MILLENNIUM

ASSET MANAGEMENT

Strategic asset allocation report

Jan 17, 2014

CRACKS IN THE WALL

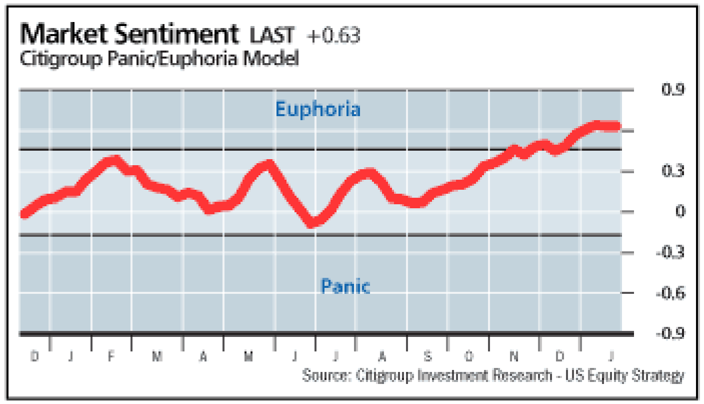
S&P 500 1838
Rut 2k 1168
1 yr. Bills 0.13
10 yr. T-Bond 2.82

Market sentiment: bearish

As the usual market pundits chime in unison that" it is a bull market until it isn't", cracks in the wall are beginning to appear. As the cheery, bullish cacophony rises, behind-the-scenes, margin debt is rising to near 2007 pre-crash record levels. Cheap valuations no longer provide support. In turn, the Fed is starting a program of tighter money amid extreme bullish sentiment while insider selling explodes to near cyclical highs.

The momentum market's lifeblood is higher growth expectations- tapering seem destined to throw cold water on those that hold them. While we remain bullish, we know that our DCF model projects 9% total return from these levels and the S&P 500. If we use a equity discount risk premium of 9%, the market has 0% upside from today's level.

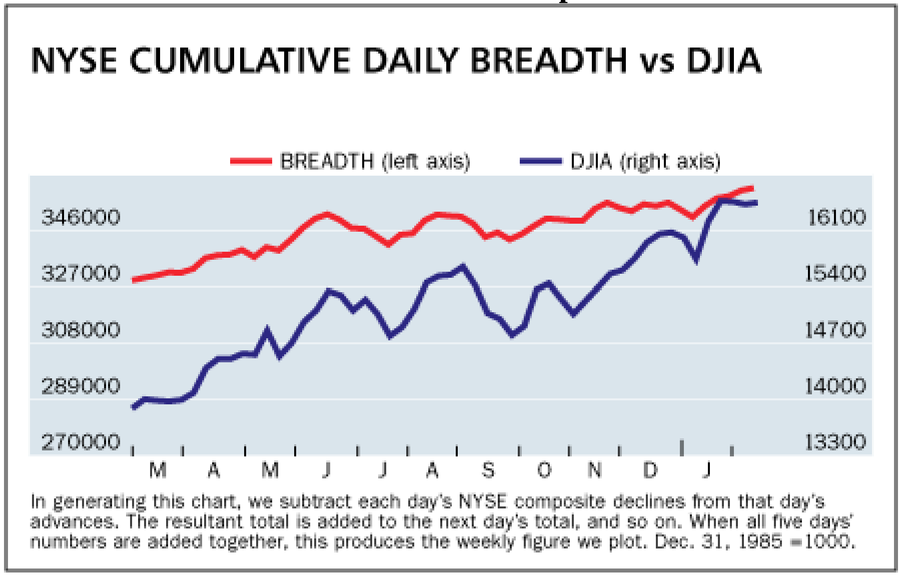
Market sentiment is negative. Bulls out number bears by 1.7 which is a very negative sign. The VIX at t 12.5 demonstrates a boatload of complacency. Other sentiment indicators such as the Consensus Index and Market Vane confirm this over zealousness. In addition, Short interest has also moderated nearly 10% from last month; although much of that is due tax deferred selling to delay taxes to 2014.



