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ECONOMIC & MARKET UPDATE: FEBRUARY 14, 2011 "RECOVERY HERE TO STAY WITH EQUITIES FLASHING CAUTION"

Economic Data - Previous Week

Date	Series	Actual	Survey	Prior	
2/7	Consumer Credit	\$6.1B	\$2.4B	\$2.0B	First rise in revolving credit in 27 months
2/10	Wholesale Inventories	1.0%	0.8%	0.0%	Inventories grow faster to keep up with sales
2/11	Trade Balance	-\$40.6B	-\$40.5B	-\$38.3B	Excluding oil, deficit narrows on rising exports
2/11	UMich Confidence	75.1	75.0	74.2	Sentiment improving, inflation expectations tame

Economic Data - Upcoming Week

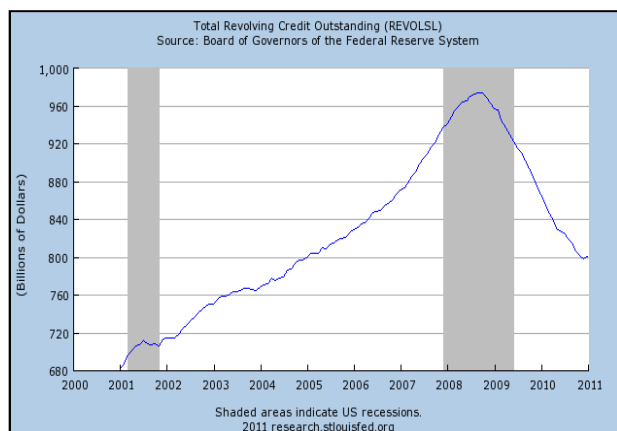
Date	Series	Actual	Consensus	Previous	
2/15	Retail Sales	--	0.5%	0.6%	Analysts look for 7th straight increase
2/15	Business Inventories	--	0.7%	0.2%	Preliminary orders data points to growth
2/16	Housing Starts	--	540K	529K	Rebound expected after weather rel. decline in Dec
2/16	PPI	--	0.8%	1.1%	Non-core items to keep producer inflation elevated
2/16	Industrial Production	--	0.5%	0.8%	Data mixed but still pointing to mfg expansion
2/17	CPI	--	0.3%	0.5%	Consumer inflation still muted, flat at core level

Source: Bloomberg

EQUITY MARKETS MELT HIGHER AS ECONOMIC DATA IMPROVES

The stock market benefitted from continued strength in the economy and improving corporate fundamentals last week. By the end of the week, the S&P 500 Index was up 1.4% and the Dow Jones Industrial Average gained 1.5%.

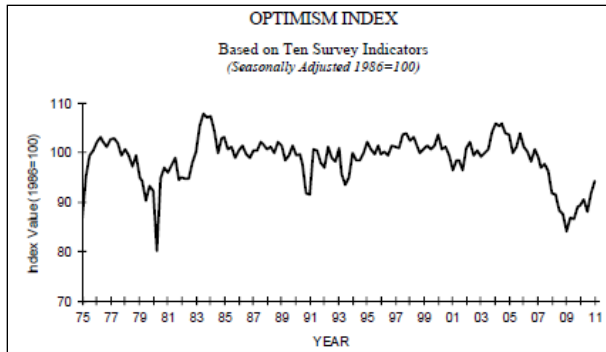
From the economic side of the ledger, consumer credit outstanding increased by \$6bln in December. Revolving credit (i.e. credit cards) experienced its first monthly increase in 27 months after posting a slight \$2.3bln gain. This is consistent with the expansion in consumer spending during the final quarter of the year but on an aggregate basis, revolving credit is down more than \$170bln since its 2008 peak.



Source: Econoday

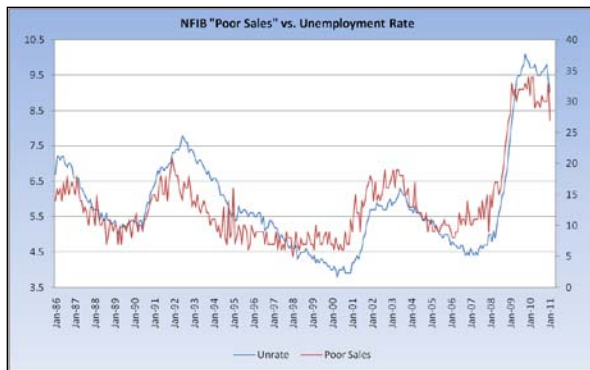
Small businesses displayed their own bit of optimism in January after the National Federation of Independent Business (NFIB) Small Business Optimism Index rose from 92.6 in December to 94.1 in January. That represents the highest reading since December 2007, but as pointed out by the NFIB, the average reading of the index prior to the recession was 100, so there is still considerable ground to make up before optimism is in a historically normal range.

