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THE FSAG ADVISOR

Market & Economic Update

Recent economic data has generally been in line with a scenario of an economy that is still firmly improving. The ISM manufacturing survey for March was above the 50 mark for the eighth consecutive month and is now at its highest level since the summer of 2004. Forward-looking indications are that strong production levels should continue. Also, data has shown a continued comeback in consumer spending levels and in retail sales, also positives for the broader economy.

Additionally, inventory levels have been rising as companies continue to rebuild from an incredible depletion of inventories that occurred during the recession. Even the beleaguered housing market has been showing improvements, with the Case Shiller home price index in January showing the eighth month of upward moves.

Perhaps most importantly, the March payrolls report showed that 162,000 jobs were created for the month; 123,000 of them from the private sector with the rest from the hiring of census workers. The report also showed some upward revisions to private sector jobs hiring from January and February. Although the March figures were slightly less than expected by most economists and while the unemployment number was unchanged at 9.7%, we believe the turnaround in jobs growth is significant and helps point the way forward for accelerating jobs growth into the spring and summer.

Some of the downside risks include: ongoing credit related issues (in the Euro region), the possibilities of premature policy tightening (in China), and a slowdown in the rate of economic growth in Asian economies. These markets have been key drivers of global economic growth in recent years, but have been foundering a bit over the last six months. Additionally, we remain concerned about protectionist sentiment from Washington, DC. In all, equity markets have not been overly concerned about all of these risks, but these are trends that continue to bear close monitoring.

With the renewed rally, investor sentiment has moved back into the optimistic zone (a contrarian indicator). In addition, close to 90% of stocks in the S&P 500 were recently trading above their 10-week moving averages—a higher percentage than we saw prior to the January correction—resulting in the possibility of a near-term pullback.

We would continue to view mild corrections as a healthy part of any cyclical bull market and remain relatively optimistic on near-term prospects of the market continuing to grind higher.

Low volatility, as measured by the Volatility Index (VIX), is of concern to traders. It's often espoused that low volatility can't last forever and is considered to be a sign of complacency, which can lead to a corrective phase for the market.

2010 Returns

DOW	*4.82%*
S&P 500	*5.41%*
NASDAQ	*5.91%*
Russell Small Cap	*8.85%*
Russell Mid Cap	*8.67%*
MSCI EAFE	*0.87%*
Barclay US Agg	*1.91%*
Barclay Muni.	*1.42%*

Investment Implications of Health Care Reform

We need to recognize that in discussing this issue, like any other issue in investing, it is critical to leave politics and emotion to one side. People have very strong opinions on all sides of the health care debate – they are entitled to those opinions. These comments are solely focused on the investment implications of the combined bills.

Passing over the generally recognized positive of expanding coverage to roughly 30 million of the 50 million U.S. residents who don't currently have insurance, what does it all mean for the economy and markets?

Taxes

The most obvious quantifiable impact of the bill is an increase in taxes for upper income Americans, particularly on investment income. Starting in 2013, the Medicare tax rate on households with income over $250,000 will be increased from 1.45% to 2.35%. In addition, a new 3.8% Medicare tax will be introduced for the same group on investment income.

Currently, the tax rate on dividends and long-term capital gains is 15%. In 2011, those rates are expected to rise to 20% for households earning

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Got Stock? The Long and Short of Capital Gains

If you buy or sell shares of stock, you need to be familiar with the rules that govern the way capital gains are taxed. That's because the amount you owe in tax can depend on a number of factors, including the length of time you hold the shares and the federal income tax bracket you're in. Here are the basics.

Basis and holding period

"Basis" refers to your investment in the shares of stock you hold. Generally, your basis is the amount you paid for the stock, plus any commissions you paid to purchase the shares. (Note, however, that special rules apply if you received the stock as a gift or as part of an inheritance.) If you sell a share of stock and the sales price--less any commission--is more than your basis, you have a *gain*; if the amount you receive is less than your basis, you have a *loss*.

Your holding period is generally the length of time that you hold a share of stock before you sell or exchange it. If you hold a share of stock for a year or less before selling it, any gain you have is *short-term* capital gain. If you sell a share of stock after holding it for more than a year, any gain is *long-term* capital gain. Your holding period typically starts on the trade date the share is purchased, and ends on the trade date it's sold.

Short-term capital gain

Short-term capital gain is treated as ordinary income, just like interest on your savings account or wages from your employer. It's added in with all of your other income, and the amount of federal income tax you owe depends on the federal marginal income tax bracket you're in. For example, if you're in the top tax bracket in 2010, you'll pay tax on ordinary income at a maximum rate of 35%.

