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2011 ECONOMIC FORECAST

STATE OF THE U.S. ECONOMY

The economy has surprised on the upside demonstrating a sustainable moderate growth pattern after surviving the most severe recession in post World War II history. In an environment of benign inflation, low interest rates and a depreciating dollar, our economy has been a direct beneficiary of the rebalancing of global demand found in the emerging and other developing economies. Especially in countries such as China and India, their consumer demand is in the early stages of a self-feeding domestic economic progression. Our domestic demand will receive the short-term stimulus associated with the Bush-era tax cut extension, the 2% reduction in the employee Social Security and the extension of unemployment benefits. However, our exploding federal deficits and the related $14 trillion in national debt plus unfunded fiscal obligations, unrelenting real estate downturn and persistent unemployment will continue to be a drag on consumption and the overall economy in the long-term. Given the Fed's quantitative easing, inflation may rise but remain both moderate and manageable and short-term interest rates should stay relatively low. However, long-term interest rates should trend higher, given the inflationary expectations of the Fed's policy response to the deflationary forces in our economy. Although a double dip recession is not in the cards, the path to recovery remains crowded in both risk and uncertainty. No recovery is the same. What makes this cycle different from all others is that it will continue to feel as though we are still in a recession until the unemployment trend starts to unwind, which may take four to five years to reach full employment. **It is more probable than remote that the U.S. economy will continue to surprise on the upside against the backdrop of improving global economic fundamentals, domestic demand, corporate earnings and the success of the Fed's experimental policy of quantitative easing.**

THE GOVERNMENT SECTOR

Ben Bernanke and the Federal Reserve's implementation of their unprecedented monetary intervention have been successful in avoiding a global depression. Bernanke clearly recognizes that our 2010 anemic growth approximating 2.8% GDP clearly falls short of the economy's ability to reverse the unemployment trend. The prerequisite to a sustainable expansion lies in job creation and reversing these deflationary forces that continues to infect our economy and especially the real estate sector. The Fed recognizes that deflation is the most destructive underlying force in any modern day economy. Bernanke believes the best way to cure this deflationary disease is with an inflationary injection. Either way, the Fed will continue to do whatever it takes to reflate demand. Bernanke, our leading expert on the Great Depression, is employing Milton Friedman's belief that the Great Depression could have been avoided had the government acted as a lender of last resort and

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purchased government bonds with the objective of increasing liquidity in the economy to boost growth and avoid deflation. This is called **Quantitative Easing** and represents the Fed's inflationary injection. Bernanke is currently in round two of this program (QE2), which should not be confused with the retired luxury cruise ship. The intended goal of QE2 is to raise inflation expectations, reduce the cost of borrowing and depreciate the dollar. The Fed's expectation to arbitrarily inflate asset values in every class shows signs of success as evidenced by the 2010 year-end run up in both the stock and commodity markets. As consumers' wealth increases along with the stock market appreciation, they become more likely to spend and businesses become more likely to invest in capital goods, ultimately leading to job creation. The Fed hopes asset inflation will eventually pour over into the housing sector recapitalizing our banking system and promote their lending practices. So there is no misunderstanding, consumers are the drivers of our economy while credit is the fuel for their economic engines. The corporate sector's level of confidence is expected to rise against a backdrop of both enhanced consumer spending and export profits resulting from the depreciating dollar and global rebalancing. **All of these positive factors will lead to higher employment and sustainable growth.**

Quantitative Easing

There is no one who can predict how quantative easing will play out given Bernanke is traveling in uncharted waters. On the upside, there is a school of thought that believes it may be partially successful. But on the downside, there are those who believe that it will overshoot its intended results triggering uncontrollable rapid inflation, asset bubbles in both the equity and commodities markets and potential currency wars. The Fed will probably fall short of their objective requiring round three in the second half of this year. Notwithstanding asset inflation is clearly their intent; core inflation is not a bi-product of the massive expansion of the government's balance sheet. Core inflation should only rise during economic expansions when the demand for goods and services exceeds the economy's ability to supply them. For this to occur, the banking sector would need to expand credit by freeing up the reserves they are currently holding sourced from the Fed's quantitative easing. When the expansion starts to heat up, the Fed would normally start selling off some of their assets and raise the federal discount rate to counteract any inflationary forces. However, monetary policy is more likely to err on the side of ease resulting in higher inflation down the road. Many of the world leaders, economists, U.S. politicians and even some of the Fed officials believe that the QE2 will destabilize the global recovery. Their beliefs of currency wars / competitive devaluation and a dollar crisis are clearly overstated. At this stage of the cycle, none of the developed economies in the world want to see their currency appreciate. This would have a negative impact on their export recoveries. Obviously, not every country can maintain a weaker currency and therefore, exchange rate policy will become problematic in the long-term. On the upside, QE2 will promote global expansion by forcing other developed countries central banks to become bias towards an easy monetary stance in order to prevent appreciation in their currencies. This should represent the policy of choice rather than trade protectionism consisting of tariffs and import quotas. So long as U.S. inflation remains relatively benign, foreigners will be reluctant to sell off U.S. assets in a world where developing / emerging countries' currencies are undervalued in relationship to their developed countries counterparts. **Either way, the prerequisite global rebalancing rests in the China connection.** The enormous expansion found in the emerging world has attracted substantial capital inflows given the low real interest rates in the developed world. No matter what emerging countries do to counteract the inflationary implications of these substantial capital inflows, whether it be capital controls, surcharges or otherwise, investor sentiment will not abate. **This sets the conditions for the next asset bubbles and investment mania in both emerging and commodity markets.**

