

American Capital Management, Inc.

Investment Counsel

50 Broad Street, Suite 1609, New York, NY 10004-2307 • 212-344-3300 • Fax: 212-344-2045

ECONOMIC & INVESTMENT SUMMARY APRIL 2011

Strong fundamentals and stimulative monetary policies are powering the markets higher despite worries related to Japan's earthquake and nuclear disaster, rising oil prices, violence in the Middle East and North Africa and European sovereign debt problems. The combination of favorable economic reports, excellent earnings and strong inflows into equities has propelled the DJIA and S&P 500 to their best first quarter returns since 1998. Importantly, the second round of quantitative easing (QE2) announced last fall is responsible for bolstering business confidence, minimizing the risk of a double-dip in our economy and creating the foundation for sustainable future growth. Correspondingly, equity and commodity prices have strengthened in response to the reflationary actions in accordance with the old market adage "Don't fight the Fed." We continue to believe the intermediate-term outlook offers solid appreciation potential, but there are new concerns that threaten the expansion's sustainability and may increase volatility. Accordingly, we view any meaningful correction as an opportunity to selectively add to equities. A summary of index returns through March 31, 2011 is as follows:

Dow Jones Industrials	+7.1%	Russell 2000	+7.9%
MSCI EAFE	+3.4%	S&P 500	+5.9%
NASDAQ Composite	+5.1%	Wilshire 5000	+5.6%

CONFLICTS, QUAKES & SHOCKS

Mideast popular uprisings, Allied airstrikes on Libya, the Japanese earthquake, the Fukushima radioactive threat and a possible oil supply shock have created new uncertainties and presented investors with a combination of unusual risks. The Japanese disaster and nuclear accident will cause an economic contraction in Japan during the first half of 2011 followed by higher than expected growth in late 2011 and 2012 due to rebuilding activity. In response, the Bank of Japan has initiated another round of large scale asset purchases (QE), including Japanese stocks and bonds, and the G-7 has undertaken coordinated efforts to depreciate the yen for Japan's benefit. Japan represents 10% of global GDP as the third largest economy and these disasters probably destroyed about 4% of their economy – a devastating local loss but a minor impact on global GDP. The impact of a short-term downturn in Japanese demand on the rest of the world will be modest as Japan is a moderate importer -- only 6% of U.S. exports are sent to Japan. However, the world may experience a greater than usual increase in demand from Japan as it rebuilds its infrastructure. Additionally, Japan has been suffering from overcapacity and these disasters may help end its deflationary period by eliminating some excess capacity.

A greater economic concern is a possible disruption in the Mideast and North African oil supply due to armed conflict or sanctions that could send prices dramatically higher since supply and demand are in tight balance – a risk to the outlook that is hard to quantify. To date, higher oil prices -- up +24% this year to \$113 per barrel -- are expected to reduce global growth slightly. For example, economists estimate that previously anticipated benefits of the temporary payroll tax reduction in the U.S. are likely being

consumed by higher gasoline prices. From a longer term perspective, the price of oil may gradually increase until additional supply or other larger scale energy sources become available. The unrelated events in Japan and the Mideast highlight the need to develop alternative energy to reduce our dependence on oil as the dominant transportation fuel. Unfortunately, it will be challenging to develop secure oil supplies because most of the large reserves reside in difficult and unstable places like the Arctic, Iran, Iraq, Libya, Russia, Venezuela and deepwater wells similar to British Petroleum's Macondo in the Gulf of Mexico. Nuclear energy, the world's largest non-fossil fuel energy source, will receive renewed skepticism. This will delay new construction as the industry focuses on analyzing Japan's nuclear accident, upgrading existing plants and designing safer plants for the future. In the U.S., we need a comprehensive energy plan that emphasizes conservation, exploration and the development of our significant coal and natural gas reserves and alternative energy sources. We should set a priority on the development of energy technology to support our economic growth, environment, national security and job creation. At this stage, the worrisome collection of exogenous events has created "more smoke than fire", but vigilant monitoring is necessary as these situations continue to develop and represent new risks to the outlook.

THE ECONOMY

Will these events slow the pace of global growth? Yes, but we believe healthy global growth remains the most likely outcome based upon strong underlying fundamental trends and stimulative policies. However, recent events diminish the potential for an upside surprise and forecasts have been reduced slightly to +4.5% (ex. U.S.) primarily due to higher oil prices. Prior to these events, expectations were increasing based upon stronger economic data, so it is important to note the trend is changing. Now, the outlook includes a different trajectory with growth slightly lower than expected in the first half of 2011 and somewhat higher during the second half supported by the reconstruction efforts of Japan.