Long-term capital gain

If you sell shares of stock that you've held for more than a year, any gain is long-term capital gain, and special maximum tax rates apply. If you're in the 10% or the 15% marginal income tax bracket in 2010, you'll pay no federal income tax on long-term capital gains (a "0% tax rate" applies). So, for single individuals with taxable income of $34,000 or less ($68,000 for married individuals filing jointly), long-term capital gains are federal income tax-free in 2010.

For those who aren't in the lowest two federal income tax brackets (i.e., those in the 25%, 28%, 33%, and 35% brackets), a 15% maximum tax rate generally applies to long-term capital gains. There are limited cases, however, when individuals in the higher tax brackets can still benefit from the 0% tax rate.

For example, a retired couple with taxable income of $60,000 would be in the 15% marginal income tax bracket in 2010 if they file jointly (the bracket covers married couples with taxable income less than or equal to $68,000). The couple sells stock, resulting in a long-term capital gain of $40,000. This increases their taxable income to $100,000, placing them in the 25% marginal income tax bracket. In this situation, they would pay no federal tax on the first $8,000 of long-term capital gain, and the maximum 15% rate would apply to the remaining $32,000 in gain.

Offsetting gains with losses

Any capital losses that you may have realized during the year can offset some or all of your capital gain. If your losses offset all capital gains, any excess capital loss can be applied against up to $3,000 of ordinary income ($1,500 for married individuals who file separately), and any unused capital loss can be carried forward to future years.

Big exception: retirement plans, IRAs

All of this assumes your stock is not being held in a tax-advantaged retirement account like a 401(k) plan or IRA. Special tax rules apply to investments, including stock, held within these plans. If you sell shares of stock within one of these plans, there's no immediate tax consequence. Instead, you'll generally pay federal income tax when you take withdrawals from the plan, and any income will be considered ordinary income--even if the earnings are attributable to capital gains. (Certain Roth retirement plans and Roth IRAs provide for tax-free treatment of qualified withdrawals.)

Uncertainty in 2011

The special federal income tax rates that currently apply to long-term capital gains expire at the end of 2010. Absent new legislation, in 2011, individuals in the 15% tax bracket (under current law the 10% bracket disappears in 2011) will pay tax on long-term capital gain at a rate of 10%. For everyone else, a 20% rate will generally apply. Special rules (and slightly lower rates) will apply for qualifying property held five years or more.

Tax Rates Needed to Reduce Deficit to 3% of GDP in 10 Years: Three Alternatives

Marginal Income Tax Rates

Current Rates	Raise All Rates	Raise Top Three Rates	Raise Top Two Rates
10.0	13.7	10.0	10.0
15.0	20.6	15.0	15.0
25.0	34.3	25.0	25.0
28.0	38.4	52.6	28.0
33.0	45.2	61.9	72.4
35.0	48.0	65.7	76.8

Rates on Capital Gains and Qualified Dividends

Tax Bracket	Raise All Rates	Raise Top Three Rates	Raise Top Two Rates
10.0	0.0	0.0	0.0
15.0+	20.6	28.2	32.9

It's worth noting that the 3% deficit/GDP ratio was selected because it represents the upper end of the threshold at which policy is perceived to be sustainable over the long run.

Source: Morgan Stanley

Chart of Interest: S&P 500 Through the Financial Crisis

Source: Invesco

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over $250,000, and with the new Medicare tax, these rates will rise to 23.8% for the same group. Under current tax law, investors get to keep 85% of the income stream from taxable stock market investments. Under the new law, this will be cut by 8.8% to 76.2%, reducing the value of the income stream by 10.4% (that is 8.8% of 85%). This is obviously a significant number. However, it is worth noting a few things about this:

- First, this bill does not put stocks at a further disadvantage relative to fixed income. The maximum federal tax rate on bonds and cash accounts is currently 35% and with tax changes coming in 2011 combined with these changes, that maximum rate will rise to 43.4% for households with income over $250,000 in 2013.
- Secondly, we've been here before. On average, over the past 40 years, the maximum federal tax on capital gains was 24.7% and the maximum tax rate on dividends was 44.6%.

Medical Care Industry

For the medical care industry, this bill will expand demand without much effort to rein in costs. A combination of federal subsidies and mandates will increase the pool of insured individuals, and while there are many constraints preventing insurance companies from limiting coverage, there are few that limit how much they can charge for it. The pharmaceutical industry will benefit from this, as well as a plan to remove the donut hole from the Medicare prescription drug benefit program by 2020.

The Economy

Despite dire predictions, it's not clear that health care reform will really slow economic growth that much. Most of the tax provisions don't kick in until 2013 and the mandates on businesses and individuals don't kick in in a big way until 2016. Between now and then, the economy is quite capable of staging a full cyclical recovery. It may be that businesses will, in the end, be forced to pay more for the health care of their workers – however, overall, American business is quite capable of limiting wage increases to add to benefit costs.