Fiscal Disequilibrium

The era of fiscal irresponsibility consisting of 40 years of excessive governmental deficit spending and the creation of the great American debt society must be reversed. Otherwise, the financial markets will react violently. The mid-term elections gave the Republicans control of the House and six more seats in the Senate. The new Congress must pass a huge spending bill in order to keep the government running in February and the greater challenge probably in spring when the federal debt ceiling reaches its limit of $14.3 trillion. Our current federal debt is $14 trillion growing by $4 billion a day. At this rate, the national debt will hit the ceiling on or before March 21st. The entire world will be watching given their understanding that our enormous national debt trajectory is clearly unsustainable. The General Accounting Office forecasts the 2011 national debt at 100% of growth domestic production (GDP). By 2080, it is projected to be 600% given the demographic implications of the baby-booming generation. Like our public companies, if the U.S. government is required to utilize generally accepted accounting methods as promulgated by the A.I.C.P.A., they would have to record unfunded obligations consisting of Medicare, Medicaid and Social Security. The present value of these unfunded obligations is estimated between $52 to $200 trillion. Using the average of these unfunded liabilities this would equate to almost $600,000 of debt for every U.S. citizen. The long-term risks to our economy would be devaluation of the dollar, excessive interest rates, unmanageable inflation and below trend economic growth. The solutions offered by the Bi-partisan debt committee were deemed unacceptable by both the Republicans and Democrats before the mid-term election. **Yes, our government is clearly insolvent.** The writing is on the wall, something has to give and the solutions lie in the choices of raising taxes, cutting entitlements and discretionary spending, debt monetization and or outright bankruptcy. **Failure of our new Congress to act appropriately with respect to the budget and debt ceiling will cause turmoil in the global financial markets.**

The Super Cycle of Debt

The debt super cycle remains intact. This represents the Fed's policy of injecting liquidity into the system in order to reflate demand to counter the deflationary risks in the economy. This is the basic theory behind supply-side economics also known as Reaganomics. Keynesian economic theories advocated that governments during periods of economic expansion should be able to set aside enough revenue in order to support the periods of downturns with fiscal stimulus. Since President Reagan, our political process bifurcated these theories and consistently reduced taxes and borrowed to finance their wars and excess spending. This is evidenced by the fact that our national debt did not exceed $1 trillion from birth of the nation to President Carter and is currently at $14 trillion. $12 trillion of our national debt is exclusively associated with the Republicans fiscal misconduct. The downside to the debt super cycle is that the buildup of economic imbalances during each expansionary phase never fully unwound which normally occurred during economic downturns, causing a severe decline in growth. Our new Congress appears to be more fiscally responsible and against deficit financing. Since the recession, the debt super cycle has gone through a metamorphosis from the private sector to that of the government sector. The government has leveraged itself up through quantitative easing. The Fed has been purchasing bonds in the marketplace and placing the proceeds with the banks who are sitting on the reserves that were meant for lending which created a liquidity trap. This policy action was designed to lower interest rates yet long-term rates actually rose about 60 basis points in the past month. This unintended result may be attributable to better economic fundamentals or investors' demand for a higher risk premium. If QE2 does not meet its intended results then the Fed may do a third round starting mid-year. Otherwise, the Fed can monetize deficits by printing money and purchasing their own bonds which would be a direct injection of liquidity into the system. **This Fed action is clearly inflationary by nature and is in substance nothing other than a sovereign Ponzi scheme.** However, Bernanke did not need to discuss the scheme with Madoff or Rothstein. The Fed will continue to do whatever it takes to reflate demand and smooth out the business cycle. **On the downside, it is absurd to believe that the government can continue to borrow their way to future prosperity.** On the upside, the Fed still has monetary and fiscal tools at large. If all fails, the Fed can nationalize the banks and ultimately become the employer of last resort. **Either way, if there is one person in the world that I would want navigating our economy through these turbulent waters, it would be Ben Bernanke.**

FINANCIAL SECTOR

The massive amount of liquidity is trapped in our largest banks who have been the direct beneficiaries of quantitative easing. Notwithstanding the minimal improvement in lending, in this environment there still remains a high degree of risk aversion in the entire sector preventing a normal flow of credit in the economy. Banks of all sizes will continue to remain cautious with respect to the declining values of any collateral in this deflationary cycle. The sector needs to be divided into two categories. The first are the large banks considered too big to fall and the second consists of the smaller regional and community banks. All the banks are still carrying toxic assets on their balance sheets that are of questionable value such as $2.4 trillion in mortgages and more than $1 trillion in mortgage-backed-securities. The large banks are facing years of enormous litigation that will force them to mark-down their assets and require them to buy-back tens of billions of dollars of non-performing mortgages that they originated, securitized and sold to investors. This is occurring simultaneously as their profits are being squeezed by the Obama banking regulations and the increase capital requirements due to the Basil III International Capital Standards coming into play. Yet, the U.S. Treasury actually made a decent profit on selling their stake in CitiGroup. To add insult to injury, these large institutions invested their excess capital reserves sourced from quantitative easing into the equity markets rather than lending it out. The Fed's failure to act on behalf of the smaller institutions has fueled their crisis. Although last year I predicted 150 bank failures, the actual number was 157 representing an 18 year high since 1992. In this environment of the prolonged foreclosure crisis and with both residential and some commercial real estate values more likely to fall rather than rise, 2011 will surely grow uglier for bank failures than in preceding years. The FDIC has 860 institutions on their watch list with Florida leading the nation. I suspect 150 to 200 additional banks will fail in 2011. Credit fuels the wheels of economic activity and banks are the engines running out of gas. The community banks represent the back bone of lending to small businesses that generate 60% of all jobs and for local commercial and residential real estate. These institutions have great difficulty in raising new capital and are vulnerable to any future economic shocks. In order for the Fed to induce job creation lending, it needs to take positive action and act as a guarantor for both the business and commercial real estate loans held by community banks. On the upside, the large institutions have deleveraged themselves to the extent their capital reserves-to-asset ratio is at the highest level since the Great Depression. This will enable them to absorb any future financial shocks. **On the downside, the regional and commercial banks without support from the Fed face extinction and or consolidation as evidenced by many Canadian banks' planning acquisitions of U.S. banks.**

