CHART OF THE MONTH

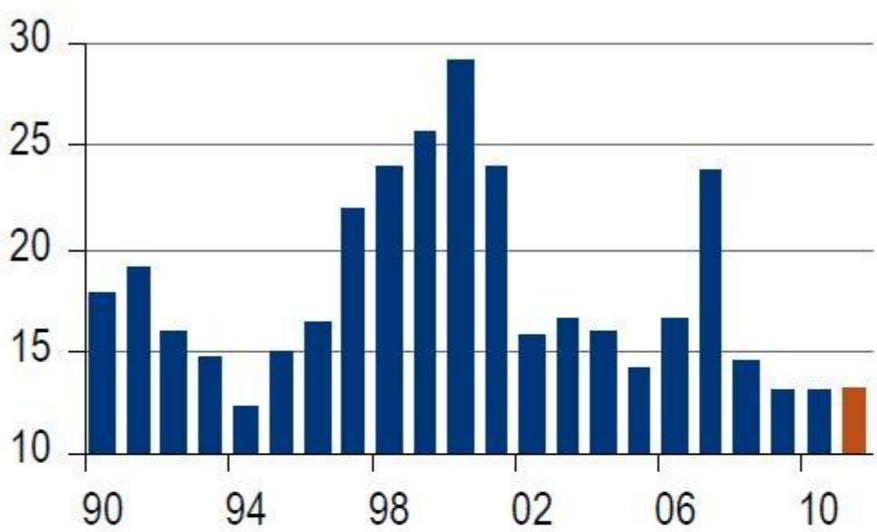
FEBRUARY 2011

After suffering the worst week since November due to higher oil prices and tensions in the Middle East, the major stock market indexes rebounded on Monday to record their third straight month of gains. The Standard & Poor's 500 has now doubled from its low in March 2009 and the percentage increase over the past 500 trading days is the largest for that time period since the end of World War II.

Was the correction last week the pause that refreshes or a sign that the market has finally topped out? In order to answer that question, we thought it would be instructive to take a look at the valuation and earnings of the S&P 500. As shown below, the P/E ratio, at 13.5x forward earnings, is not only about the same as it was in 2009 and 2010 when the market was significantly lower but it's as cheap as it has been since 1994. While the past may not be prologue, it's worth noting that the market had one of its best runs ever from 1995-1999. Although we would not expect P/Es to rise above 20 as they did in 1997 -2000, we believe there is room for valuations to return to a more normal 15 times forward earnings.

Using a 15 multiple and the Thomson consensus of $97.00 EPS for the S&P 500 in 2011 produces a target price for this index of 1,455, or roughly 10 percent above today's closing level of 1,327. If the earnings come in a little shy at, say, $95, the S&P would be worth 1,425 based on a P/E of 15. On the other hand, if the earnings exceed projections and jump to $100, then the same index would be worth 1,500. Either way, we believe there is more upside than downside given the current valuation and the outlook for earnings.

S&P 500 Forward PE: 1990-2011



P/E	S&P 500 EPS			
	$85	$90	$95	$100
13x	1,105	1,170	1,235	1,300
14x	1,190	1,260	1,330	1,400
15x	1,275	1,350	1,425	1,500
16x	1,360	1,440	1,520	1,600