

Market Outlook Letter

May 18, 2011

INVESTMENT COMMENTARY & OUTLOOK

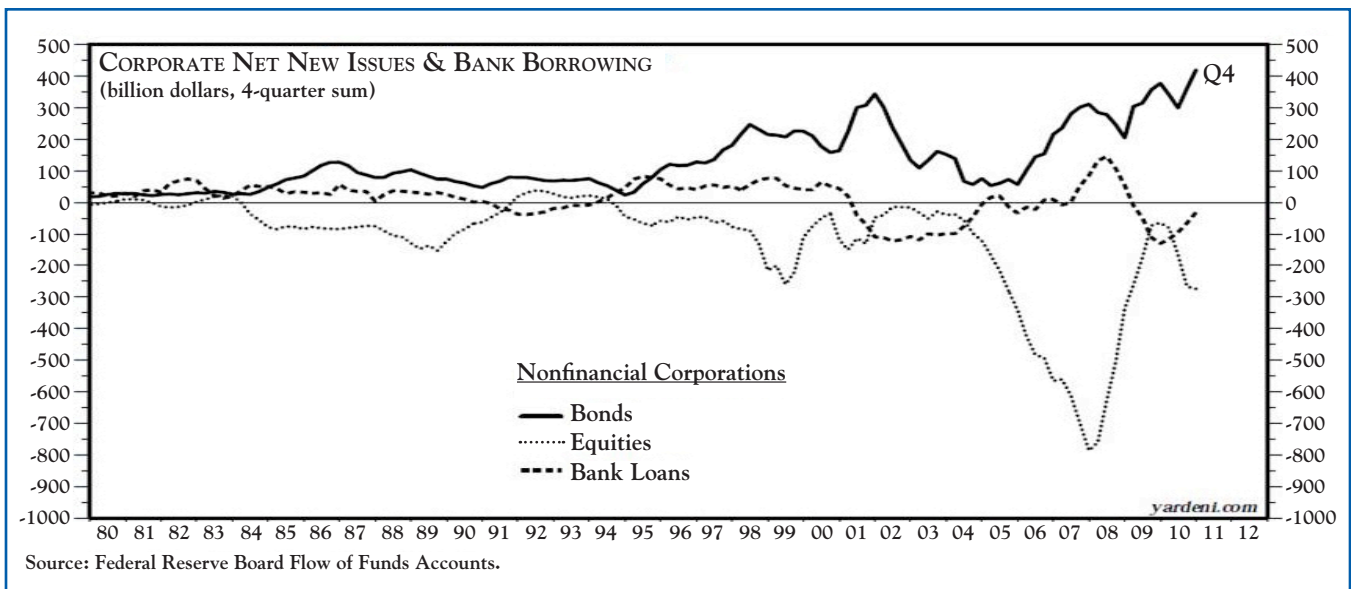
The first-quarter earnings announcement season is now over and for the first time we can remember, all 10 sectors in the S&P 500 beat analysts' expectations. Also very impressive is that the first-quarter earnings surprises were even better than the fourth quarter's exceptional reports. Looking ahead, many companies provided positive earnings guidance, so the second-quarter earnings season should also be very strong. Relentless corporate stock buybacks (boost earnings per share), a weak U.S. dollar (appreciating foreign currencies boost corporate profits since approximately 40% of the S&P 500's sales are from outside the U.S.), high commodity prices, and surprisingly resilient consumer spending continue to boost corporate earnings.

Yet, despite what appears to be almost a "perfect storm" for growth stocks, Wall Street loves to climb a "wall of worry." We are now at the famous time of year when many investors like to "sell in May and go away." Interestingly, after a few choppy days and profit-taking in early May as the U.S. dollar regained its "mojo" in the wake of the news that U.S. Navy Seals killed Osama bin Laden in a daring raid, many of our growth stocks firmed up on persistent institutional buying pressure on down days, which is a good sign that the smart money is favoring companies with strong sales and earnings prospects. As a result, we do not expect the market to retrench until the second-quarter earnings announcement season winds down in mid-August and Wall Street likes to go on an extended vacation.

