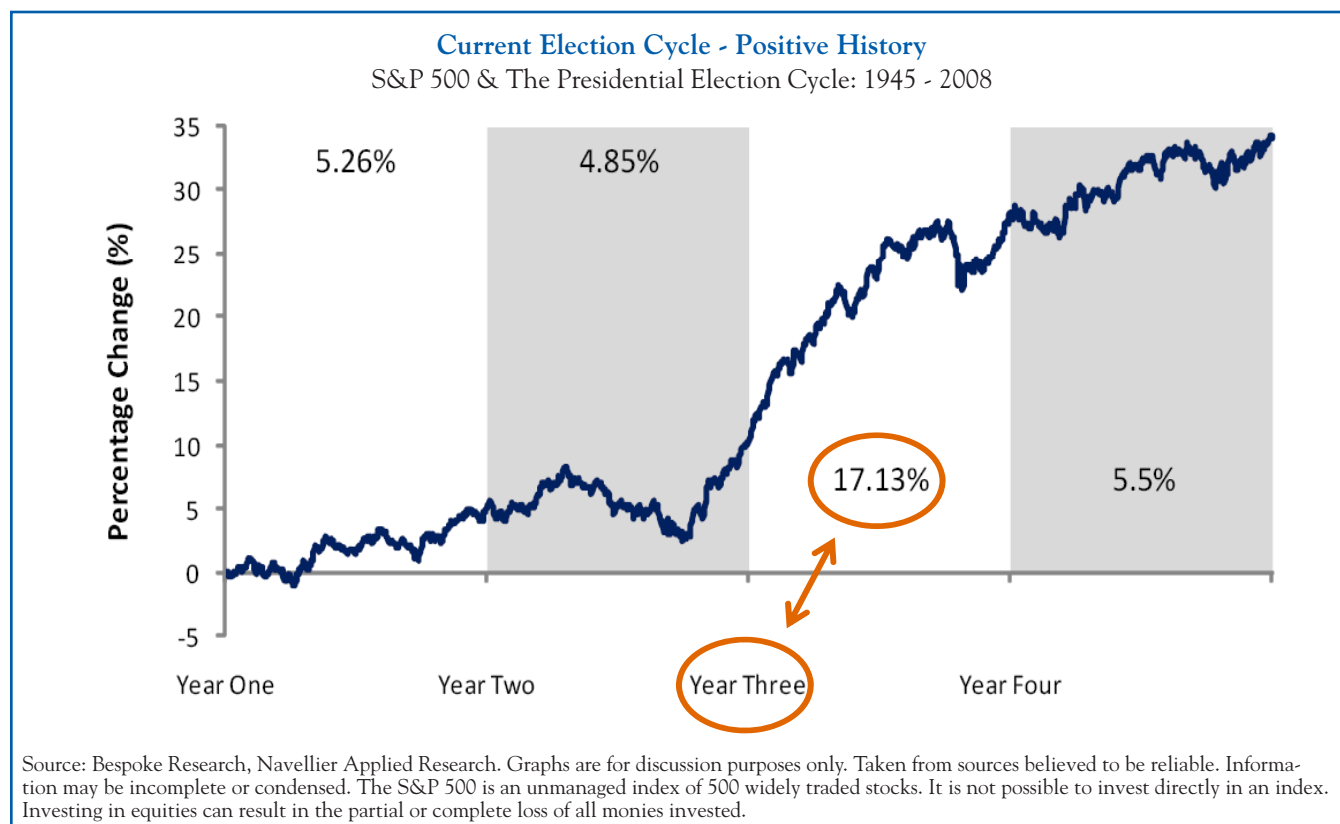


## Market Outlook Letter

February 4, 2011

### INVESTMENT COMMENTARY & OUTLOOK

Our growth portfolios have risen for several consecutive months, and we appear to be on the verge of another strong earnings announcement season for our growth stocks. Traditionally, as any earnings announcement season draws to a close, some consolidation and profit-taking is normal, so by mid-February, it may get a bit bumpy. However, based on the Presidential election cycle, where the third year is by far the strongest year, any serious consolidation is typically postponed until mid-August, as the following chart illustrates. So this means that if history repeats itself, we may have smooth sailing through July. Any consolidation around mid-August, or whenever it arrives, could be a great buying opportunity.