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Source: National Federation of Independent Business

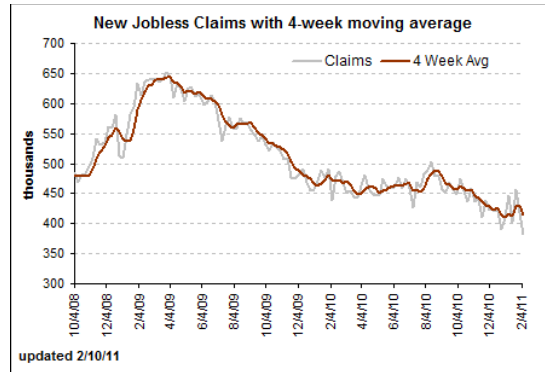
Small businesses point towards a lack of sales as the primary concern and as Barry Ritholtz showed, there is an unsurprisingly high correlation between the unemployment rate and the number of firms citing poor sales as a concern. Without improvement in labor markets, small businesses are unlikely to see much in the way of higher sales.



Source: National Federation of Independent Business

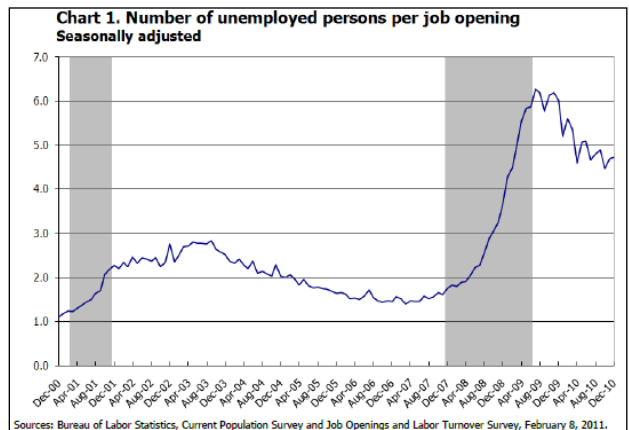
Two reports on employment provided uncertain outlooks last week. The first, initial claims for unemployment benefits, fell to 383k in the week ending February 5th. A drop of 32k from the previous week was largely seen as reversing some of the unusual impact of severe winter weather across portions of the country. Strategists and economists frequently cite 400k as the threshold at which the economy would begin generating sustainable job growth. It will be important to watch this indicator over the next several

weeks to determine if the trend lower is merely an aberration or the start of a legitimate recovery in labor.



Source: Econoday

On Tuesday, the Job Openings and Labor Turnover report for December provided a mostly unchanged look into the state of turnover in the labor markets. There were roughly 2.0mln people that quit their job in December, a modest improvement from the trough of 1.7mln in September 2009. This indicator is generally considered to be a sign of confidence that another, usually better, job opportunity is available elsewhere. Confidence might be improving slowly, but the challenge is that for every job opening there are 4.7 unemployed persons, well above the long run trend.



Source: Bureau of Labor Statistics

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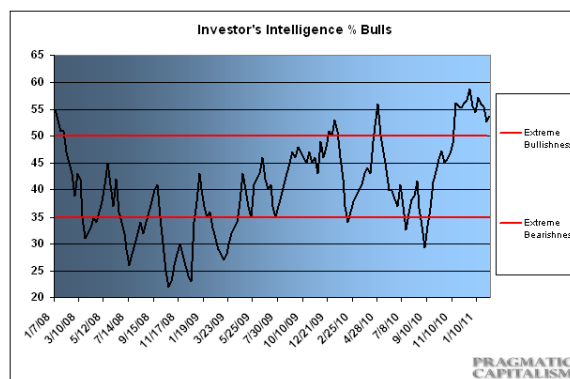
SENTIMENT EXTREME BY SOME INDICATIONS, NOT SO BY OTHERS

Equity markets continue to melt higher, despite several unfavorable technical developments. The market began its recent rally in September of last year, with only a brief respite in November. Since that time, each pull back is used as an opportunity to pile more money into equities and with the Federal Reserve offering massive liquidity to all corners of the market, this phenomenon could potentially last longer than any are willing to admit.

The most frequently cited indicator that the market is overbought is currently retail sentiment, notoriously wrong at market extremes. According to the American Association of Individual Investors, 49.4% of retail investors are bullish on the six month outlook for equities, well above the long-term average of 39%.

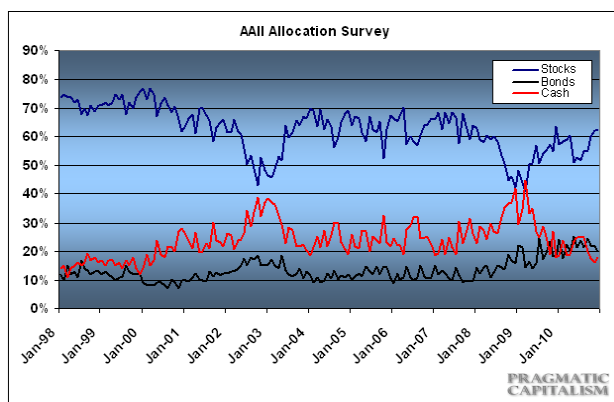
Interestingly, retail sentiment has been consistently above its long-term average since the week ending September 9th. Clearly, retail investors are on the winning side given the market rally since then. At the same time, however, retail investor's allocation to stocks is only slightly above 60%, well within a historically normal range. In the late 90's, during the technology bubble, retail investors reached a peak stock allocation of 78%.

