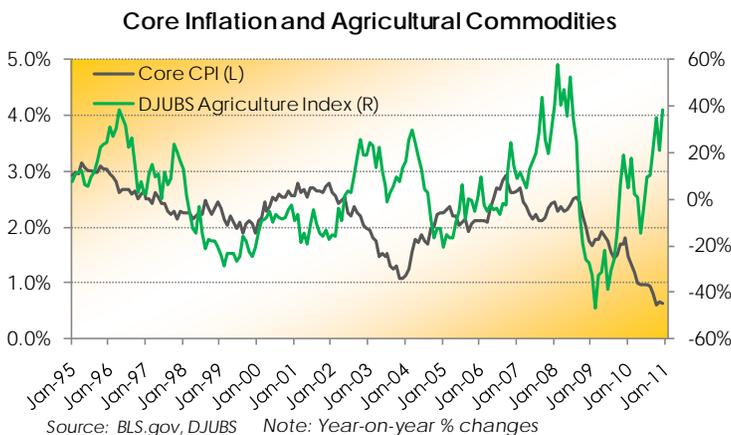


The Federal Reserve concluded its first policy-setting meeting of the year this week. It came as no surprise to anyone that the committee voted to keep the fed funds rate unchanged from the current near-zero percent level – although the unanimous decision was somewhat eyebrow-raising with two new hawkish voting members on the committee. The most interesting information came (as it almost always does) from the post-meeting statement, and the nuance of the language regarding the economic outlook. The committee acknowledged that the economic recovery is continuing, albeit constrained by a stubbornly high unemployment rate. In light of this as-yet insurmountable hurdle, the Fed plans to fulfill its goal of purchasing \$600 billion of Treasury securities by the end of the second quarter of 2011. They also left the door open for additional purchases – in other words, another round of quantitative easing – by indicating that the size and pace of the purchase program is continually reassessed *“in light of incoming information”* and they will *“adjust the program as needed to best foster maximum employment and price stability.”*

There is no doubt that the U.S. job market needs a shot in the arm, but full employment is not the only directive for policy makers. The Federal Reserve’s dual mandate also requires that they foster price stability, which means keeping inflation in check. A debate has raged over the last few years between those who believe that the stimulus poured into markets will eventually ignite inflationary pressures versus those who believe that anemic growth makes deflation the greater risk. The Fed has routinely fallen into the “deflation risk” camp, and has openly pursued an aggressive campaign to stimulate growth. Throughout the worst of the recession in 2008-2009, the weakness in global economic activity seemed to warrant these aggressive tactics. In recent quarters, however, the landscape has changed. Growth in Asia and the rest of the developing world has picked up to the point where central banks are raising rates to contain inflation. Renewed global growth – as well as a depressed dollar resulting from both the Fed’s easing measures and the euro’s troubles – have helped fuel a run-up in commodity prices. Despite the flow-through impact that many of these commodities have on the cost of food and energy, the situation is not sounding alarm

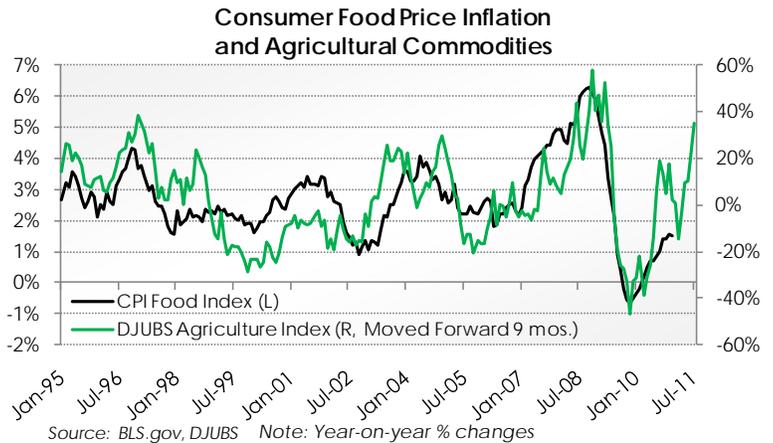


bells for the Fed. Policy makers in the U.S. focus only on “core” inflation – the general price level excluding food and energy. In this week’s post-meeting statement the Fed commented, *“Although commodity prices have risen, longer-term inflation expectations have remained stable, and measures of underlying inflation have been trending downward.”*