Technical indicators: bullish

Technical indicators are bullish. Taken in the aggregate, technical indicators portray a near bulletproof scenario. The advanced decline ratio on the NYSE is 1.89 matched by the ratio on the NASDAQ at 1.87. Up /down volume nearly mirrors and confirms this bullishness in keeping with the up/ down ratio on the NYSE at 1:84 and on the NASDAQ at 1.68.
However, the 10 day moving average of up to down volume on both exchanges diverges from these indicators slightly at barely 1.0. The advance / decline lines on the NYSE and NASDAQ confirm upside with the NYSE at 1.79 and NASDAQ at 1.27. Major market indices are cruising healthfully above their 200 day moving averages lead by the NASDAQ up 14% above its 200 day moving average followed by the S&P up 9% and the Dow at 7%. It is challenging to find fault with the technical picture with the exception with the fear that this is as good as it gets and it's all downhill from here.

Technical Picture still positive



Liquidity indicators: Bullish

Liquidity indicators are positive. Margin accounts on the NYSE are a flashing bright red flag. At 39% equity to debt traders are nearly as leveraged now as they were at the market peak of 2007. This is a major negative. However, there is plenty of cash on the sidelines with nearly $2.7 trillion additional buying power. While major market indices are up over 30% over the last 12 months, money market balances remaining nearly unchanged at $2.7 trillion. This implies that the bull market has been driven largely by the effect of a major asset reallocation trend from bonds to stocks. In the interim, $29 billion in new cash flowed into the equity markets over the course of the last four weeks. This is a reasonably strong number provided the traditional Christmas slowdown. Bulls have also been buttressed by the IPO market shutdown for the holidays. Bankers are back to work now and as of the week of January 6 there are $2.5 billion of deals in the pipeline.

Share buybacks continued at a seasonally adjusted torrid pace. Buybacks were $12.billion, however they were relatively concentrated with Kraft and 3M accounting for $7 billion of all buy backs. Mergers and acquisitions exceeded $5.7 billion down from a recent monthly average of over $10 billion. In addition, there is an influx of public companies buying private equity highlighting the higher valuations making public acquisitions less attractive in today's market.

(Ample buying power remains in MMF)

	Money Market Funds# (Bil.$)	Last Week	Prev. Week	Year Ago
1/15		2,701	2,715	2,701

Source: Investment Company Institute, 1401 H Street NW, Suite 1200, Washington, DC 20005-2148 (202) 326-5800