CORPORATE SECTOR

Corporate America has demonstrated strong earnings growth in 2010 in an environment of low interest rates, benign inflation, a depreciating dollar and global rebalancing. Their profit margins benefitted from gains in productivity primarily due to enormous cost cutting that contributed to the unemployment crisis. However, this trend will not continue. Almost 50% of their top-line revenue growth was earned overseas. With the dollar trending lower, we will witness enhanced rebalancing in global demand as the expanding emerging economies continue to support our exports and with it the potential for top-line revenue growth in our corporate sector. Their profit margins will be squeezed against the background of rising commodity prices. Even though these costs will not be able to be passed unto their customers, their pre-tax profits will still grow above trend given their expected top-line revenue expansion. It is the growth in profits that is a prerequisite to job creation. Other than the financial sector, their balance sheets remain in excellent order. They are holding $2 trillion in unrestricted cash reserves which gives them the working capital to fuel acquisitions and expansions. On the upside, corporate bankruptcies have declined by more than 50% since last year. However, as the recovery progresses there will still be corporate survivors and the ones that fall from grace. Bond insurer, **AMBAC** was debonded and defaulted into bankruptcy representing 2010's largest case. Grocery giant **Great Atlantic & Pacific Tea,** owner of A&P Supermarkets, got carted into bankruptcy due to competitors such as Wal-Mart and Whole Foods. The **National Inquirer** ran out of ink and declared bankruptcy primarily due to the free content on the Internet which did not need ink. **Blockbuster** got busted by Netflix and rewound itself into the bankruptcy court. This constructive trend of declining bankruptcies will continue as the economic recovery takes hold. **Given these positive forces and improvement in consumer demand, it is more probable that corporate America will beat earning expectations which will bode well for the equity markets.**

CONSUMER SECTOR

On the downside, the minority of consumers are either in fear of losing their jobs or unemployed. They have over extended themselves and are subject to debt derailment. Their deleveraging will continue to persist in the long-term causing a drag on consumption. Although consumer debt levels remain high on a historical standpoint, the predominance of the deleveraging directly resulted from defaults rather than voluntarily repayments. In 2010, 1.53 million Americans filed for personal bankruptcy representing a 9% increase. This trend will continue as these consumers struggle with their excessive debt in an environment of uncertainty. Although there was a weak improvement in employment, 14.5 million Americans, the lowest since April 2009 remain unemployed. The government would have you believe that the unemployment rate is 9.4 %. When you add those who had been unemployed for more than one year, quit looking for jobs and those who settled for temporally work, the rate actually becomes more than 22%. The largest contributors to the unemployment crisis will be federal, state and local governments against the backdrop of sever spending cuts required to balance their budgets. The unemployment trend in the near-term is more likely to rise rather than fall given the temporary Christmas seasonal employment. Although corporate America's job cutting mentality may be limited in this stage of the cycle, even very profitable companies have adopted this mind set in both mergers / acquisition for the necessity of improving their bottom lines. **Pfizer**, as a result of its merger with **Wyeth,** cut 19,000 jobs giving everyone the blue pill, Viagra, with their pink sheets. Fifteen hundred employees involuntarily seceded from **United Technologies** and, after their announcement, their stock traded near a 52 week high. Navy defense contractor, **Northrop Grumman** shipped out almost 1,000 jobs and sent them to Old Navy with jean discount coupons. Seventeen thousand five hundred employees got jerked from **Merck** for failing drug tests. **Verizon** discommunicated 13,000 employees and sent them to church. The **City of New York** sent 11,000 employees to Arizona for deportation hearings. Finally, the **U.S. Postal Service** delivered 30,000 to the unemployment line via priority mail. In this moderate growth recovery, it may take four to five years before we reach full employment, defined as a 5% unemployment rate. **Notwithstanding all the negative economic implications associated with this group of consumers, their plight should not cause a double dip recession.**

On the upside, the majority of consumers are fully employed and contrary to the general belief they are not subject to debt derailment. Their personal balance sheets may have lost value but remain healthy given the current stock market performance. The retrenchment in consumer spending was primarily related to the fear factor associated with the severe recession. This is now abating. 2010 produced the best holiday shopping season since 2006 which supports my theory of pent-up demand. As the global recovery continues to gain momentum, primarily precipitated by the emerging countries, the unemployment trend will slowly unwind. Pent-up demand, the two-year extension of Bush-era tax cuts, the one year extension of emergency unemployment benefits and the one year employee payroll tax cut will boost personal income, and with it, both consumer confidence and consumption. **It is this group's positive fundamentals that will enhance domestic demand, which may provide the prerequisite momentum to a sustainable recovery.**