Unfortunately, it is not only the retail investors that are bullish on the market. Financial advisors, as measured by the Investor's Intelligence weekly survey, are now bullish at an extreme level. Almost 54% of advisors are bullish on the equity outlook, above the 50% threshold considered to be extremely optimistic.



Source: Pragmatic Capitalism

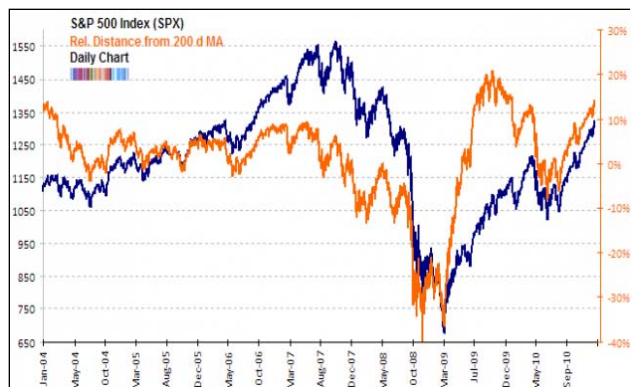
One area of pessimism is emerging from corporate insiders, who are selling stock at almost unprecedented rates. Vickers Weekly Insider Report compiles insider buying and selling. They found that in the week ending February 4th, the corporate sell-to-buy ratio stood at 5.45 to 1. This was down from the 7.74 to 1 sell-to-buy ratio in mid-January, but is still a very negative development for market participants.



Source: Pragmatic Capitalism

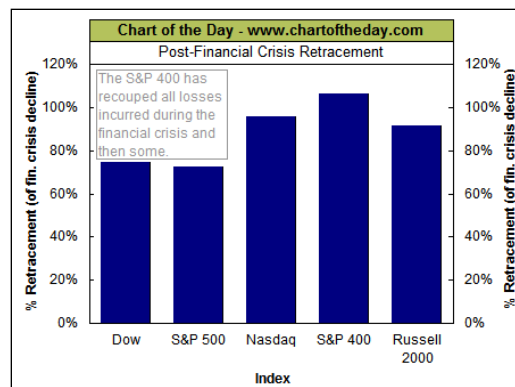
The final indicator that bears watching is the 200-day moving average of the S&P 500 Index. Through February 8th, the S&P 500 Index closed 14.4% above its 200-day moving average. It is rare for the S&P to move past 20% above its 200-day moving average and in fact, the highest it has ever recorded is 23% above the moving average in October 1982. From this point, it would be difficult for the S&P to hold above 10% or 15% for long.

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Source: *Trader's Narrative*

Indices such as the DJIA and the S&P 500 recovered more than 70% of their previous peaks. It would be easy to assume that the best days are behind us based not only on the strength of the recovery but also on the many indicators flashing great big caution signs. As any investor knows, though, “markets can remain irrational longer than you can remain solvent.”



Source: *Chart of the Day*

The role of the Federal Reserve in providing ample liquidity to market participants is effectively putting a floor on market pricing (known as the famed “Bernanke put”). Investors understand this all too well and are eager to capture profits while the Fed is willing to pass them out. With sentiment at unusually extreme levels, now is not necessarily the time to become overly aggressive, but standing on the sidelines is also not an appropriate strategy.

THE WEEK AHEAD

There is no shortage of corporate and economic news to dissect this week.

Domestically, economic releases of relevance include retail sales for January on Tuesday. Sales picked up momentum in the fourth quarter, but a wide range of forecasts for January suggests weather may have played a role in slowing down that momentum. Producer and consumer inflation return to the forefront on Wednesday and Thursday, respectively. Producer inflation continues its strong pace with raw materials costs on the rise. Consumers, on the other hand, are seeing little inflationary pressure due to stagnant shelter costs. Finally, the Conference

Board Leading Economic Indicators (LEI) index will be released on Friday. The overall economy continues to grow and the LEI is expected to show a 0.2% gain.

Corporate earnings season is slowing, but several important announcements will be revealed this week. This includes Marriott, MGM Resorts, Barclays, Danone, Dell, BHP Billiton, CBS, Daimler, ING, Societe Generale, BNP Paribas, Nestle and Anglo American.

On Monday, President Obama unveils his fiscal year 2012 budget proposal. It will undoubtedly be a contentious document given