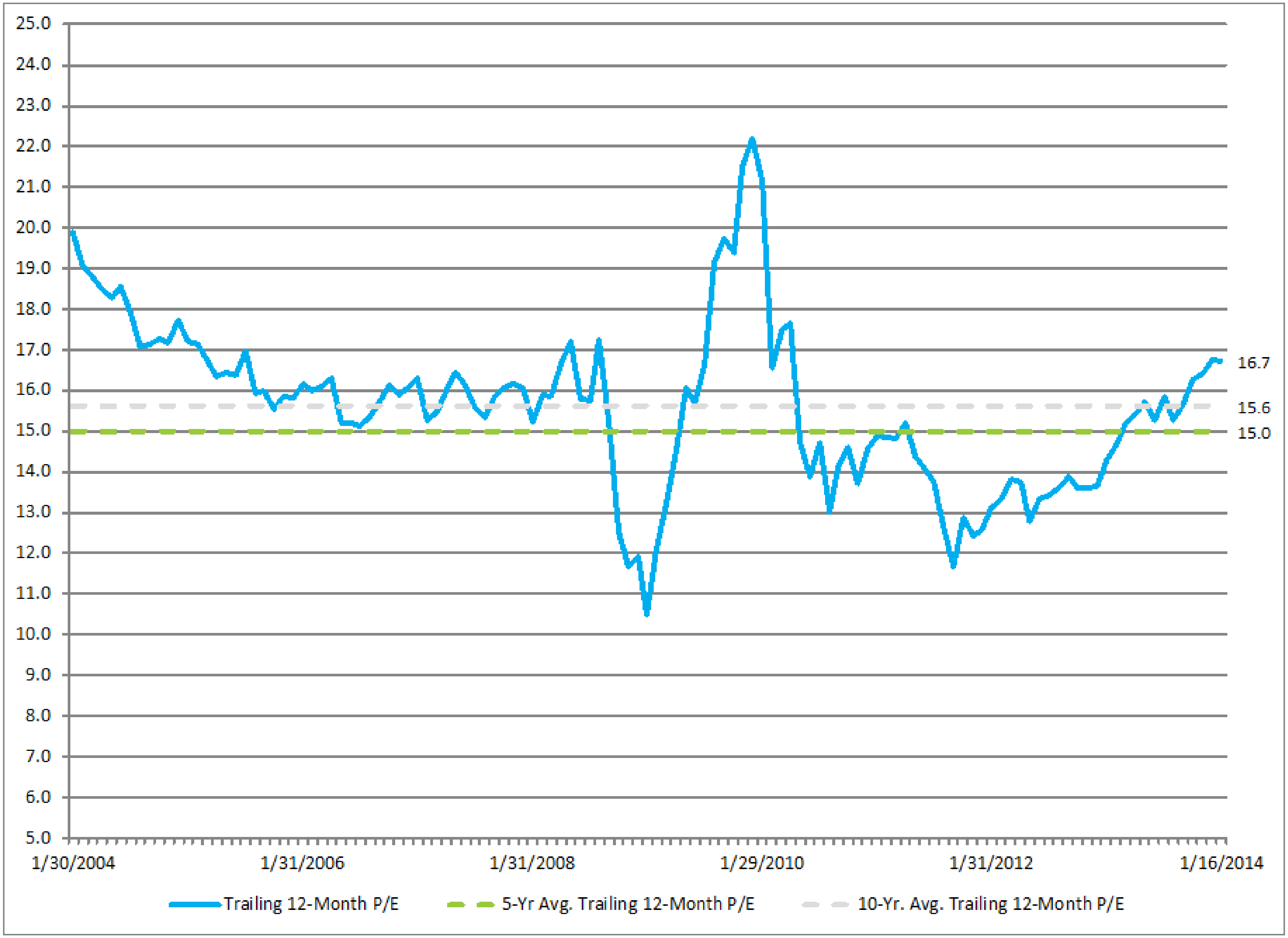
Valuations: Negative

Valuations are negative. Over the course of the last 12 months most major market indices and equity asset classes involved seemed to have moved in unison – averaging + 25% to +35%. In 2013 our DCF multiplier model indicates that the market currently trades at a 14% premium to fair value. We derive our target of 2016 for the S&P 500, applying a 17 multiplier to consensus 2014 estimates: an increase of 9%. Total market capitalization exceeds $23 trillion: a 15% premium to replacement value of $19.6, according to the last Fed Z report. Tobin's Q ratio shows a 40% premium, comparing total market cap to GDP.

On a relative basis the market appears attractive with an earnings yield of 6.2% vs the A rated corporate bond yields averaging 3.8%. This has been the key market catalyst propelling the asset reallocation shift : the "great shift" as it's known from bonds to equities. Noting that currently, equity ownership exceeds 48% of household financial assets, it appears the effects of this reallocation may be in the 11th hour.

Most market indices appear fully valued with the S&P 500 at 17x and our internal small cap proxy at 30 x TTM.
Further upside will have to be powered by EPS growth now that the market multiple is at a slight premium to historical levels.

