

Market Outlook Letter

December 28, 2011

INVESTMENT COMMENTARY & OUTLOOK

Like many investors, we view the New Year as an exciting time, especially since 2012 is a presidential election year. If history repeats itself, the stock market will rally right up to the November presidential election. Both consumer and investor confidence should improve when the presidential field narrows to the final two candidates who typically run around and suck up to voters. We realize there will be negative ads, similar to what are already airing in Iowa; but in the end, one cannot be elected President of the United States unless you are a happy, positive person, so we predict the presidential candidates will continue to smile regardless of political action committee (PAC) financed negative ads.

When we look back on 2011, it is obvious that high-dividend stocks and large blue chip companies were the oasis around the world; so we are especially excited about the prospects for our Concentrated High Dividend Portfolio and our Large Cap Growth Portfolio. Our Covered Call Portfolio also merits special attention because during periods of high VIX volatility, it brings opportunities for us to capture especially large premiums by writing covered call options. We expect that these strategies will likely lead the way in 2012. And as investor confidence improves, we believe small and mid-capitalization stocks will find favor, especially since they continue to be characterized by the strongest sales and earnings as shown in the following table:

	Average Sales Change Quarter/Qtr. 1 Year Ago	Average Operating Earnings Change Year/Year	Average Return on Equity Trailing 4 Qtrs.	Average Forward P/E FY2	Average Earnings Surprise % Latest Qtr.	Average Operating Margin % Change Trailing Year
Nav. Fundamental 'A'	53.19	250.60	32.24	16.58	24.50	16.09
<i>Russell 3000 Index</i>	29.09	96.10	4.33	23.02	6.69	1.45
Nav. Mid Cap Growth	19.10	107.29	47.48	16.11	4.76	4.05
<i>Russell Mid Cap Growth Index</i>	4.67	95.95	27.91	22.68	5.34	2.37
Nav. Small-Mid Growth	70.21	206.72	26.90	20.25	11.75	3.48
<i>Russell 2000 Growth Index</i>	48.91	107.03	(7.47)	22.22	7.50	1.16
Nav. Large Cap Growth	19.69	87.53	27.36	17.10	4.52	1.85
<i>Russell 1000 Growth Index</i>	4.49	96.64	28.75	21.00	4.84	1.99

Source: FactSet

As optimistic as we are about the upcoming fourth-quarter sales and earnings announcements for our stocks, we should add that the bears on Wall Street have been warning investors that all nine sectors of the S&P 500 (based on State Street Select Spiders) have had negative fourth-quarter analyst revisions, and only three of these sectors are exhibiting relative strength (consumer staples, healthcare, and utilities). As a result, our defensive portfolios in the Vireo product-line have been conservatively positioned for the latter half of the year with some cash, since the F-Squared system is designed to increase its cash allocation as volatility increases.

We are in the third year of the stock market recovery, and typically in the initial stages of a recovery, we see the recovery led broadly by many sectors. As the recovery continues, the market naturally loses breadth and power, so we are now in the stage of recovery where stock picking prevails. Fortunately, our Large Cap Growth Portfolio

Investment in equity securities involves substantial risk and has the potential for partial or complete loss of funds invested.

is concentrated in high quality blue chip stocks. We anticipate strong results for the Large Cap Growth Portfolio; please be sure to check our website for the year-end performance results.

We are getting the most attention for bond Unit Investment Trusts (UITs) where we have been a consultant on 42 domestic and 5 foreign bond UITs. Our domestic UITs are invested in BBB-rated corporate bonds (investment grade) for approximately a 5-year duration. We are proud that net of all fees, these UITs continue to produce exceptional yields to our investors. Ironically, we can get an even higher after-tax yield (corporate dividends are taxed at a 15% federal rate) for many investors via our Concentrated High Dividend Portfolio. For investors who are not concerned about tax-efficiency for their retirement accounts, we are adding some other products with significant tax advantages. At Navellier, we are increasingly proud of our conservative fixed income investment portfolios that are designed to fulfill each client's specific fixed income needs.

