



PVG Asset Management Corporation

May 17, 2011 Investment Comments

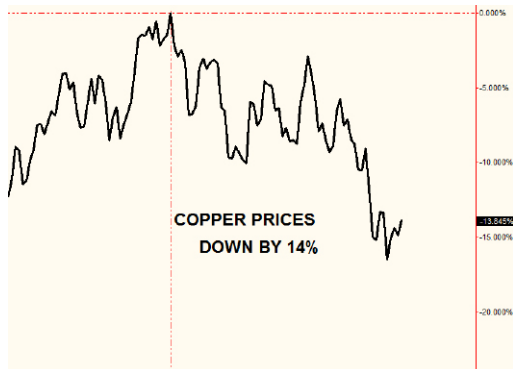
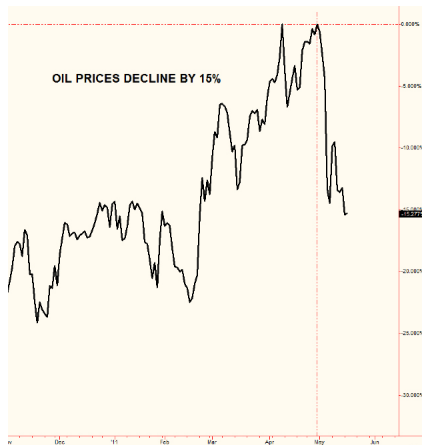
Budget Cuts Ahead Suggest Weaker Investment Markets

In fact, stock prices have been dragging since late February, as seen on the next page. This chart also shows how the strong uptrend which started last September may have come to an end. Prices are just 9% higher than a year ago when the markets began a spring and summer slide of -15% on concerns over economic growth. Recent weak markets seem to have been started by similar concerns and have been led by investment leaders, most prominently - commodities including energy and base metals. Crude oil prices have been hit particularly hard (-15%) as noted from the chart. Copper, often seen as a leading indicator of economic weakness, has fallen -14%. Even gold has turned in negative price action over the last month.

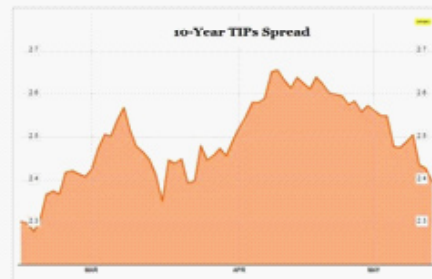
As is often the case, when investors become nervous about stocks, government interest rates have been falling. The 30 year US Treasury yield is down from near 4.8% to 4.3%. Perhaps more telling, investors' inflation expectations have also fallen. This is evidenced by the drop in inflation protected bond yields shown on a chart on the next page. It is too early to say whether bond investors are predicting an economic slowdown or may just prefer the safety of US Treasuries following a significant run in stock prices.

PVG Defensive Again

Risk management or protecting your money being our primary objective, we are again being defensive with your portfolios, holding substantial cash and hedging additional portfolio risk. Currently, stock market exposure in portfolios (growth) is approximately 32%, after accounting for hedges and cash-like investments of 31-32%. We are aware that our conservative market positions over the last year have cost returns. As mentioned above, we underestimated the impact of the Federal Reserve's quantitative easing program. However, the bulk of this program is now past. We are concentrating on what might occur rather than what was missed. Overall, we continue to grow portfolios without the wild up and down swings that market conditions cause most traditional managers to experience.



Inflation Expectations Are Falling in Bond Market



Based on the "breakeven rate," or the difference between 10-year nominal Treasury yields and 10-year Treasury Inflation Protected Securities (TIPS) yields, the bond market's expectation of future inflation has been falling over the last month, **not rising**. After peaking at 2.65% on April 11, the breakeven rate has been gradually falling, and dropped below 2.40% yesterday (Friday) for the first time since March 23. That's a 25 basis point drop in the breakeven rate over the last month.

**STOCK AND COMMODITY CONDITIONS
DETERIORATE WHILE INTEREST RATES
DECLINE**

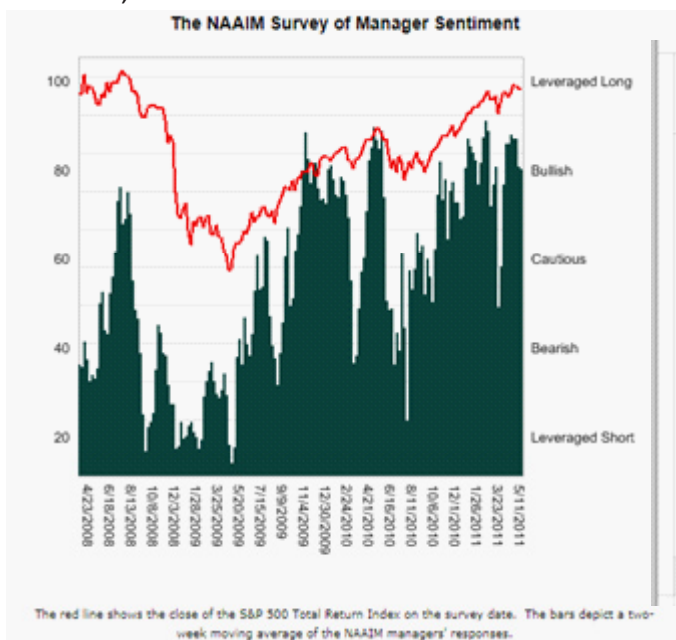
Debt Still the Immediate and Long-Term Problem for Investors

While Western Nation economies are currently growing, political attempts to tame the sovereign debt monster, particularly in the United States, are likely to have some impact on near-term economic growth, and corporate profits upon which stock prices depend.