What seems to be helping the stock market is that there is really nowhere for investors to go. The bid/ask spreads on municipal bonds are now so wide that investors could lose up to a year's worth of interest when they buy and sell municipal bonds. Meredith Whitney, the *Financial Times*, *The Wall Street Journal*, and others have sounded the alarm on flagging municipal finances that are compromised due to state budget woes and a weak housing market hindering municipal property tax revenues. In the first quarter, Treasury bonds had their worst quarter since 1999 as soaring yields caused principal to erode. So far in the second quarter, Treasury bonds have regrouped in the wake of weaker first-quarter GDP growth. However, many investors remain wary of Treasury securities because the Fed is still conducting quantitative easing and after June 11th when QE2 ends, the Fed has stated that it will continue to buy Treasury bills, notes, and bonds. So with fixed income investors frustrated with both municipal and Treasury securities, it appears that they are finding better opportunities in corporate bonds and the safety of strong corporate cash flow.

A couple of years ago we decided to team up with Advisors Asset Management (AAM) in order to launch corporate bond Unit Investment Trusts (UITs). We have raised over \$500 million in assets via 31 separate UITs. We were pleasantly surprised by the demand for these bond UITs. It served as a confirmation that many fixed income investors could see better opportunities in corporate bonds than in munis or Treasuries. The following chart illustrates that Corporate America continues to raise record levels of new bonds, which are now running in excess of \$20 billion per week (over \$1 trillion per year annual pace):

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



The fact that Corporate America continues to raise record amounts of new bond debt has profound consequences. Companies are generally issuing new corporate bonds to (1) refinance their outstanding bond debt at lower interest rates, (2) buy back their existing stock, and (3) buy their competitors. In other words, a healthy corporate bond market is helping to boost earnings per share and fuel the merger mania that has been underway for several months. In fact, we would respectfully argue that the stock market cannot help but rally due to the healthy corporate bond market, since when a Chief Financial Officer (CFO) can borrow in the corporate bond market at 3% to 5%, but their Return on Equity (ROE) is over 12%, they might as well continue to issue new corporate bonds and continue to buy back their outstanding stock debt to boost their respective earnings per share.

We have to say that we were surprised by the first-quarter earnings for some major corporations with mediocre sales growth; it led us to believe that the underlying earnings for many companies were definitely being boosted by corporate stock buybacks and a weak U.S. dollar. Naturally, in our growth portfolios, we demand strong sales growth and even stronger earnings growth, which is being fueled by profit margin expansion. The following table illustrates how some of our growth portfolios are characterized by truly stunning sales and earnings growth, which is fueled by profit margin expansion that can help to create spectacular earnings surprises:

	Average Sales Change	Average Operating Earnings Change	Average Return on Equity	Average Forward P/E FY2	Average Earnings Surprise % Latest Qtr.	Average Operating Margin % Change Trailing Year
Navellier Large Cap Growth	24.39%	116.23%	32.96%	19.46	7.86%	4.38%
Navellier Small-to-Mid Growth	52.65%	256.91%	50.64%	18.25	8.79%	4.69%
Navellier Mid Cap Growth	22.28%	217.02%	17.74%	18.73	8.78%	6.89%
Fundamental 'A'	51.86%	297.98%	34.06%	12.74	12.53%	8.85%

Data Source: FactSet

Average Sales Change: Last fully reported quarter divided by same quarter one year ago minus one.

Average Earnings Change: Last fully reported quarter divided by same quarter one year ago minus one.

Average Return on Equity: Trailing four quarters from last fully reported quarter. Net income divided by stockholder equity.

Average Forward P/E FY 2: Price divided by average analysts' estimate for fiscal year two.

Average Earnings Surprise %: As of last fully reported quarter, actual earnings divided by mean or consensus minus 1.

Average Operating Margin % Change: Trailing four quarters percent change in operating margin from last fully reported quarter.

Currently, it appears that many of our growth portfolios remain undervalued relative to the bond market and their underlying earnings, so we continue to be in a unique time when our growth portfolios are characterized by both strong earnings and reasonable Price-to-Earnings (PE) ratios. As a result, the long-term outlook remains

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outstanding. Additionally, as long as companies continue to issue record corporate bond debt, we expect the stock market to continue to rally and aggressive corporate stock buybacks to persist.