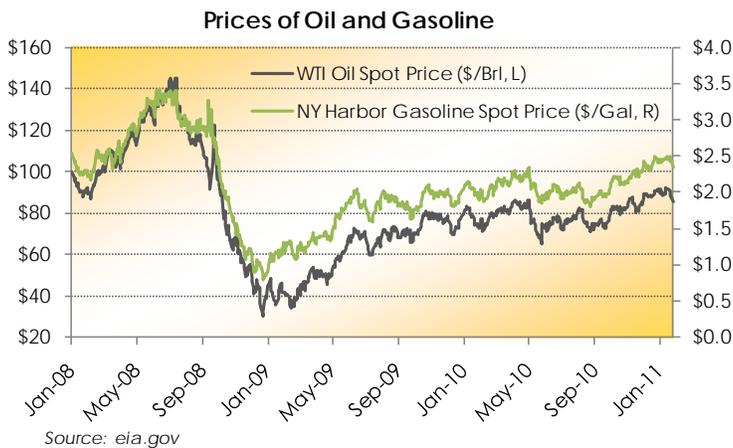
In our opinion, the Fed should be more concerned about the rising cost of food and energy. U.S. policy makers generally regard fluctuations in the prices of these goods as very volatile, temporary, and not indicative of underlying economic growth. This may have been the case in the past, but today the economic landscape is changing. The emerging world is exerting greater demands on resources which could indeed be contributing to higher prices on a structural, not temporary, basis. Here we explore some of the reasons why we believe that inflationary pressures should be of concern to U.S. policy makers, and some of the implications for the sustainability of our fragile economic recovery.

Recipe for Higher Prices

The chart on the previous page showing annual growth rates of the Core CPI index and Agricultural Commodities prices illustrates that indeed the trend of underlying inflation (gray line) is downward, for now. Price fluctuations in raw materials do not impact consumer prices immediately. It takes time for the pricier underlying goods to flow through the supply chain into finished products and hit the shelves of grocery stores.



The chart above right shows the relationship between the year-on-year change in the Agricultural Commodity index (green line) and the Food component of the Consumer Price Index (black line). This relationship, however, is shown with a nine-month lead time for the raw commodities. The green Commodities line extends out to September 2011, predicting the likely path of the food inflation index in the months to come.



The chart above right shows the relationship between the year-on-year change in the Agricultural Commodity index (green line) and the Food component of the Consumer Price Index (black line). This relationship, however, is shown with a nine-month lead time for the raw commodities. The green Commodities line extends out to September 2011, predicting the likely path of the food inflation index in the months to come. **This signals that the cost of food for consumers has nowhere to go but up.** Oil, too, has been steadily on the rise since its December 2008 low, bringing higher gasoline prices to the pump for consumers. Anyone who fills up a gas tank or does the grocery shopping can attest to what is shown in these charts, even if the Fed declares that inflation is non-existent.

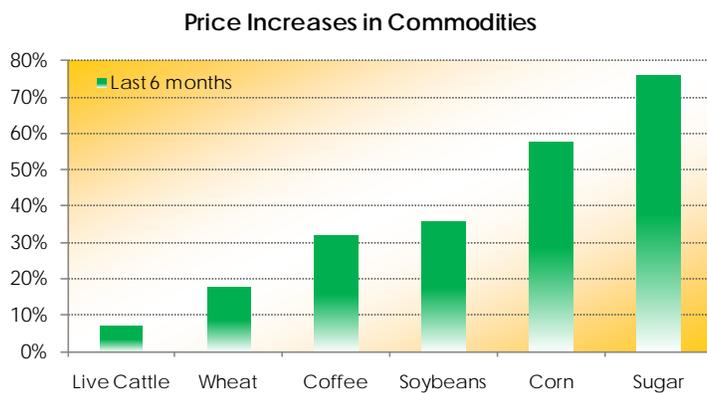
Unlike the Federal Reserve, central banks in Europe are cautious of these trends and are prepared to act. In Britain, the Bank of England is reevaluating its interest rate policy as inflation suddenly jumped to 3.7% in December on the back of higher gas

prices and rising vegetable and cereal costs. Speaking from the World Economic Forum in Davos, Switzerland, European Central Bank President Jean-Claude Trichet reiterated the Bank's commitment to maintaining price stability in the face of a 29-year high in German import prices. Other ECB officials have explicitly stated that they will counter inflation risks from workers demanding higher wages to compensate for higher living costs. Given the slack labor markets in the U.S., it remains to be seen whether workers could successfully demand higher wages. If prices continue to rise and compensatory wage gains are not possible, however, we could see the nascent recovery in spending come to an abrupt end as consumers need more disposable income for staples like food and fuel.

