

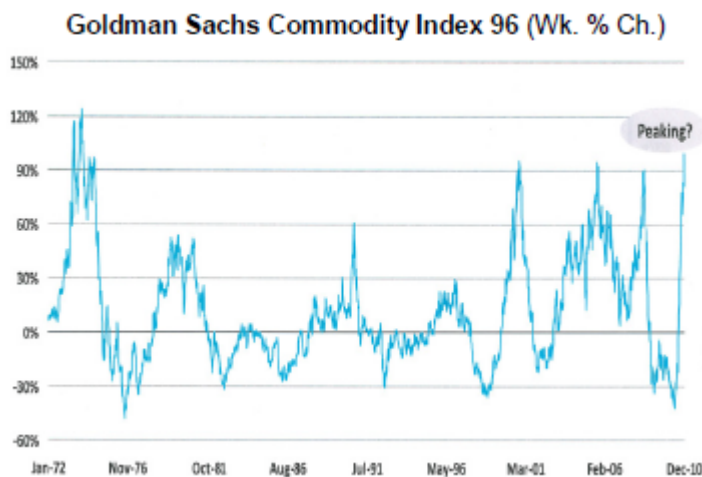
February 11, 2011

"You can never say never, but I cannot imagine a convincing argument for further quantitative easing after this round, given what is developing now in the economy."

-Dallas Fed Chief RICHARD FISHER

## POINTS TO PONDER

1. The battle against inflation in emerging markets continues to escalate, largely driven by soaring commodity costs. The combination of rising interest rates in developing nations and exceedingly extended commodity prices could lead to a plunge in the latter.

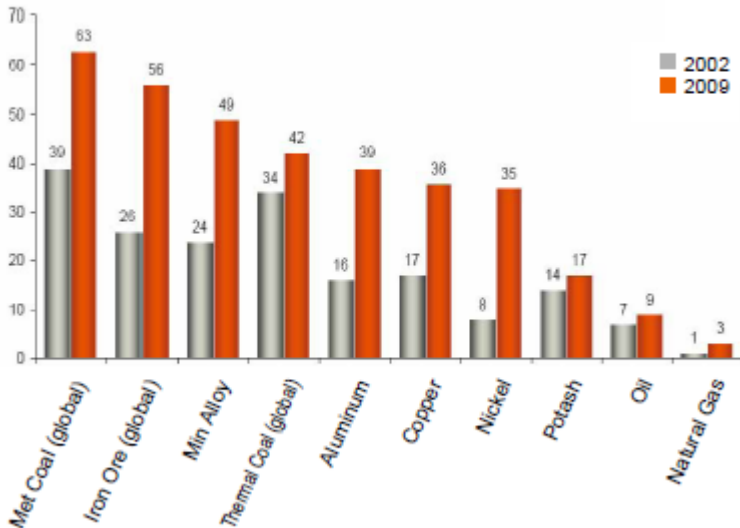


2. Increased tightening measures by central banks in emerging countries have caused spreading weakness in their stock markets. With the S&P 500 up another 5% this year, US share prices are now ahead 20% since the beginning of 2010 versus a rise of 16% for emerging markets.

3. Once the world's leader in the production of TVs, stereos, cameras, and other related devices, Japan has just become a net importer of consumer electronics. As noted by the *Financial Times*, this has ominous implications for its balance of trade.

4. Rating agency Fitch has estimated that if Chinese economic growth were to decelerate from its current 10% to 5%, commodity prices could fall by 20%. Given China's extreme influence on the demand for many key raw materials, this conclusion seems plausible.

**China is the major driver of commodity demand**  
**China's share of global demand by commodity (%)**



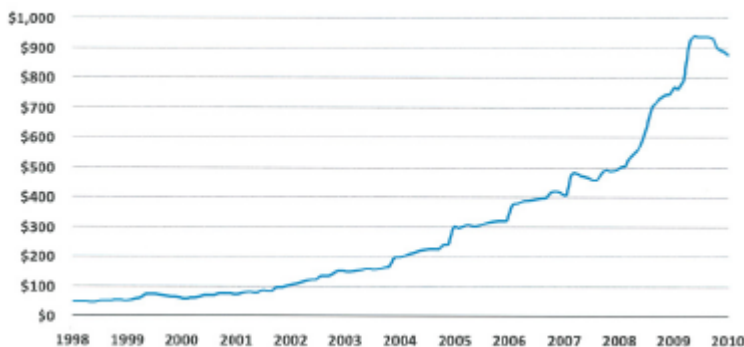
5. Popular newsletter writer John Mauldin recently quoted a factoid from Newt Gingrich underscoring waste in government healthcare. Mr. Gingrich noted the contrast between fraud in American Express' medical plan of just 0.3% versus 13% in Medicare's, largely due to the AMEX system being far more automated.