The big news at Navellier is that we now have a Private Client Group that caters to investors' needs for income via our (1) bond UITs, (2) Concentrated High Dividend Portfolio, and (3) covered call option writing on large capitalization stocks. Essentially, the Private Client Group is an extension of the conservative investment management that Louis Navellier has been doing for his family. Like all our accounts, the Private Client Group works with your bank or broker. More aggressive investment options are also available for clients who want their portfolios to have more growth potential. For further information, please call Navellier and ask for Carol Whann. Carol had several years of experience in private banking before joining Navellier.

EURO-ZONE CRISIS UPDATE

In December, High Frequency Economics (HFE) sent a "highlight e-mail" with the headline "European Financial Crash Likely In Q1; Economic Depression To Follow" according to economist Carl Weinberg. Essentially, Weinberg argues that the troubled countries in the euro-zone failed to qualify for aid from the International Monetary Fund (IMF) and the European Financial Stability Facility (EFSF). Another pessimistic outlook came from IMF Managing Director Christine Lagarde who warned that the global economy faces the prospect of "economic retraction, rising protectionism, isolation and ... what happened in the 30s (i.e., an economic depression)," which helped re-ignite fears of an imminent financial crisis. The common theme seems to be an extremely pessimistic outlook for Europe, but there are other points of view out there.

Our favorite economist, Ed Yardeni pointed out last week that Europe accounted for 17.7% of China's exports in November. Due to euro-zone weakness, China's exports to Europe were down 7.1% in September and declined 5.5% in October compared to a year ago. The global domino theory is that as an economic malaise descends on the euro-zone, China's exports will stall. However, the only problem with this theory is that China's exports to Europe rose 5.1% in November compared to a year ago, so maybe the theory of Europe dragging down the rest of the world is a bit premature.

Nonetheless, when top economists are talking about a European "economic depression" and a "financial crash" in the first quarter, there is clearly going to be an investor confidence problem. Not surprisingly, the euro finally broke the \$1.30 barrier before recovering recently, but it is still near its lowest level in almost a year.

Recently in *The Wall Street Journal*, economist Alan Blinder wrote an opinion piece that the euro has two problems, namely that: (1) 17 sovereign nations signed up for a currency union without homogenizing their budget deficits, tax systems, bank regulations, etc., and (2) there is no strong central government on which to impose a solution or finance large monetary transfers to weaker countries. For example, German Chancellor Angela Merkel continues to refuse suggestions to issue euro-based bonds for all 17 countries that share the euro. Furthermore, the German-influenced European Central Bank (ECB) refuses to conduct quantitative easing and aggressively buy bonds by printing money, just like Britain, Japan, Switzerland, and the U.S central banks have all done. As a result, many economists are convinced there will be a crisis in the euro-zone despite 23 of 27 countries (15 of the 17 that share the euro) recently pledging to adopt stricter budget guidelines relative to GDP and to become more *German-like*.

Interestingly, German Chancellor Merkel recently said that countries in the euro-zone have set themselves on an “irreversible course towards a fiscal union” to help shore up confidence in the euro, even if it may take a few years for some countries to meet their budgetary goals. Merkel also expressed “great regret” that Britain vetoed full-scale treaty changes but stressed an alternative treaty for “at least” the 17 countries that share the euro. In the meantime, bond yields remain very high in Italy, which is making many economists nervous that the euro-zone is running out of time to shore up its fiscal union in the wake of Britain’s veto that essentially caused a “constitutional crisis.” The rift between Britain and the deal that France and Germany were trying to broker is very serious and seems to be the primary reason many economists have suddenly become so pessimistic.