CLOUDS ON THE ECONOMIC HORIZON

While Corporate America can raise approximately \$20 billion a week (\$1 trillion annual pace) in the bond market, the foregoing chart illustrates that the banking industry is now making fewer loans since 2010. What is happening is the new banking reforms are cutting off credit to some consumers and a potential “double dip” in housing is causing banks to remain wary and curtail lending. So far in 2011, foreclosures remain at a record level and with approximately 11% of all homes in the U.S. unoccupied, the number of foreclosures in the pipeline is causing a big hangover for the entire banking industry. According to Zillow.com, during the first quarter, median home prices had fallen at the fastest pace since late 2008 due to an abundance of foreclosures in the pipeline, so it appears that a double-dip in housing is clearly underway. Fed Chairman Ben Bernanke recently predicted a high level of foreclosures in 2011 and said that he “hoped” foreclosures would start to decline in 2012, but until the foreclosure activity dries up, the Fed is anticipated to remain very accommodative since its job is to also keep the banking industry afloat.

The national housing hangover is clearly weighing on consumer confidence, as are high gasoline prices, which are now accounting for 9% of household spending. Recently the Institute for Supply Management (ISM) reported that its services index dropped dramatically to 52.8 in April down from 57.3 in March. This was a surprise to economists, who expected the ISM services index to rise to 57.8 in April. In fact, the decline in the ISM services index was the largest ever reported in its 13-year history and larger than any monthly decline during 2008 or even after 9/11. The culprit for the decline in the ISM services index was a sharp decline in new orders, and it is widely speculated that high gasoline prices are dramatically changing consumer behavior. The good news is any reading over 50 signals that the services sector is still expanding and fully 17 of the 18 service sectors that ISM monitors reported growth in April. ISM concluded that “lingering uncertainty about the economy” was definitely impacting its ISM services index.

The “wall of worry” that Wall Street likes to climb has not shown up yet in retail sales. Specifically, major retailers recently reported better-than-expected April same-store sales, led by the Limited, which reported a 20% increase in April same-store sales and raised its first-quarter forecast. Also notable is that Costco posted a 12% April same-store sales gain, boosted by gasoline sales and appreciating foreign currencies. Excluding gasoline sales and windfall currency gains, Costco’s same-store sales still rose an impressive 7% in April. There is no doubt that Easter shopping helped to boost April’s same-store sales, but overall same-store sales growth was significantly better-than-expected.

There are also clouds building on the horizon for employment growth. Despite April’s stunning payroll report of 244,000 new jobs, which was the strongest monthly growth in over five years, there remains a lot of anxiety regarding the job market. Temporary jobs actually fell 2,000 in April and since temporary jobs lead payroll jobs, it appears that there will likely be smaller payroll gains in the upcoming months. Another warning sign is that the broader household survey reported that employment declined 190,000 in April, which represents the first monthly decline since last November and a sign that there is some slack in the labor force. Finally, new claims for unemployment recently soared to the highest level in the past eight months, so clearly the pace of job creation may be slowing down and the unemployment rate rose to 9% in April, despite the best job growth in five years.

SUMMARY

Wall Street continues to climb a “wall of worry,” but when it comes to corporate balance sheets, cash flow, and earnings, our growth stocks clearly remain quite attractive. We are clearly in an environment where growth stocks are being rewarded as investors seek better reward/risk opportunities. The fact that growth stocks are not overvalued relative to bonds is very bullish, as are relentless corporate stock buybacks and a weak U.S. dollar that continue to boost corporate profits.

We suspect that the crude oil prices are peaking near-term and will help consumer confidence to rise and should help to sustain impressive retail sales. The fact that the commodity bubble appears to have let some air out near-term will help both businesses and consumers to resume spending with confidence. The Labor Department reported that productivity rose 1.6% in the first quarter, so hopefully much of the inflation that materialized on the wholesale level will not be passed directly to consumers, who are suffering from minimal wage growth.

Interestingly, the Fed's repeated claim that inflation was "transitory" appears to now be partially true, so the Fed will continue to maintain its low interest rate policy. These low interest rates in an inflationary environment continue to frustrate fixed income investors, so we expect assets will continue to move into the stock market seeking better prospects. Overall, it looks like we are in an incredibly bullish environment for the overall stock market, and particularly for growth stocks.

Sincerely,



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