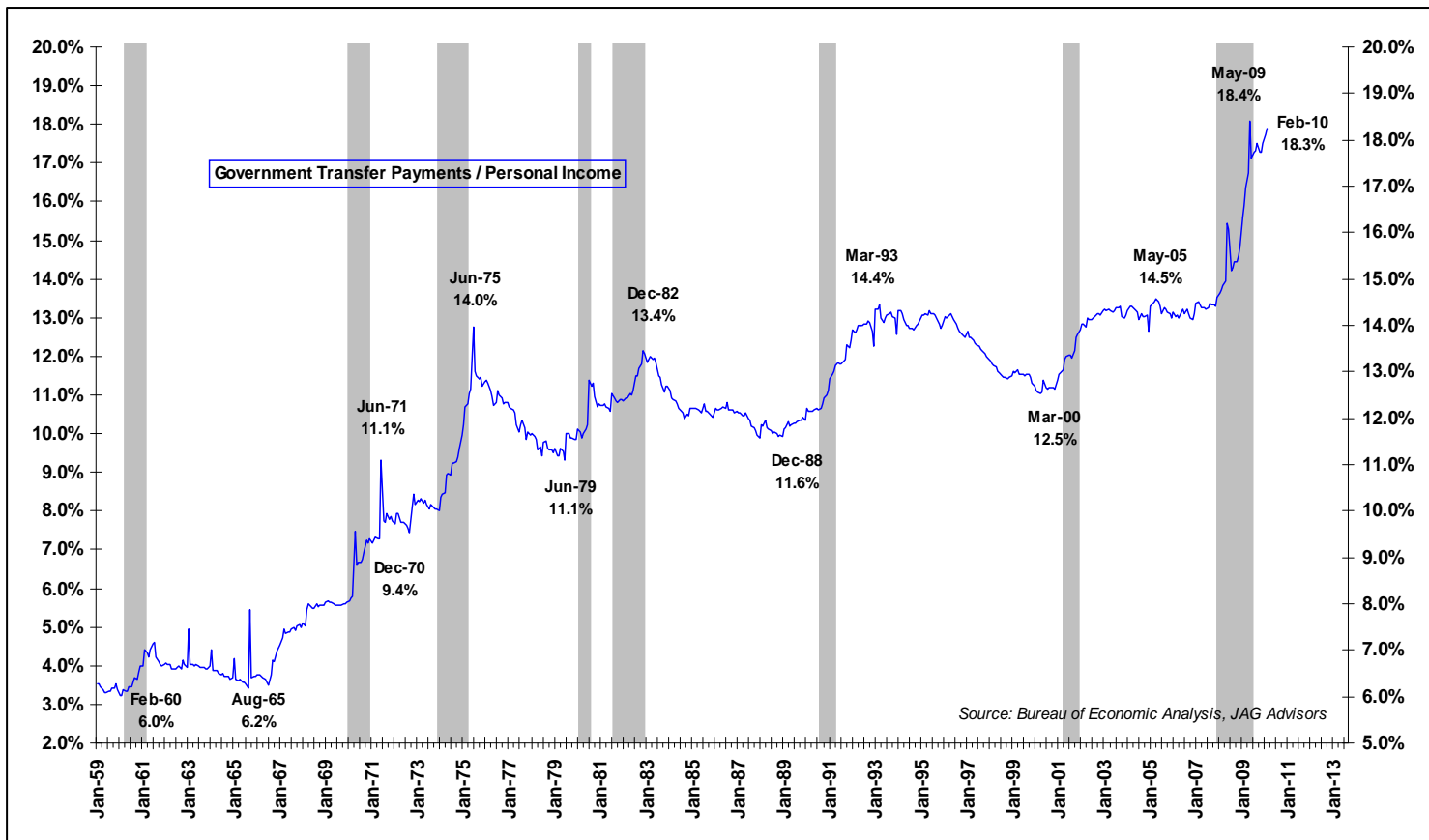
Meanwhile, we believe the risks of higher inflation and higher interest rates are greater than most expect. We are advising our clients to maintain short- to intermediate durations, overweight to corporate debt versus Treasuries, and utilize laddered maturities in their bond holdings to minimize interest rate risk. We expect these types of conservative bond portfolios to produce a total return of between 3% and 5% over the next twelve months.

A Scary Long-Term Chart

Longer-term (i.e. over the next decade), we have a variety of concerns regarding the economy and the markets. Chief among our worries is the massive growth in entitlement spending we have witnessed over the past several years. The chart below plots the percentage of government transfer payments as a percentage of total personal income in the United States back to 1959. (Note: "Transfer payments" are government payments to persons for which no current services are performed. Examples include Social Security, welfare, unemployment insurance, and other federal government program benefits.)

The most striking aspect about this chart is the conspicuous rise in the percentage of transfer payments over the past 50 years. Beginning in the 1960's at a modest 6%, transfer payments grew to equal 18.3% of all personal income in the United States in early 2010. Admittedly, a portion of the recent spike in this ratio is directly attributable to the Great Recession (gray bars on the chart denote recessionary periods). That said, transfer payments never exceeded 14% of personal income prior to the early 1990's, and they hovered between 11.1% and 14.5% between 1971 and 2007. Our recent recession blew the roof off of transfer payment spending, and it remains to be seen when (or if) our policymakers will have the courage to bring transfer payments back into line as the economy continues to stabilize.

More importantly, this trend is simply not sustainable in the future. If the historical growth rate of transfer payments were to continue at the same rate for the next 50 years, transfer payments would equate to approximately **55%** of all personal in-



come by 2060. One can only imagine what tax rates would have to be to support that level of spending!

We expect that charts like this will become a fixture in future national elections. Our nation faces some hard decisions over the next decade and beyond. In terms of government spending and transfer payments, we will have to balance compassion with fiscal prudence. If history is any guide, this will prove to be a challenging task.

Norm Conley
CEO