Market at 10% Premium: Trailing 12M P/E Ratio: 10-Year


25.0
24.0
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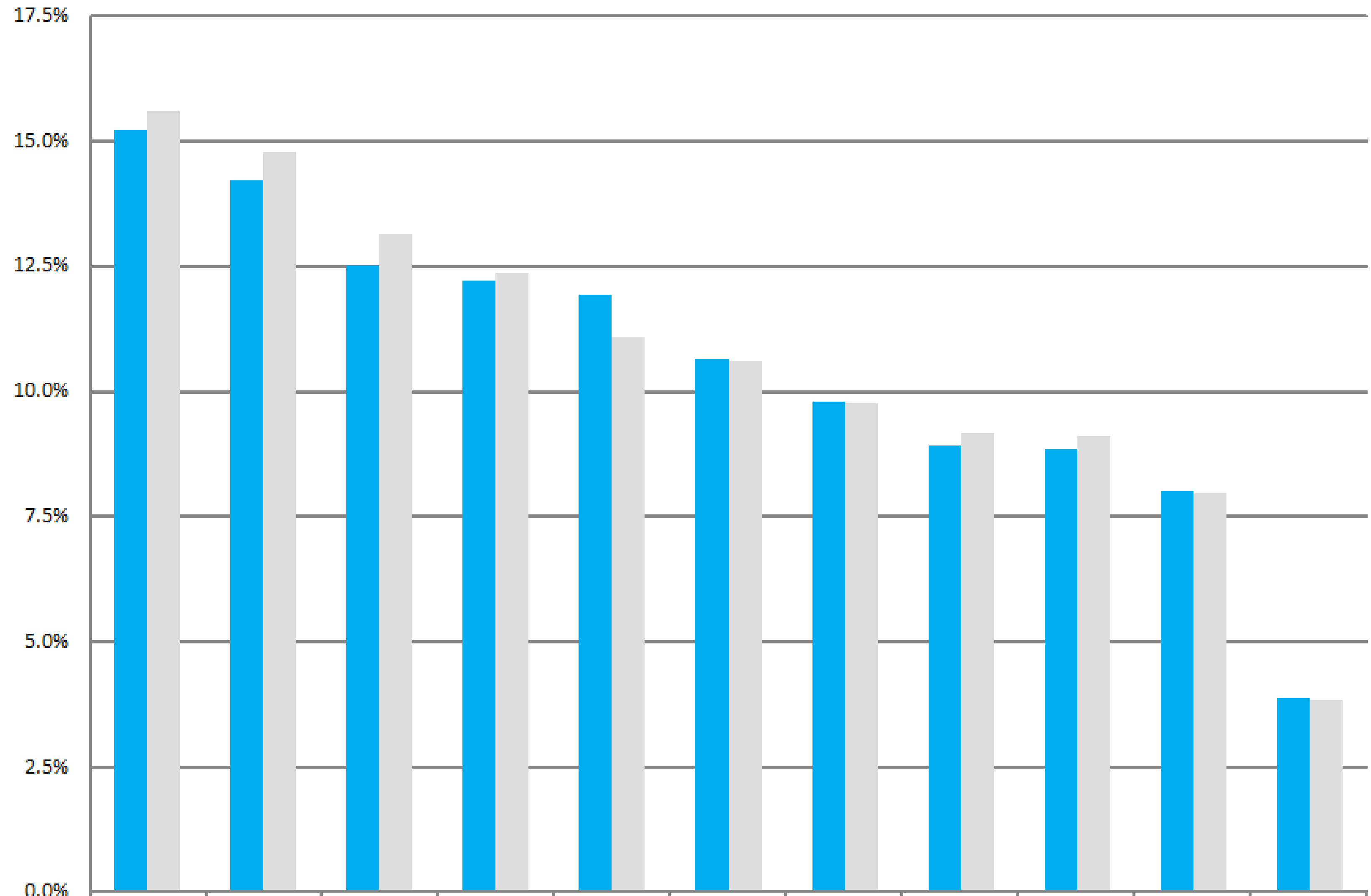
7.0
6.0
5.0
16.7
15.6
15.0
1/30/2004
1/31/2006
1/31/2008
1/29/2010
1/31/2012
1/16/2014
Trailing 12-Month P/E
5-Yr Avg. Trailing 12-Month P/E
10-Yr. Avg. Trailing 12-Month P/E