Last May, our Large Cap Growth Portfolio exhibited tremendous relative strength in a down market as a flight to quality stocks commenced. We performed substantially better than the S&P 500 that month. In June and July, this flight to quality persisted, and our Large Cap Growth Portfolio continued to significantly outperform the S&P 500. In August, “merger mania” heated up, and there were several mergers announced as companies snapped up many of their competitors at bargain valuations. Subsequently, our Small-to-Mid Cap Growth and Mid Cap Growth portfolios heated up since much of the merger and acquisition activity was in their capitalization ranges. In November, the entire stock market got a “turbo boost” when the “bond bubble burst” for both municipal and Treasury bonds. As a result, bond investors continue to exit the bond market, with net inflows into equity funds. This shift in investment focus is often very bullish for stocks.

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

Interestingly, while both municipal and Treasury bonds are faltering as yields rise, and default fears spread, the corporate bond market remains very healthy. Corporate America continues to raise approximately \$20 billion a week in new bond offerings, which means they are raising cash at a \$1 trillion annual pace. All this new cash is being added to approximately \$2 trillion in cash on corporate balance sheets on top of strong earnings for the overall stock market. In other words, a year from now, corporate America could have \$4 trillion of cash on the sidelines.

Just like cash can burn a hole in consumers' pockets, it does the same thing in corporate pockets. The easiest option is for many companies to buy back their outstanding stock, which helps their earnings per share rise even further. The second option is to redeem more expensive debt, which is why Ford Motor announced it would not have any long-term debt by the end of 2011. The third option is to go on a buying spree and buy your competitors to venture into new businesses. As a result, "merger mania," which started back in August, is expected to remain alive and well for the next several months.

Technology stocks remain the spotlight for acquisitions as many technology companies strive to acquire companies that have market share in rapidly growing mobile devices. The mobile boom is about to hit "warp speed" as AT&T and Verizon are preparing to introduce 4G. 4G is literally 10 times faster than 3G, and Apple, as well as virtually all other mobile device makers, is set to introduce 4G phones and other mobile devices to take advantage of high speed internet finally being in the "air." To speed up 4G networks even further, fiber optic lines are being run to cell phone towers and network speeds are being boosted, which is all great news for many of the behind-the-scenes technology stocks in our growth portfolios that are speeding up network traffic. After a long dormant period, technology investment is experiencing a rebirth, and the broadening of performance in this sector is very bullish for growth stocks overall.

#### CLOUDS FORMING ON THE ECONOMIC HORIZON

The bears believe three scenarios could derail the economic recovery and hurt investor confidence: (1) a municipal bond default, (2) an impending downgrade of U.S. Treasury securities by major rating agencies, and (3) the continued resurgence of inflation, especially in food and energy. Frankly, we are prepared for all three scenarios, but let us address each scenario individually.

Municipal bond defaults will most likely focus on "revenue bonds" tied to specific projects, such as housing, hospitals, airports, bridges, and toll roads. These bonds are likely more vulnerable to default opposed to "essential services" bonds tied to sewer systems, water plants, and power projects. General obligation bonds are not tied to any specific municipal project and typically have access to better cash flow. For example, even in cash-strapped California, general obligation bonds are second in the Golden State's cash flow pecking order since first-in-line goes to school, and second-in-line goes to California's general obligation bonds. So even though California has fiscal problems, there is likely no serious risk of it defaulting on its general obligation bonds. Another fiscally challenged state, Illinois, recently raised state income taxes 66% to try to plug its big budget deficit, so its default risk on its general obligation bonds is now less likely. Fear of municipal bond defaults remains, and it is part of the reason for the inflow of capital into equity funds. This directional flow generally benefits growth managers like Navellier.