Source: Dr. David Kelly, J.P. Morgan

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Stock in the News: Applied Materials (AMAT)

Applied Materials (AMAT) is the largest manufacturer of semiconductor equipment in the U.S. The company develops, manufactures and services integrated circuit (IC) fabrication equipment, including products used in deposition, etching, ion implantation, metrology, wafer inspection and mask-making.

AMAT has made several acquisitions over the past few years, which have expanded its presence in flat panel displays, provided access to a new market segment (clean energy), and helped in the development of nano manufacturing technology. The company's acquisitions of Baccini S.p.A in 2008 and Advent Solar in 2009 have expanded its presence in the solar market.

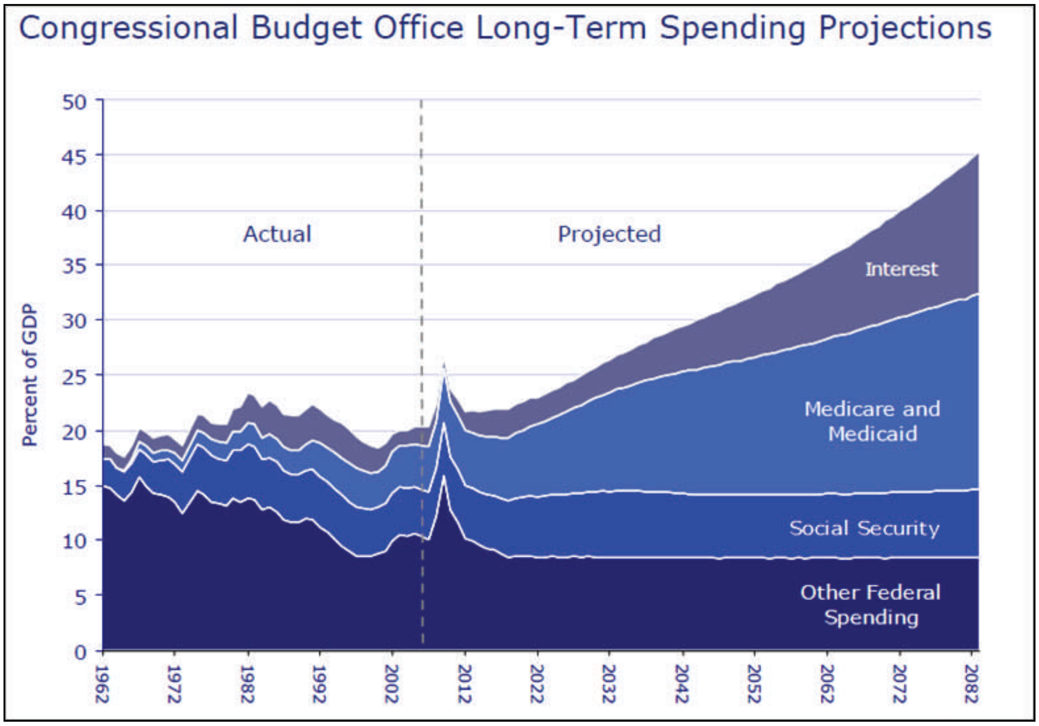
For a third consecutive quarter, AMAT sharply exceeded consensus expectations. The company also meaningfully raised its top-line guidance for the fiscal 2010 year. The best performance in the quarter came from the company's core business of semiconductor capital equipment manufacturing, where orders shot up 80%.

Key Statistics: AMAT

Price	*$13.35*
Trailing EPS	*($0.07)*
Estimated EPS	*$0.73*
EPS Growth Forecast	*11%*
Current P/E	*18X*
PEG Ratio	*1.6X*
Dividend Yield	*1.8%*
Market Cap	*$17.9B*
52 Week High	*$14.94*
52 Week Low	*$10.31*
Beta	*1.07*
ROE	*12.8%*

Sources: Morningstar, S&P Stars, & Argus

Chart of Interest



Note: The above chart does not take into consideration the passing of the Health Care Bill. *Source: Invesco*

Noteworthy News

Market: As of March 29th, the market has gone 24 sessions without a decline of 1% or more, and 89% of the stocks in the S&P500 are now trading above their 50-day moving averages. The Dow has advanced in 17 of the past 21 days.

Taxes: If the Administration does not enact a new tax law, the tax rate on dividends reverts to the pre-2001 rates, which are the same as rates on ordinary income – 39.6% at the top bracket.

Treasury Yields: Last week's bond auctions did not go well. It seems that Japan and China did not show much interest. The 7-year Treasury note yielded 3.29% versus 3.05% a month earlier. April is a cruel month for the Treasury market, with 10-year yields rising in each of the past 4 Aprils and in 6 of the past 7 and by an average of 25 basis points.