Earnings momentum: negative

Earnings momentum is negative. As the season unfolds, the bar is slightly higher for Q4 with 6% EPS growth expected vs 3% growth posted in Q3 2013. Reports appear to be coming in below historically bullish levels. Of the 54 companies that have reported, only 57% have beaten estimates vs. the 73% avg. beat ratio over the last four years. Early guidance has been decisively negative at 6 to 1 downward. The average beat is down from the 5.8% avg. of the last four years to 2.2% in q4 2013. Also, the average revenue surprise is only +0.5%: These are very tepid numbers at this point as these current valuations hover 10%-15% above the ten-year average. On the contrary, 2014 is looking a bit stronger with analyst's looking for 10% eps growth. Top sectors are financials +24.6% expected EPS growth followed by tech info +15.3% and industrials + 13.7% energy brings up the rear at- 10.5%

2014 Earnings Growth: 10.6% EPS Expected



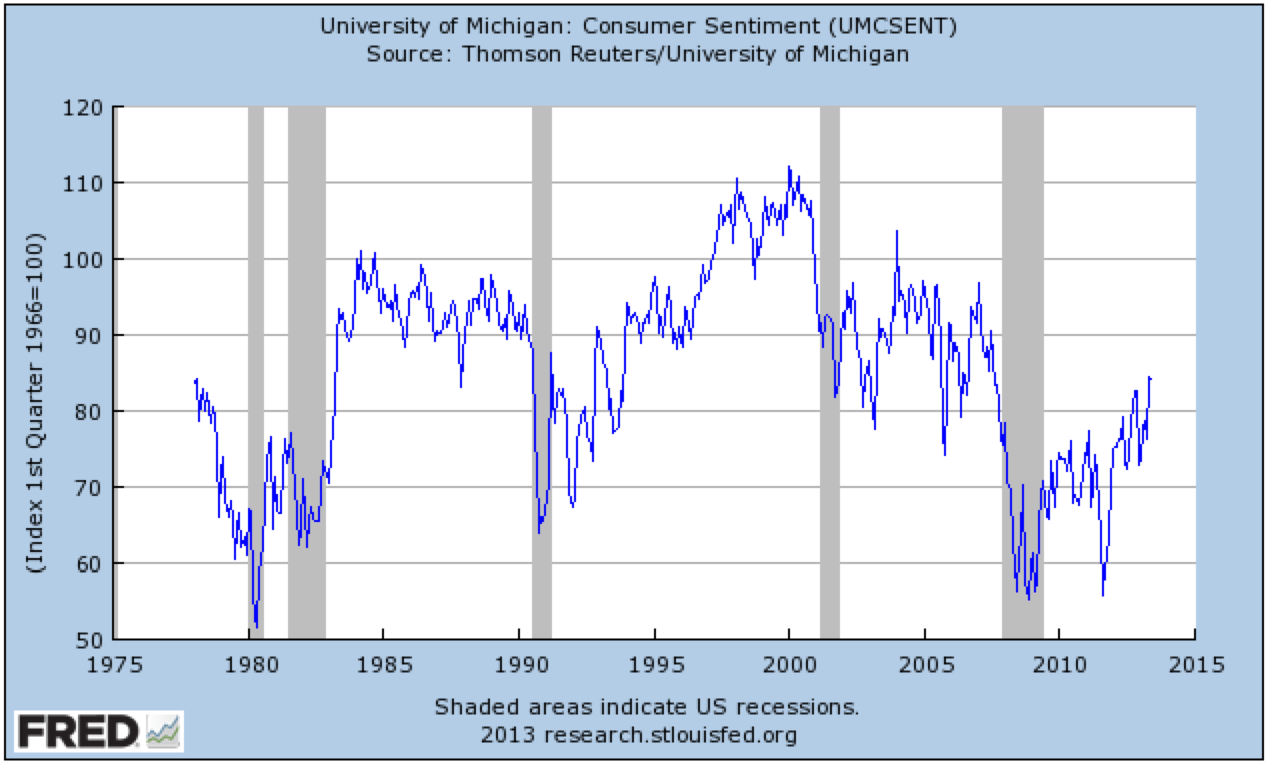
	Consumer Disc.	Materials	Telecom Services	Energy	Financials	S&P 500	Info. Technology	Consumer Staples	Industrials	Health Care	Utilities
Today	15.2%	14.2%	12.5%	12.2%	11.9%	10.6%	9.8%	8.9%	8.8%	8.0%	3.9%
31-Dec	15.6%	14.8%	13.1%	12.4%	11.1%	10.6%	9.8%	9.1%	9.1%	8.0%	3.9%