IN-SUM: The U.S. economy is on a sustainable moderate growth trend that will accelerate along with the global expansion. The U.S. will be the primary beneficiary of global rebalancing. Our economy is in the midst of transformation from consumption to an export led growth. The expansion in our export sector is the prerequisite for unwinding our trade deficit and creating jobs. Although corporate margins are being squeezed given the rise in commodity prices, their top-line revenue will accelerate along with the global expansion which will bode well with pre-tax profits. To a great extent, the corporate sector's productivity gains associated with cutting costs have come to an end. So long as domestic demand continues on a sustainable trend, job creation will follow. QE2 has created asset inflation as reflected in the equity markets. With this enhancement in wealth and pent-up demand, the rise in consumer spending produced the best holiday shopping season since 2006. Credit is becoming more available and capital spending is starting to reaccelerate. Although inflation is rising, it will be manageable and remain low given the deflationary factors in the economy. On the downside, the prolonged contraction in the residential real estate market will continue to be a drag on the economy for many years to come. In order to balance their distressed budgets, state and local governments will implement austerity measures which will severely cut their spending. On a long-term perspective, the Federal government will face the enormous financial imbalances associated with the unfunded Social Security, Medicare and health insurance liabilities in addition to the demographic issues concerning the retirement of 78 million baby-boomers. Our national debt trajectory is clearly unsustainable estimated to be 110% of our GDP by 2015. The government's failure to properly address the unwinding of these imbalances will cause turmoil in the financial markets and chaos on the streets. **The outlook is full of risks and uncertainties. However, the downward trend in real estate is slowing with recovery insight. In addition, it appears governmental imbalances are in process of being reconciled. All the improving economic fundamentals are falling in line and accelerating along with the global expansion. These positive forces will outweigh the underlying risks enabling the U.S. economy to produce sustainable moderate growth demonstrating 3% to possibly 4% GDP in 2011. So that there is no misunderstanding, the Fed will do whatever it takes to promote perpetual prosperity whether it is round three of quantitative easing or debt monetization.**

STATE OF THE GLOBAL ECONOMY

The fears of a double dip global recession have abated. The global economies are divided into two categories. The first are the emerging economies which are inflationary. They have demonstrated spectacular growth during this recovery stage given their transition from export to consumption led growth. These countries are continuing to benefit from a self-feeding domestic economic progression notwithstanding the evolution of their economies are in their infancy stages. The continued rebalancing of consumer demand is the driving force fueling the global expansion. The demographic benefits of Asia, and more specifically China and India, have been the catalyst to this force which is spreading throughout the emerging world raising their living standards and with it, hopefully, redemption for the developed world's excesses. While number two represents the developed economies which are deflationary. They have demonstrated a dismal growth given their transition from consumption to export led growth against the backdrop of the contraction in consumer demand, excessive unemployment and governmental debt derailment. While on the upside, the entrenchment in consumer demand is reversing, inflation remains relatively benign, monetary policies are accommodative and government's austerity measures employed or planned will be the prerequisites to economic expansion. Global trade has clearly surprised on the upside and it will continue especially with the new free-trade agreements. So there is no misunderstanding, free trade is the evolution of economic progress and any deviation from this progression will place the global expansion in sever jeopardy. Although there are many risks to the outlook it may take four plus years to restore the global economy to pre-crisis levels. Global rebalancing is the primary driving force to world prosperity. We will witness living standards rising in emerging countries and falling in developed ones. **Although it may be difficult to surpass 2010, the odds favor global GDP will exceed 5% in a bifurcated environment where emerging countries' growth will substantially surpass that of the developed economies.**

CHINA: With the best demographics in the world, China is arbitrarily biased towards an easy monetary stance which is continuing to **overheat** their economy by reflating domestic demand on the upside and creating enormous global imbalances on the downside. That's why they call it **Red China**. Since they peg their currency to the U.S. dollar, they have in substance, adopted the U.S. overly accommodated monetary policies which is clearly destructive to an economy that expanded at an incredible pace of 10% in 2010. Their lack of action on their yuan policy has become the catalyst to excess speculation and has resulted in both asset and core inflation and an enormous current account surplus. **It is China that holds the global rebalancing card.** Given their current inflationary environment, it is more likely they will allow the yuan to rise rather than risk a trade war with the U.S. The fear of a currency war with China is unfounded. If China decided not to support the U.S. dollar, the Fed would employ quantitative easing and buy up their vast treasury holdings, the dollar would fall and our exports would become more competitive. In addition, the U.S. represents a major export market for their goods. China will probably raise their interest rate 25 basis points at least 3 times during 2011 and permit the yuan to fall 5% or more but not near the level necessary to unwind our trade imbalances. China is actually a poor country with per-capita income at only $7,500. However, its spectacular growth and prosperity is producing an expanding middle and wealthy class. This has been the stimulus to their retail sales growth averaging 17% over the past five years. They are also producing an enormous military machine which includes stealth bombers. President Reagan won the Cold War by bankrupting the Soviets due to our excessive military spending. Can we afford a **Red War** with China? The U.S. is already insolvent. China's demographics will enable them to absorb any excess capacity in their system. Despite the fact that their overvalued real estate sector is at risk for a correction, it was not created by unmanageable debt. Minimum down payments are 25% and the predominant of real estate is acquired with cash. **Yes, China's authorities have become hooked on the debt super cycle process.** Even if their banks hold toxic assets, they are basically government owned and will survive any financial crisis. Their foreign reserve holding of approximately $3 trillion makes China more fiscally sound than most other nations in the world. As China's faith in foreign currency reserves fade, they will become one of the world's largest purchasers of gold. **The odds favor an 8% to 9% growth rate and a 5% or more appreciation of their currency even though 10% would be appropriate to unwind the existing global imbalances. Even though a near-term economic slowdown may be in the cards, China equities may be the markets star performers in 2011 and thereafter.**

INDIA: The world's second largest democracy, has demonstrated growth of 8.6% GDP. Their policy makers induced domestic-demand driven by an environment of easy money and aggressive fiscal policy. Their massive policy response resulted in higher inflation, an expanding current account deficit and tight inter-bank liquidity attributable to contraction in deposit growth. Although their authorities would like to push their growth rate to 10%, they will need to implement monetary restraint probably to the extent of 100 basis points gradually over the year. This will continue to be a positive influence on foreign investment inflows. Their consumer demand driven growth trend will remain intact given their positive demographics. At this stage in their expansion, their authorities will be able to gradually remove both monetary and fiscal policy support, transforming growth driven by the private sector rather than by the government. **All of these fundamentals support a continued sustainable expansion that may surpass the rest of the world. The odds favor 9% to 10% growth rate in 2011.**