Of course, debt, including promised local, state, and Federal retirement and health benefit entitlements, including Social Security, Medicare, and Medicaid, is a major long-term problem that must be handled to ensure future economic growth. How it is handled, however, creates a great deal of uncertainty for businesses and investors who avoid new commitments as a result. The problem is more difficult than merely increasing retirement ages, raising insurance co-pays, and finding some group from which to coax more taxes. All solutions have an immediate effect on someone's income and thus economic growth. Take, for instance, the less discussed debt problem at the officially "off-budget" US Postal Service. It recently ran through \$15 billion of taxpayer loans and is now asking for up to \$75 billion more to fund salaries and benefits which represent 80% of the postal service's budget. While this debt is not likely to ever be repaid, how do you shrink the Post Office without reducing the labor force and home delivery, despite what the Postmaster General says are unprecedented declines in postal volume as electronic delivery replaces delivered mail?

To the debt problem, we must add uncertainty created by the end of the Federal Reserve Banks "quantitative easing" program over the next several months. The Fed's program of "propping up markets" to boost wealth was an unqualified success, far more successful than we expected. What the Reserve Bank does this summer is unknown, probably even to those within the bank, but will regardless have a significant impact on the direction of both stock and bond prices.

None of this is new. Investors, however, are newly focusing on these issues. Risk is substantially higher since market prices and valuations are higher than last summer, and public and professional investors became rather bullish about future prospects for stocks and particularly commodities. For instance, stock valuations, adjusted for cyclical earnings, are 45% above the historic average (equivalent to big peaks in 1901 and 1966), according to Robert Shiller of Yale University. And, the National Association of Active Investment Managers (below) shows bullish sentiment at high levels normally associated with at least a near term market decline. Approximately this time last year, for instance, equivalent sentiment was followed by a 15% market decline through the summer. A similar decline may or may not reoccur. Protection, however, is in order.



Another Sign Manufacturing Leads Recovery: Mich. Could Collect \$1 Billion in Extra Taxes in 2011-2012

LANSING -- "A day after the Legislature delivered most of Gov. Rick Snyder's business and personal income tax overhaul, state government got the best news it's had in a decade: Tax collections are exceeding expectations again, with analysts predicting Friday that the state will take in up to \$690 million more next year than had been forecast only four months ago.

Forecasts released Friday by the House and Senate Fiscal Agencies said 2012 tax collections will be between \$484 million and \$690 million higher than had been contained in official estimates in January. According to the Fiscal Agency forecasts, tax collections also will exceed earlier projections in the current fiscal year by between \$426 million and \$557 million."

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Reasons to be Optimistic

Jim O’Niel, Chairman of Goldman Sachs, suggested recently that investors’, definitely including us, have been guilty of “seeing every problem that crops as a reason to remain too conservative”. Good hindsight, but the situation might have been different. Market direction is always uncertain and unknowable. Our marching orders are to avoid the consequences of money lost for our clients, as we have successfully accomplished over the last decade of wild swings. However, there are positives to be considered, particularly after market declines have reduced investment risk for clients.

We see the fact that our politicians are dealing with debt problems as a major positive for the long-term health of the investment markets that may even have a positive short-term impact. You have to give them credit given the nature of politics and the fact that it has been estimated that well over half of all Americans are net tax beneficiaries of government spending. Perhaps their efforts will lead to structural changes in both spending and taxation that will be beneficial to longer term fiscal health and economic growth. Economic studies, repeatedly find that structural changes in government’s spending, particularly if not heavy on taxes and accompanied by monetary easing, tends to have a favorable economic and investment market outcome.

Furthermore, near-term economic statistics continue positive, even if slowing. These positive statistics include many sectors of our economy, including industrial output, exports, and employment. Even tax revenue seems to be coming in ahead of expectations as suggested by not only recent Federal but state tax receipts as well (see previous page). Lower energy and other commodity prices put more money in consumers’ pockets and also serve as a brake on inflation expectations, helping to keep interest rates low.

Overall, we are optimistic that the markets will provide opportunities to generate positive returns with minimal volatility and risk of serious losses for our clients. We increasingly are being flattered by the adoption of our approaches to avoiding risk by a number of money managers and new mutual funds – even if this new product comes a decade late. Asset protection or risk management now seems to be the mantra of more and more investors, including leading pension and endowment funds. In the end, generating a consistently positive return that our clients can take to the bank regardless of market conditions is the goal. We thank you for your confidence.

Questions are always welcome. Please feel free to give us a call (800-777-0818 or pvg@pvgassetmanagement.com) for greater explanation or just to get more of a feel of our current thinking. For additional information on our thinking, please also visit <http://pvgassetmanagement.wordpress.com/>.

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