The potential credit downgrade of U.S. Treasury securities is no joke. Moody's and Standard & Poor's both recently expressed concern over the federal government's deteriorating fiscal situation. Moody's said in a report that the U.S. needs to reverse an upward trajectory in debt ratios to support its triple-A rating. Specifically, Moody's Senior Analyst, Sarah Carlson said, "We have become increasingly clear about the fact that if there are not offsetting measures to reverse the deterioration in negative fundamentals in the U.S., the likelihood of a negative outlook over the next two years will increase." S&P did not rule out changing the outlook for its U.S. Treasury securities because of the recent deterioration of the country's fiscal situation. Specifically, Carol Sirou, head of S&P France, stated at a Paris conference that, "The view of markets is that the U.S. will continue to benefit from the exorbitant privilege linked to the U.S. dollar" to fund its deficits, and added, "But that may change. We can't rule out changing the outlook." S&P's Sirou pointed out that the jobless nature of the U.S. economic recovery was one of its biggest threats and said, "No triple-A rating is forever." Downgrade fears affected Treasuries. Since October 2010, interest rates on Treasuries have risen fairly steadily, lowering the value of the bonds. This is likely another reason for the outflow of assets from bond funds and into equity funds.

The final threat to investor confidence is serious inflation, especially in food and energy. If this inflation persists, it has the potential to derail the economic recovery, and in our opinion, is the biggest storm cloud on the horizon. The Producer Price Index (PPI) rose 1.1% in December. In the PPI, energy costs rose 3.7%, with wholesale gasoline rising a whopping 6.4%. Wholesale food prices rose 0.8% in December, with vegetable prices rising a whopping 22.8% as freezing conditions sent prices soaring. Excluding food and energy, the core PPI rose only 0.2% in December, but in the past 12 months, the PPI has risen 4%, with the core PPI rising 1.3%. Clearly higher food and energy costs are emerging as threats to economic growth. The Consumer Price Index (CPI) rose 0.6% in December, which represents the sixth straight monthly increase. Energy prices rose 4.6% and food prices rose only 0.1% on the consumer level, so the core CPI, excluding food and energy, rose only 0.1%. Due to a tame core CPI, the Fed will likely continue to keep short-term interest rates low, even though inflation is obvious every time we go to the gas station and grocery store. Despite these inflation fears, we can profit from these brewing inflation clouds as agricultural and energy stocks have recently demonstrated. We continue to hold positions in these sectors, and we are keeping a close eye on inflation and may add to the sector exposures in the coming months.

### SUMMARY

Our growth portfolios have risen for several consecutive months and could potentially rally well into the summer months before we become concerned about consolidation. The most likely time for this consolidation or correction is mid-August. We are currently in the midst of the fourth-quarter earnings announcement season, so we remain hopeful for wave-after-wave of outstanding sales and earnings announcements propelling our growth stocks higher. As any earnings announcement season draws to a close, some consolidation and profit-taking is normal, so by mid-February, it may get a bit bumpy; but again, we do not anticipate a serious correction until mid-August.

As the overall stock market climbs higher, it seeks new leaders, and we believe we are loaded with such leaders in our growth portfolios. With average annual sales growth of 49.56% and annual earnings growth of 48.90%, our Small-to-Mid Cap Growth Portfolio is representative of some of our other growth portfolios that continue to sustain strong earnings momentum in a decelerating earnings environment due to more difficult year-over-year comparisons. In recent quarters, the average earnings surprise for our growth stocks was several percentage points higher than estimates, so we remain very optimistic about the current earnings announcement season.

Although the overall stock market's earnings momentum may be slightly decelerating due to more difficult year-over-year comparisons, economic growth is definitely accelerating, and the fourth-quarter GDP growth surged to an annual pace of 3.20% due to resurging consumer spending. Although no economic recovery is perfect, there is no doubt the U.S. economy has some positive momentum in key sectors. Our technology stocks should be poised for positive earnings announcements with the excitement over 4G, speeding up networks, cloud computing, enterprise software, flash memory, and all the other great innovations. Despite Steve Jobs' recent medical leave, Apple is expected to have a banner year, especially after announcing new 4G devices in the upcoming months. Last quarter, our automotive stocks posted the biggest earnings surprises due to strong vehicle sales worldwide, so we remain especially optimistic that they will continue posting stunning sales and earnings.