Emerging Appetite

Traditionally, exogenous forces such as weather patterns or crop or livestock diseases were responsible for supply constraints that caused big swings in agricultural commodities. Today, however, increased demand from emerging nations may also be fueling the fire. According to the National Bureau of Statistics, in the twelve months ending November 2010, consumer prices in China rose by 5.1%. About 75% of that increase was due to higher food prices.

A new Chinese middle class is emerging as urbanization accelerates. As their wealth grows, their diets are evolving to include more expensive "western" staples such as meat, poultry and milk. Compounding the problem, the flow of population toward cities has reduced the production resources for food in rural areas. Continued urban population migration will only cause strains on the supply of animal-based foods to intensify. Economic prosperity has also brought food pricing pressures to another emerging powerhouse – India. **The deputy governor of the Indian central bank estimates that there has been a 39% rise in income per person over the previous five years, resulting in an additional 220 million regular consumers of milk, eggs, meat and fish.** Problems such as poor infrastructure and land restrictions have left producers with inadequate supplies to meet demand, thereby driving up prices. Price increases are not constrained to just animal products, however. **India's commerce ministry estimated that food inflation reached over 18% in December**, with vegetables the



Source: DJUBS Commodity Subindices; as of Jan. 25, 2011

primary culprit. Globally, commodities such as sugar and corn have experienced the most dramatic price gains in recent months. According to the U.S. Department of Agriculture, as of September 30th China was a net importer of corn for the first time in 14 years. **China is now the second-biggest corn consumer in the world, and the leading importer of soybeans.**

Food Fight

In December, the food price index from the U.N. Food and Agriculture Organization breached its previous record high set in June 2008 as the credit crisis took the wind out of commodities' sails. During that previous high, food riots erupted across the globe, and once again rising food prices are igniting political instability. Already we have seen these economic pressures contribute to unrest across the Middle East. Protests have broken out in Egypt, Algeria, Morocco and Yemen, while Tunisians ousted the country's dictator several weeks ago. Although in the U.S. the Fed prefers to exclude food and energy prices from its inflation considerations, in emerging markets it is impossible. Food accounts for a much larger percentage of household spending in the emerging world than in the U.S. or Europe. During a panel discussion in Davos this week, **a former deputy governor of the People's Bank of China indicated that food prices make up 34% of the consumer price index in that country.** This is in stark contrast to the roughly 15% of a household's budget that Americans typically spend on food.

Overindulgence

The Federal Reserve continues to pursue a course of extremely loose monetary policy to stimulate employment, but at some point their strategy could snuff out the very demand they are trying to kindle. A dollar depressed by quantitative easing and low interest rates has helped stimulate several areas of the economy. It has helped fuel the equity rally by pushing investors toward higher yielding assets, and it has also stimulated U.S. exports by making our goods cheaper to other countries. The opposite side of that coin, however, is that a weaker currency means that goods are more expensive for Americans to purchase on the global market, and commodities priced in dollars are pushed upward. Even though Americans spend a smaller share of their incomes on food and energy than much of the world, higher prices still take a larger bite out of consumers' incomes. Most people cannot afford to give up any additional income at this point in the recovery as they try to reestablish a fraction of their former lifestyles yet still deleverage. In addition, as higher food prices in exporting countries like China put upward pressure on its wages and eventually finished products, the rest of the world will import this inflation. With the U.S. consumer accounting for over 70% of GDP, the benefits of a lower dollar are far outweighed by the hit that consumers may take in the wallet. If higher food and other commodity prices are indeed structural and not a temporary phenomenon, then the Fed may be behind the eight ball already.

The best case scenario for the global economy would be for high growth, high inflation countries to engineer a "soft landing" by raising interest rates enough to quell demand, but not too much to eliminate it. In fact, despite our continued easing policy in the U.S., inflationary pressures have already nudged many of the world's central banks near, or into, policy tightening mode. The People's Bank of China has raised the reserve requirements for lenders four times in the past two months, on top of

two interest rate hikes since October. Brazil recently raised its benchmark interest rate by 50 basis points to 11.25% to combat inflation. As we discussed earlier, the ECB is prepared to tame higher prices even in the midst of a severe fiscal crisis across the continent. The health of the U.S. economic recovery is still very dependent on strong growth outside of our borders. To a large extent, our economic fortunes may lie in the hands of policy makers abroad.