6. Massachusetts' experience with healthcare reform is a cautionary tale for the country as a whole. Prior to its passage, health insurance premiums in the state were rising 3.7% per year less the national average. Since it was signed into law, premiums have been increasing at an annual rate that is 5.8% above the average of the rest of the US.

7. Although US Treasury interest rates have been rising of late, the causes are likely tied to improving growth prospects and concerns over commodity-driven inflation rather than liquidation by foreign investors. The much feared rout of Treasuries once China halted its buying program has turned out to be a non-event.

8. Adm. Mike Mullen, chairman of the Joint Chiefs of Staff, has recently stated that exploding government debt is our number one security threat. His worries are understandable considering that our nation is 245 years old and our overall indebtedness has risen by one-third in just the last three years.

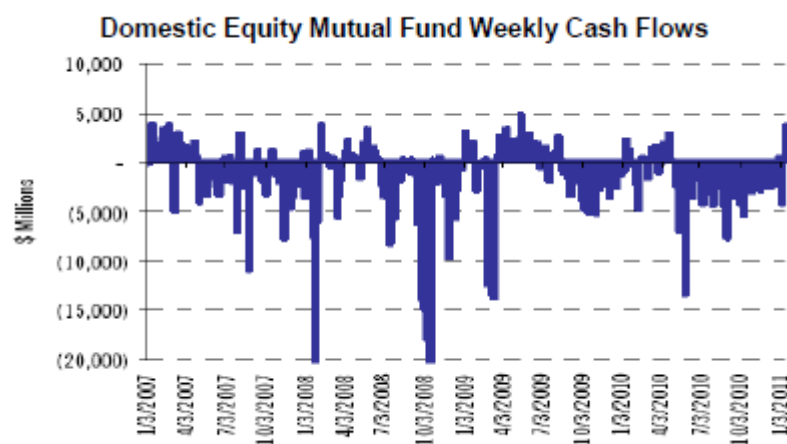
**Total China Holdings of US Treasuries (\$in billions)**



9. One of the more unusual aspects of last year's 15% total return (appreciation plus dividends) for the S&P 500 was that 94% of the gain occurred on the first trading day of each month.

10. US mutual fund investors are finally beginning to feel better about domestic stocks. Their timing, however, could be less than ideal due to the overbought status of the market as well as the correlation between Chinese and US share prices. The Shanghai exchange has tended to lead by three months and lately has entered bear market status.

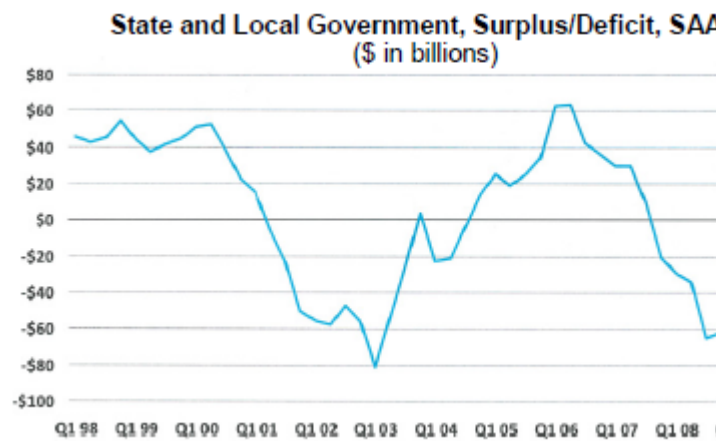
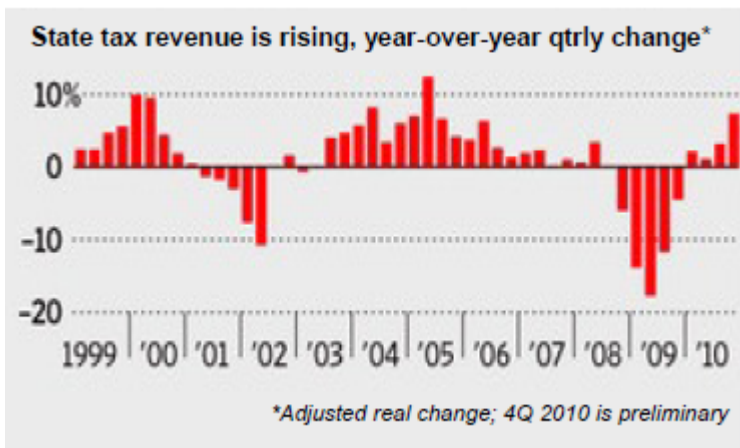
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12. In the wake of Meredith Whitney's ominous comments about the tax-free bond market, a growing chorus of experts has rallied to its defense. Yet municipalities are not helping their cause given that 40% of issuers were at least three years behind in filing financial statements as of 2009.

13. On the positive side for munis, tax revenues are definitely on the mend. Additionally, municipal budgets are increasingly in surplus status despite gaping deficits among some of the largest states.



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