JAPAN with the worst demographics in the world, consisting of the oldest population, continues to remain in their protracted deflationary stagnation. In response to both fiscal policy and improvement in corporate earnings, they actually produced growth of 3.7%. Although the benefits of fiscal policy measures will fade in 2011, the fears of a double dip recession are abating. Japan will clearly benefit from their Thailand free-trade pact and the China and emerging world export dividends. With their gross public debt projected to exceed 200% of GDP, their authorities no longer have the fiscal cards to play. The Bank of Japan needs to employ the inflationary injection of quantitative easing in order to fight their long-protracted stagnation. This will require aggressive monetary easing. The yen would fall enabling their exports to rise which is a prerequisite to reversing the deflationary stagnation that they have been subject to for 22 years. **Japan could produce 2% GDP and if the yen trends lower against the dollar, their stock market could rise suggesting a contrarian investment play.**

EUROLAND and THE U.K.: The sovereign debt crisis has temporarily abated. However, debt defaults could erupt down the road, possibly within two years. On the upside, Germany will remain the star performer while France is in the early stages of expansion driven by domestic demand. On the downside, both Greece and Ireland are in insolvent while Portugal and Spain's debt crisis are associated with liquidity issues. The severe contraction in economic activity that occurred in both Euroland and the U.K. was the direct result of the sudden collapse in real estate values in a deflationary environment. Many believe if Spain defaults on their sovereign debt it would possibly be a death sentence for the Euro. This probability is clearly remote given the fact that their bank collateral includes personal guarantees that are not dischargeable in bankruptcy. The mortgage debt further appears to be manageable since only 8% of borrowers are upside down as compared to 22% in the U.S. **The Euro is destined to doom in the long-term.** The members need their own currencies to expand their money supplies to become more competitive in the global marketplace.

Without this flexibility they are forced to implement anti-prosperity austerity measures that will result in years of uncontrollable unemployment triggering both price and wage deflation. The E.U. mandates to restore fiscal order are unsustainable and add to the cost of sever contractions in economic activity for their members. Their authorities (ECB) have engaged in buying member's debt which will probably avoid any future sovereign debt defaults on a temporary basis. It is plausible that the ECB will implement quantitative easing in Euroland once they determine the brutal austerity measures required by the members are counterproductive and they recognize the necessity to devalue their currency in order to promote their export sectors. While in the **UK**, their economy and export sector has benefitted from their 20% currency devaluation against the Euro over the past three years. However, their massive austerity measures will become a major drag on their growth. Their contraction in government spending may cause unemployment to rise by possibly 10% equating to 1/2 million jobs lost on a long-term perspective. Although their real estate values may continue to contract by 10% or more, any further depreciation may be limited in their high inflationary environment. **Both Euroland and the U.K. will demonstrate the slowest growth in the world producing GDP of 1.5% and 1.7% respectively. Even though the U.K. growth is despicable, their downside risks are limited suggesting a contrarian investment play.**

RUSSIA has the worst demographics in Euro-Asia given their aging population. Their economy clearly showed signs of expansion for the first half of the year until it fell due to a contraction in their export sector and retrenchment in consumer spending. Notwithstanding their inflationary pressures, their authorities will be biased towards monetary ease until domestic consumption improves and the economy displays signs of expansion. The Kremlin will implement fiscal stimulus in order to reflate demand before the scheduled parliamentary and presidential elections in 2011 and 2012 respectively. The government will continue its practice of privatization in order to finance their fiscal deficits at the cost of foreign investor capital inflows. Foreign capital will further contract given the geo-political risks associated with the violent incidents that occurred in their north Caucasus. This lack of investor confidence will have a negative impact on the economy as Russia prepares for the Sochi Winter Olympics scheduled for 2014. On a positive note, their export sector will clearly benefit from their enormous reserves of natural resources in an environment of rising commodity prices. **Although Russia may still outperform this year, the odds still favor 3% growth rate. However, Russia remains corrupt and therefore, carries much greater investment risk considerations.**

BRAZIL / LATIN AMERICA: Most of the countries, with the exception of Venezuela, have demonstrated unsustainable levels of growth. Although growth will contract it will remain above trend against the backdrop of rising domestic demand and commodities export growth. The current inflationary pressures should be contained with Brazil, Chile and Peru restraining monetary policy, while Mexico will be biased to an accommodated stance in the short-term. The one exception is Chavez's Bolivarian Revolution, Venezuela. This corrupt oil based restricted currency country has difficulties attracting foreign capital. Venezuela can only rely on building external debt and the country is currently suffering rapid inflation at 28%. **Brazil** is the largest economy in the region. The star performer's economy will contract in their current environment where domestic demand substantially exceeds production. This has caused inflation to surpass the government's expectation requiring their central banks to tighten monetary policy. This will cause their already overvalued currency to further appreciate placing a drag on their export sector. Given the fact that the government intends on curtailing fiscal policy, it is more likely their authorities will limit the extent of their monetary restraint. Their preparation for the Olympics will place extreme pressure on their fiscal policy. Brazil has relied on foreign capital flows to finance their current account deficit at rates of 12% and rising, this becomes an expensive proposition. As such, Brazil, like many other emerging countries, are placing capital controls and/or taxing these inflows. This creates a risk premium on doing business in Brazil. Former President Lula da Silva's protégé, Ms. Rousseff, became president on January 1. She maintained during her campaign that she will continue the former leader's economic model that produced these stupendous growth rates that raised the living standards in the country. It remains to be seen whether or not, the president and her team, while struggling to make budget cuts in this environment will remain business friendly. **Although Brazil will show a major economic contraction it is more likely to show growth of 4% in 2011.**