Even the bad news is good. Concerns with the bond bubble bursting in municipal and Treasury bonds have caused investment capital to flee bond funds and find its way into equity funds. The inflation clouds emerging on the horizon are also a concern, but our energy sector positions are poised to continue profiting from higher crude oil prices. The fact is that despite the brewing inflation threat, the Fed continues to keep key interest rates low and money into the financial system via its second round of quantitative easing. Since the Fed says it will keep its quantitative easing pump running through June, it is hard not to be optimistic.

The third year of a Presidential term is historically the best year for the stock market, and any serious correction does not typically happen until late summer. Congressional gridlock, according to many investment experts, is good, and thanks to the new Congress, gridlock looks like it will persist for the next two years. The extension of the 2003 tax cuts was the first big test for Congress and the White House. The next test will likely be raising the federal government's debt ceiling. If the federal government can start to demonstrate some fiscal discipline, like many states and municipalities are now working toward, the stock market could potentially explode to the upside,

since such a change would represent a big relief. In the interim, it is the Fed's job to keep the federal government afloat, and it is doing just that via its interest rate policy and ongoing quantitative easing.

Optimism is addictive. Many investors that saw the glass half empty a year ago now see the glass full and rising. Thanks to surging exports and strong consumer spending, 2011 is expected to be the best year for economic growth in several years. No matter the World's problems, consumers around the globe love their smart phones and other technology devices. Globally, consumers are also buying more vehicles and helping put some upward pressure on crude oil prices. Our portfolios are well positioned to profit from these trends.

Sincerely,



LOUIS G. NAVELLIER



SHAWN PRICE



MICHAEL J. BORGEN



MICHAEL GARAVENTA



JAMES O'LEARY, CFA

P.S. Please visit our stock rating system on over 5,000 stocks on [www.navellier.com](http://www.navellier.com). The enhanced version of our stock rating system allows you to save portfolios, so that you can check the stock ratings on separate portfolios every week. We update our stock database every Monday following our weekend research.

#### **Important Disclosures:**

Past performance is not indicative of future results, and there can be no guarantee as to the accuracy of market forecasts. Opinions, estimates, and forecasts may be changed without notice. This material is not an offer, or a solicitation of an offer, to purchase any securities, including shares of any investment company. The views and opinions expressed are provided for general information only.

The S&P 500 Index measures the performance of 500 stocks that are considered to be widely held by Standard & Poors, a division of The McGraw-Hill Companies, Inc., and comprises approximately three-quarters of the total capitalization of companies publicly traded in the United States. The S&P 500 Index is weighted by market value and its performance is thought to be representative of the stock market as a whole. It is reported that over 70% of all U.S. equity funds are tracked by the S&P 500. The index selects its companies based upon their market size, liquidity, and sector. Most of the companies in the index are mid cap or large corporations. This index is composed of 400 industrial, 20 transportation, 40 utility, and 40 financial companies. Many experts consider the S&P 500 one of the most important benchmarks available to judge overall U.S. market performance. Presentation of index data does not reflect a belief by the Advisor that any stock index constitutes an investment alternative to any Navellier equity strategy, or is necessarily comparable to such strategies. Among the most important differences between the indices and Navellier strategies are that the Navellier equity strategies may (1) incur material management fees, (2) concentrate investments in relatively few stocks, industries, or sectors, (3) have significantly greater trading activity and related costs, and (4) be significantly more or less volatile than the indices.

All information contained in this material is provided in good faith and is believed to be accurate and reliable at the time of compilation. The information in this material is subject to applicable statutes and regulations and is provided "as is" and on an "as available" basis without warranties of any kind. Navellier does not warrant that the information will be error free.

No Financial Advice: The views and opinions expressed do not constitute specific tax, legal, or investment or financial advice to, or recommendations for, any person, and the material is not intended to provide financial or investment advice and does not take into account the particular financial circumstances of individual investors. Before investing in any investment product, investors should consult their financial or tax advisor, accountant, or attorney with regard to their specific situation.