As bad as all this sounds, the ECB recently flooded the 523 euro-zone banks with \$641 billion of largely 3-year loans at only 1%. European banks are taking this 1% money and aggressively buying higher yielding sovereign bonds in Italy, Spain, and other countries that suffered from rising bond yields. Due to euro-zone banks borrowing short-term to invest in higher yielding long-term government bonds, this arbitrage trade is helping shore up capital at euro-zone banks and curtail the massive interest burden on Italy, Spain, and other countries that suffered from rising interest burdens. So essentially, by flooding the euro-zone banking system with cheap 3-year loans, the ECB has avoided conducting controversial quantitative easing, plus it is helping to shore up the capital at euro-zone banks and reduce the interest burden on troubled euro-zone countries. As a result, the respect for new ECB President Mario Draghi is soaring and helping restore the international credibility of the euro.

Thanks to the ECB’s essentially unlimited lending to banks via low interest 3-year loans, a euro-zone credit crisis has been temporarily averted. For example, Spain was able to recently sell short-term debt at substantially lower interest rates and its 10-year bonds fell below 5%. Unfortunately, Italy’s 10-year bond yields remain over 7%, but yields are expected to fall in the upcoming weeks when the liquidity improves after the holidays.

Also helping boost euro-zone confidence is the German business climate index rising to 107.2 in December (as reported by CESIfo), up from 106.6 in November, which represents the second monthly rise in business sentiment. The other good news emanating from Germany is that consumer spending is rising and helped GDP rise 0.5% in the third quarter (2% annual pace) compared to the second quarter as household spending rose 0.8%. As a result, between its strong export growth and its consumer sector heating up, Germany looks well poised to generate stronger GDP growth in the upcoming quarter. So now with the primary engine for euro-zone growth, namely mighty Germany, clearly heating up, the entire euro-zone may be able to avoid a recession in 2012.

CONCLUSION

Overall, the stock market remains at an inflection point despite all the distractions emanating from the euro-zone. The S&P 500 continues to have a higher dividend yield than 10-year Treasury bonds. Not only are there several companies with dividend yields in excess of Treasury bond yields, but many of our Large Cap Growth companies continue to aggressively borrow in the bond market at ultra-low interest rates below 3%, which encourages many of these companies to buy back their outstanding stock, which boosts their underlying earnings per share. The number of our Concentrated High Dividend and Large Cap Growth stocks that continue to buy back a billion dollars or more of their outstanding stock is now above 25 stocks.

We believe the ultra-low interest rate environment that now exists will undoubtedly help repair the housing market in the upcoming months and years. An ultra-low interest rate environment will persist for “years” since the Fed already confirmed it will keep the Federal Funds rate “near 0%” through mid-2013 and is further flattening the yield curve via Operation Twist. However, *The Wall Street Journal* recently reported that the Fed could signal it is likely to keep short-term interest rates near 0% well into 2014 and possibly beyond. According to the *WSJ*, “Fed officials have grown increasingly uncomfortable with their August statement that they are likely to hold short-term rates exceptionally low at least through mid-2013. Some [Fed officials] believe low inflation and high unemployment could warrant low rates for longer.”

One of the few “hawks” on the Federal Open Market Committee (FOMC), Philadelphia Fed President Charles Plosser, is a supporter of publishing interest rate forecasts and said in a recent interview that the January FOMC

meeting presents a good opportunity to start publishing these forecasts. Interestingly, Plosser voted against the August FOMC decision to state that the Fed would leave key interest rates unchanged through mid-2013, so perhaps his real objective is to embarrass the “doves” on the FOMC who have put the Fed in the predicament of possibly never being able to raise key interest rates, since it would: (1) blow up all the “underwater” loans that banks now have, as well as (2) dramatically increasing the federal government’s interest burden on its massive budget deficit, which is currently over \$15.1 trillion and rising by at least \$1 trillion per year.

Like the Bank of Japan, which has to manage a massive budget deficit by keeping interest rates ultra low, the Fed is losing its flexibility to raise interest rates, and we could be in an ultra-low interest rate environment for decades. As bad as this sounds, at least an ultra-low interest rate environment is great for stocks, since frustrated savers will likely turn increasingly to high-dividend yielding and quality blue chip stocks. As a result, we remain especially bullish on our Concentrated High Dividend Portfolio and our Large Cap Growth Portfolio. We remain optimistic that 2012 will be a positive year, just like most presidential election years.



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