AUSTRALIA continues to transform its export led economy to one based on industrial production and with it, a healthy and confident consumer sector. This investment spending is so profound that it will become the primary driving force to their expansion and improvement in their living standards. In an environment of low inflation, manageable unemployment and rising commodity prices, their continued expansion will persist on the upside. Their recent flooding catastrophe will have adverse implications in the short-term. **Australia will be one of the few countries to avoid contraction in economic activity and will likely show more than 3% growth in 2011. Although their 2010 equity markets were literally down under, Australia may be the comeback country in 2011.**

IN SUM: The world is in the midst of a sustainable economic expansion that may take another four years to reach pre-recessionary levels of growth. Absent any geo-political crisis, global GDP will expand at perhaps a slower pace but attain 4% to 5 % growth rate. The prerequisite to continued prosperity lies in rebalancing, reflation and deleveraging. The global expansion will be bifurcated into developed economies growing at a sub-trend pace between 2.5% to 3% versus the emerging economies with their strong economic fundamentals supporting above trend growth such as 4% for Brazil and 10% for China.

- **Rebalancing** will occur as the emerging economies transform from export to consumption led growth in an inflationary environment while the developed economies transform from consumption to an export led growth in an otherwise deflationary environment.
- **Reflation** will occur as the developed economies maintain an accommodative monetary stance to fuel consumption while the emerging economies will implement restraint to fight inflation.
- **Deleveraging** will occur in the developed economies to address the excess debt accumulated over more than 40 years which would include but not be limited to sever fiscal austerity measures, continued quantitative easing and possible debt monetization and at worst and although remote, sovereign debt defaults.

Emerging countries' performances, especially China and India will continue to expand by more than twice the rate of the developed nations such as U.S., Euroland and the U.K. The greatest risk facing the emerging economies is inflation, while currency wars / competitive devaluations and possibly even stagflation are the greatest risks facing the developed countries. Although many believe a sovereign debt crisis is a major risk, it needs to be mentioned but the odds are remote. **The global expansion is in its early stages and will take on momentum and surpass expectations alleviating the misplaced fears of a double dip recession.**

GEO-POLITICAL RISKS

The quest for peace and freedom will continue in the year of living, perhaps more dangerously than in the past. The demographic trends dictate continued political instability, tribal feuding, civil wars and terrorism in the Islamic world. As we are all well aware, no border and no country are immune from terrorism. **Iraq**: The Bush war was predicated on the fact that Hussein had weapons of mass destruction. However, it was the U.S. who sold them the weapons to fight Iran. Against the backdrop of a fragile government consisting of feuding tribes, does anybody really believe that the evolution of democracy will reach the Cradle of Western Civilization? Our combat troops are scheduled to leave December 31, 2011 with America claiming victory at a cost of $768 billion and rising, excluding ancillary cost and the sacrifice of human life. So, show me the oil? **Afghanistan**: The country that is impossible to conquer. The Persians, Alexander the Great and the British Empire all conquered but could not control this country. The fall of the former Soviet Empire was the direct result of their bankruptcy from merely attempting to conquer Afghanistan. What was our policymakers and military thinking? We have been there for more than eight years, spent more than $367 billion and we are no better off than when we invaded. Our troops are scheduled to leave 2014. Sooner would be better. **Palestinian / Israeli Conflict:** Golda Meir said “Peace will come when the Arabs love their own children more than they hate Jews.” The only way that the Muslim world will understand the concept of peace is when they emancipate themselves from mental slavery, separate religion from state and grant women equal rights. Although the peace process in the Promise Land fell into the Dead Sea, the peace dividend may very well come to fruition, maybe, even without the Israeli participation. The Palestinians are actively opening embassies in countries that recognize them as a state. To date this consists of approximately 120 countries including China and most recently Brazil. They may consider declaring independence and seek recognition from the U.N. **Iran’s** second largest export is international terrorism. It is allied with Syria, supports Al-Qaeda and finances Hamas in Gaza and Hezbollah in Lebanon. Defiant Iran’s nuclear program is probably close to producing nuclear weapons and they have the missiles to carry them. The U.N. sanctions have contributed to their economic chaos to the extent that the citizens of the country may possibly revolt. In the mean time, the world sits watches and waits. But for how long? **North Korea** sank their neighbor’s navy ship and bombed one of their outer islands whose ownership has been in dispute forever. While there are many other conflicts such as **Samaritan Pirates** interrupting international trade, the **Ivory Coast** has fallen back into turmoil over their recent presidential elections and in **Venezuela**, Chavez threatens democracy on our continent. These world disorders give rise to both the climate and environment for future crisis, chaos and conflict. The cost of controlling these world disorders depletes our global limited economic resources and impairs our living standards. **There is no prosperity without world peace.** In this information age where borders are less important, we need an international fundamental change in philosophy. **We are one world, one people.** Let us pray to shed our differences whether it be religion, race, nationality or otherwise and recognize that we are all human being. **Amen.**

THE 2011 ECONOMIC FORECAST FOLLOWS:

So there is no misunderstanding all financial investment analysis and specific investment recommendations must be discussed with your financial advisors.