Monetary policy: positive

Although still bullish this indicator is starting to lose momentum. M2 growth has declined to + 6% y/y. Our excess liquidity has suddenly turned negative, a cause for concern. Money velocity is -3% year-over-year. This has been a constant drag on the Fed's efforts to increase growth . Fear has been the dominate sentiment causing MV to fall to near 40 year lows. We believe, however, that MV is about to increase, bolstered by a consumer confidence reading that is at post-recession highs and further buttressed by household net worth of over $77 trillion, an all- time high.

While month-to-month data does not necessarily make a trend, nominal GDP growth jumped to 4.1% in Q3 , higher than our post taper adjusted liquidity indicator, which we believe will move back to positive ground very soon due to the factors cited above. Also, the slope of the yield curve is bullish with a 276 basis points difference between one year T-bills and Ten year bonds. With CPI ranging between 1.2% & 1.6%, Ten year treasuries bonds currently yielding 2.88% are pricey, trading below the 200 basis point spread that is normal. The High Yield bond sector is also very pricey at + 210 bps to Treasuries. This is the lowest spread since 2007.

Confidence at post 2008-crash highs



Asset class performance and the economy

Most economic data seems to support strengthening lead by a recovering consumer. Personal income is up 5.3% while consumption is up 3.8%. Government spending is down slightly year-over-year. Employment is up 15% while the employment cost in is down 1.6% over the last 12 months, having a positive impact on corporate net profit margins, aided by the backdrop of very low inflation at 1.2% while expected inflation is at 1.6%. The confirmation of a strengthening economy is underscored by the index of leading indicators at 98.3 , up 5.25% over last year.

Market bubble alerts:
The S&P 500 is valued at 1.4 times GDP compared to 2000 bubble at 1.8.
On a price to sales basis, the S&P 500 trades at 1.6 which is well below 2000 highs of 2.3.
Today we trade at 17× while in 2000 the PE ratio of the S&P 500 was over 29x ttm.
Also, today the earnings yield is well over three times greater than it was in 2000.

Looking at comparisons to the debt driven crash of 2007, the money center banks are far less leveraged now at 12x net tangible equity compared to 25x in 2007.

Asset class and emerging markets performance: (2013)
Small caps lead large caps by a wide margin 38.6% versus 32.5%.
Large-cap growth beat large-cap value by 32.5% versus 21.4%
Health care and industrials were the leading sectors up 41% and 40% respectively.
Bonds & commodities were the lagging asset classes down approximately 2% each in 2013.
Europe bounced back with the S&P Euro 350 up 24% while classic emerging markets such as Brazil and China were each down 17.5%.

As we enter into 2014, emerging markets are priced attractively versus the US market, China currently trades it eight x earnings and Russia at a x five times earnings.

	S&P 500	China	INDA	Russia	Brazil
P/E	16.0x	8.0x	16.0x	5.0x	14.0x
P/B	2.4x	1.3x	2.1x	0.6x	1.7x
P/S	1.6x	1.2x	1.7x	0.7x	1.0x
P/CF	8.3x	1.9x	11.7x	3.1x	6.0x