Digesting the Data

We are optimistic on prospects for the equity markets in the early months of 2011, but at this point there are many policy decisions yet to be made that will set the course for the remainder of the year. As commodities spiral higher, additional quantitative easing may no longer act as a support for equities, but instead stoke fears of inflation. We believe that scenario is several months in the future, however, and will be influenced by how nimbly China and other countries can navigate a soft landing. In our portfolios, we are benefitting from the commodities rally in the short term by owning the Market Vectors Agribusiness ETF and the iShares MSCI Canada Index ETF in our Opportunistic holdings.

We are also monitoring market sentiment for signs that the rally is overdone. The equity market climbed a wall of worry in the past year as many investors questioned the strength of the economic recovery, and the government's ability to support it. Indications that investors have become overly optimistic could signal an end to the strong gains of the last several months. We believe that a lack of better investment alternatives with such low interest rates and an unsettled municipal bond market could continue to direct money toward equities in the months to come.

January 28, 2011



Katherine Krantz
Chief Economic Strategist



Brock E. Moseley
Chief Investment Officer

Disclosures

The views of Miracle Mile Advisors, LLC ("MMA") may change depending on market conditions, the assets presented to us, and your objectives. This research is based on market conditions as of the printing date. The materials contained above are solely informational, based upon publicly available information believed to be reliable, and may change without notice. MMA makes every effort to use reliable, comprehensive information, but we make no representation that it is accurate or complete. We have no obligation to tell you when opinions or information in this report change.

MMA shall not in any way be liable for claims relating to these materials, and makes no express or implied representations or warranties as to their accuracy or completeness or for statements or errors contained in, or omissions from, them.

This report does not provide individually tailored investment advice. It has been prepared without regard to the individual financial circumstances and objectives of persons who receive it. The securities discussed in this report may not be suitable for all investors. MMA recommends that investors independently evaluate particular investments and strategies, and encourages investors to seek the advice of a financial adviser. The appropriateness of a particular investment or strategy will depend on an investor's individual circumstances and objectives.

This report is not an offer to buy or sell any security or to participate in any trading strategy. In addition to any holdings that may be disclosed above, owners of MMA may have investments in securities or derivatives of securities mentioned in this report, and may trade them in ways different from those discussed in this report.

The value of and income from your investments may vary because of changes in interest rates or foreign exchange rates, securities prices or market indexes, operational or financial conditions of companies or other factors. There may be time limitations on the exercise of options or other rights in your securities transactions. Third-party data providers make no warranties or representations of any kind relating to the accuracy, completeness, or timeliness of the data they provide and shall not have liability for any damages of any kind relating to such data.

The information and analyses contained herein are not intended as tax, legal or investment advice and may not be suitable for your specific circumstances; accordingly, you should consult your own tax, legal, investment or other advisors, at both the outset of any transaction and on an ongoing basis, to determine such suitability. Legal, accounting and tax restrictions, transaction costs and changes to any assumptions may significantly affect the economics of any transaction. MMA does not render advice on tax and tax accounting matters to clients. This material was not intended or written to be used, and it cannot be used by any taxpayer, for the purpose of avoiding penalties that may be imposed on the taxpayer under U.S. federal tax laws.

The projections or other information shown in the report regarding the likelihood of various investment outcomes are hypothetical in nature, do not reflect actual investment results and are not guarantees of future results.

Other Important Disclosures

Physical precious metals are non-regulated products. Precious metals are speculative investments and, as such, their value can be subject to declining market conditions.

Real estate investments are subject to special risks, including interest rate and property value fluctuations as well as risks related to general and local economic conditions.

Foreign/Emerging Markets: Foreign investing involves certain risks, such as currency fluctuations and controls, restrictions on foreign investments, less governmental supervision and regulation, and the potential for political instability. In addition, the securities markets of many of the emerging markets are substantially smaller, less developed, less liquid and more volatile than the securities of the U.S. and other more developed countries.

This report or any portion hereof may not be reprinted, sold or redistributed without the written consent of MMA.

Additional information on recommended securities is available on request.