2011 ECONOMIC FORECAST

EQUITIES: **Who! Who! Who let the bulls out? Ben Bernanke!** The 2010 market surpassed my own expectations. The DOW closed the year at 11,578 producing a double digit rate of return of 11.03% in a year that had its dips but was otherwise a clear upward trend. The S&P 500 closed at 1,258 generating an impressive 12.83% annual return while the NASDAQ closed at 2,653 procreating a superb return of 16.92%. In the prior year, I predicted the DOW, S&P 500 and NASDAQ would close the year at 11,200, 1,220 and 2,500 respectively. While I expected the DOW to trade between a range of 9,500 and 11,500 in a year of turbulence, it actually traded between a range of 9,614 and 11,743. The market's remarkable performance was fueled by liquidity primarily triggered by QE2, better than expected corporate earnings and optimism associated with the global / emerging market's economic expansion. On a technical perspective, the prerequisite for a bull market run lies in equity valuations, earnings expectations and abundant liquidity. All of these fundamentals remain intact. Although corporate margins will be squeezed, historically, equities have done well after they have peaked. Pre-tax earnings in the U.S. may very well surpass expectations as our export sector's top-line revenue growth expands given the momentum in global rebalancing. Notwithstanding we are in the early recovery stage of economic expansion, the market will trend higher in an otherwise multi-year bull market that may extend two to four years. On a long-term basis, if our government fails to properly address our fiscal disequilibrium by the 2012 elections, the markets will react violently. On a short-term perspective, the expectations of a slowdown in China's expansion may trigger a correction primarily in commodity based equities within the first quarter. Although remote, a Euro sovereign debt crisis could erupt if the ECB fails to be proactive which would cause a global correction. However, if there is a selloff, it would be temporally because a bull market can coexist with rising yields during the recovery stage from what was otherwise extremely low levels. A sudden and sharp spike in U.S. long-term bond yields would also trigger a broad based global correction. On both a positive and probable note, the bull market will remain intact against the backdrop of sustainable accelerating global expansion, better than expected corporate earnings; enhance domestic demand and consumer confidence and ultimately the reversal in the unemployment trend. Either way, the continued long-protracted contraction in the residential real estate sector, the negative implications of deleveraging associated with real estate foreclosures, bank failures and both personal and corporate bankruptcies will all continue to be a drag on the market for many years to come. The odds favor a continued rally as the market transcends from a liquidity / optimistism base to one that is driven on the economic fundamental of earnings. **Yes, the bull market remains well entrenched**.

IN SUM: Reflation trade strategies, ones that favor stocks over bonds, will continue to outperform during this global expansion. Mid and small caps historically outperform in this environment. On both the structural and long-term perspective, emerging markets will outperform Wall Street and will become a larger staple in portfolios. Investors should consider exchange-traded Funds (ETFs) with an overrated exposure in the emerging market star performers of China, Taiwan, Singapore, Indonesia and Australia and while the commodity bull market remains intact, Brazil. Avoid corrupt Russia, stay away from Euroland and India appears to be overvalued and probably will suffer a credit crisis. If the yen falls against the dollar, uninspiring Japan may very well prove to be a profitable contrarian play. With respect to sectors, consider overweight position in technology, energy, select industrials and commodity based equities and underweight positions in financials, real estate and consumer discretionaries. However, the investment banks need to be carved out from the financial sector since they will profit from new issues and merger and acquisition activity. Although we may reach the DOW's all time high of 14,164 within two years, if the U.S. government does not address its fiscal disequilibrium, interest rates could ultimately hit double digits and the bull market will ultimately come to an end. Given the positive global fundamentals, the U.S. market could surprise on the upside. Emerging markets and commodities will continue to outperform any other investment in this environment.

> **Absent any geo-political and/or natural disasters and assuming the emerging economies' inflationary pressures and the developed economies' deflationary pressures start unwinding while our Fed remains biased towards easy money, retains liquidity in the system and allows the dollar to depreciate without crisis, the DOW may trade between a range of 10,800 and 13,500 closing the year at 13,000. The NASDAQ and S&P 500 may close the year at 1,450 and 3,100 respectively. The trading year may be one of elevated turbulence where the market will rise on good news and fall on bad. The market may be vulnerable to a near-term correction / contraction possibly in the first quarter given the expectation of a slowdown in China and possibly Congress' failure to properly address the budget deficit and national debt ceiling. This will represent a buying opportunity rather than a bear market. The fourth quarter will perform the best as the global expansion continues to take hold and with it an improving employment picture.**

INTEREST RATES: U.S. Treasury bonds remain unattractive despite the current uptick in yields. It is more probable interest rates will rise but not materially as financial conditions improve. The thirty-year treasury yield closed the year at 4.33% and it is more likely to rise to 4.8% by year-end. While on the other hand, the ten year treasury yield closed at 3.29% and will trend a bit higher, say 4% by year-end. The Fed's quantitative easing program is designed to create asset inflation and reduce long-term interest rates. However, the later did not occur. Actually, the thirty-year treasury yields rose by 60 basis points and with it thirty-year mortgages. Mortgage rates closed the year at 4.33% and will probably rise between 4.8% and 5% by year-end. Given our deflationary environment, monetary policy will remain overly accommodative and the Fed rate should remain at .125% for the entire year. So there is no misunderstanding, the Fed will do whatever it takes to reflate demand and fight the deflationary forces in the economy whether it is another round of quantative easing or debt monetization. As such, investors should consider investment-grade high yield corporate and even municipal bonds but avoid sovereign debt.

MUNI BONDS: The belief that the municipal bond market carries enormous risk is without merit. The states and local governments have the same fiscal stress as the federal government. However, the federal government can print money. The state fiscal dilemmas are both cyclical and structural. Cyclically, their revenues have eroded against the backdrop of reduced income, sales and real estate tax collections attributable to high unemployment and the collapse in real estate values. While structurally, the states will have to confront their budgetary issues associated with unfunded pension plans and unmanageable budgetary commitments. There is no doubt that the remedies will be painful consisting of enormous spending cuts and tax increases and with it, impaired living standards. All issuers of municipal bonds are required by law to balance their budgets on an annual basis for which the debt service element represents a small portion of their budgets. The risk of defaults will remain low as compared to other debt instruments. In 2011, there may very well be two to three defaults. In the unlikely event more defaults become imminent, the Fed will implement QE4M (Quantitative Easing for Municipalities) and purchase their bonds in order to avoid financial crisis. The recent sell off in the municipal bond market, after the November elections, represented nothing more than buying opportunities. In a deflationary environment, it is income and not cash that is king and municipal bonds represents a safe haven to fulfill that investment objective. Investors should consider AAA-general obligation bonds and avoid municipal bond funds and risky states such as Illinois, California and Pennsylvania.

THE U.S.DOLLAR: The long-term bear market remains well entrenched. The government's QE2 has devalued the dollar to the dissatisfaction of the entire world and more specifically China and Germany. The weaker dollar will assist in reversing our current account deficit, enhance our exports and create inflation to counter the deflationary impact in our housing sector. Although no country wants a strong currency especially during an economic recovery, the belief that we may become subject to currency wars and/or competitive devaluations is clearly misplaced. Quantitative easing will be the catalyst to other central banks employing easier monetary policy. Although this may limit the benefits of QE2, it should allow the depreciation of the dollar to remain relatively benign and avoid any currency crisis. The dollar may drop by 5% or more, falling against the yen and emerging currencies and rising against the Euro. On the upside, China will revalue their currency to cool their economy which will assist in reversing our trade imbalance. **The dollar bear market has further to run and its position as the global reserve currency of choice will remain intact.**

GROSS DOMESTIC PRODUCT (GDP): When all is tallied, 2010 anemic growth should be 2.8%. As the global expansion continues to take on momentum, the U.S. economy will be the primary beneficiary of global rebalancing and may produce GDP of 3% and possibly 4% on the upside. This combined with the benefits of QE2 may reduce the unemployment by 1% bringing the rate to 8.4% or lower. It may take an additional four to five years for above trend GDP before the unemployment rate is brought down to the pre-recession level of 5%.

INFLATION / DEFLATION: The emerging world is inflationary while the developed world is deflationary. The Fed's inflationary injection known as quantitative easing has had success in their battle against deflation. This policy has created asset inflation found both in the equity market and commodity prices while only having a modest negative impact on core inflation. **2010 core inflation should be 1.5% while in 2011 it should rise within an acceptable range of 2% to 2.5%.**

GOLD / SILVER: I predicted in 2010 gold would hit $1,300 per ounce. It actually surpassed my expectation closing the year at $1,404 an ounce near its all time high in December producing a brilliant return of almost 40%. The inflationary expectation of currency debasement is clearly fueling demand. China with its enormous currency reserves will become the world's leading investor. While on the supply side, the German Bundesbank is retaining rather than selling their gold reserves in their return to the Deutsche Mark in an anticipation of the Euros demise. The World's Central Banks have now become net purchasers. Gold is a currency that cannot be debased and rises in time of war, chaos and crisis. **I predicted in 2009 that silver would outperform gold and it did.** Silver closed the year at $30.88 an ounce producing a majestic return of 80%. The supply constraints of this precious metal/industrial commodity will continue to mount. Given both the inflationary expectations and imbalances between supply and demand, it is probable that gold and silver could hit $2,000 and $50 per ounce respectively. Notwithstanding silver's spectacular run-up, it may very well outperform gold again in 2011. The gold/silver bull markets remain intact on a long-term perspective and may even surprise further on the upside. Although the market trend will be interrupted with occasional sell-offs, these should represent buying opportunities. These precious commodities should be at least 10% of your investment portfolios. **Welcome to the Gold Rush and HI-HO Silver will gallop along the same path.**

OTHER COMMODITIES: The commodities super cycle remains intact and will persist on the upside for many more years to come. The law of supply and demand will dictate the path of commodities. The demand will continue to accelerate with the global expansion facing even greater pressure on the imbalance in the commodities supply/demand equation. Diminishing reserves, lack of investment in facilities, exploration and production will continue to place pressure on the supply side with the exception of natural gas. **There is clearly a long-term trend to the upside for both hard and soft commodities and this bull market may run for another four to five years and turn into a stampede to renewed mania condition.**

OIL: In an environment with inventory at normal levels and rising demand along with the expanding global economy, OPEC will need to increase production. The price of oil will rise in 2011 and will trade in a range with resistance at $100 and support at $85 per barrel. On a seasonal standpoint, oil could spike to $115 during the winter and summer months. **The long-term perspective remains extremely bullish whereby oil may rise annually at a 5% rate over the next couple of years.**

REAL ESTATE: Against the backdrop of both rising excessive supply and mortgage rates, the residential real estate downturn will continue to persist on the down side in the long-run. More than 22% of mortgages are under water and the foreclosure process has been delayed. These factors will ultimately place further pressure on the supply/demand imbalance. It is more probable the residential market will further contract by 6% to 8% nationally with states such as Arizona, Nevada, Florida and California falling by as much as 10% or more. The residential market may start to rebound in 2014. However, the headwinds associated with the enormous number of homes that will be added to the supply-side of the equation from 78 million retiring baby-boomers will have severe negative implications in the long-run. The recovery in the residential real estate market is contingent upon a turn around in the employment sector and asset inflation sourced from the quantitative easing inflationary injection. On the upside, the commercial real estate market is in process of stabilization against the background of an improvement in leasing and rental rates and stronger demand for high quality properties. **So long as the contraction in the real estate market continues to trend lower, it will not jeopardize the economic recovery. Although remote, if real estate values fell by another 20% or more, the economy would probably slip back into recession.**

Notwithstanding all the risks and global imbalances, I remain optimistic to the outlook.