The U.S. expansion is broadening with self-reinforcing momentum. Growth should exceed +2.7% in 2011 based upon continued strength in consumer and capital spending. The healthy rate of consumer spending is supported by the improving job market, a temporary reduction in the payroll tax and the wealth effect of rising equity prices. The job market is steadily improving with private sector payroll growth recently showing the largest increase in four years and the unemployment rate trending downward to 8.8%. As previously stated, job growth is an important ingredient in sustaining the expansion due to steady consumer spending, greater demand for credit, fewer loan delinquencies, increased income tax collections and lower social insurance payments to the unemployed. Capital spending is benefiting from higher corporate profits, the desire to invest for productivity gains and tax incentives for accelerated depreciation in 2011. Severe underinvestment over the last decade has unleashed pent-up demand for business equipment and software - 8% of real GDP in 2010 - and we expect an extended period of strength with above average gains over the next two years. However, despite the positives, some headwinds exist due to the weak housing market, stress in state and local budgets and the recent impact of higher oil prices on spending. We believe the economy has the necessary momentum to successfully transition to the next leg of growth without additional monetary stimulus. Overall, the underlying fundamental trends are positive, but higher oil prices pose a greater risk to consumption than previously expected.

INFLATION

Inflation is drifting higher from a low level with the consumer price index (CPI) rising +2.7% and core inflation (ex. food and energy) +1.2% over the past year. Inflation measures may continue trending higher, but they should not accelerate to a worrisome rate. Core inflation recently bottomed in late 2010 at 0.8%, so it has room to increase without getting to undesirable levels. The economy continues to operate below its potential, which means there is slack that can be absorbed without creating tightness and pricing pressure, as evidenced by the high unemployment rate and underutilized manufacturing resources. Also, the increase in food and energy prices has slowed our economic expansion somewhat by absorbing a

portion of consumer spending while wages increased only +1.7% over the past year. In addition, while the key money supply gauge of M2 – cash, bank deposits and money market funds held by households – has been gradually rising, the consumer’s outlook for long term inflation has eased according to the latest Reuters/University of Michigan survey. The Federal Reserve’s view is that the near term strength in inflation is likely to moderate and current forecasts project a lower level in 2012. Importantly, the European Central Bank (ECB) responded to recent inflationary pressures by raising their key interest rate 25 basis points to 1.25%, which marks the ECB's first rate increase since July 2008 and the world's first major central bank to initiate a cycle of raising rates. The move is motivated by the ECB’s desire to keep inflation in the 2% range despite the deepening debt crisis in Europe’s periphery. Adding to the mix, inflation in emerging markets is 6% and trending higher, but monetary authorities in Brazil, China, India and Korea are responding with incrementally restrictive policies to moderate growth and inflation. Positively, the risk of deflation has significantly diminished. Negatively, we may experience above trend inflationary pressures over the intermediate term.

INVESTMENT OUTLOOK

Favorable fundamental trends, reasonable valuations and growing business and consumer confidence are powering the stock market to new post-recovery highs. We believe these factors will continue to remain favorable over the intermediate-term as we expect S&P 500 operating earnings to increase +13% to \$95 per share in 2011 and +10% to \$105 per share in 2012. Combined with moderate inflation, improved political rhetoric and increased levels of mergers and acquisitions, all of these factors suggest a positive outlook for the stock market. Additionally, Federal Reserve policy remains highly accommodative with the federal funds rate effectively set at zero and the latest round of quantitative easing concluding in June. Interest rates will likely remain low in absolute terms, even if the near-term trend favors higher long-term interest rates as the Fed’s purchases of Treasury bonds ends and the economy strengthens. Positively, the yield curve remains steep and positively sloped – a reliable indicator of future growth. At 14x 2011 earnings, the stock market is attractively priced considering the outlook for earnings and inflation, especially when compared to bonds which may face a headwind from rising interest rates. In addition, the stock market has never had a down year during both the third year of a presidential term and economic expansion. The strong January was also a positive indicator.

Corporations are flush with cash and capable of substantial buybacks or acquisition activity. In fact, first quarter global merger-and-acquisition activity rose +16% from a year ago. In the U.S., deal sizes are getting bigger which is a sign of improved confidence. For example, announced deals with a value of more than \$500 million are up +36% compared with last year. Furthermore, domestic equity funds are benefiting from the best inflows in five years with stock funds receiving \$33 billion through March versus \$11 billion last year. For comparison, bond inflows were \$5 billion versus \$55 billion last year. We have previously discussed the buying power of large cash balances and are now seeing the impact of reinvestment. For investors, a “buy the dips” mentality is replacing the “sell the rally” thinking.

The market’s technical configuration supports the recent strength with new recovery highs for the DJIA and Dow Transports confirming Dow Theory, a positive signal. Breadth has been strong with the NYSE stocks only advance-decline line hitting new recovery highs, but volume has been surprisingly light given the late March rally. At this juncture, risks to the outlook include the possibility of an oil price shock, a recession in Japan due to the earthquake and nuclear problems, a hard landing in China, higher than expected global inflation, European sovereign debt restructuring, an overheating U.S economy and municipal debt defaults. Additional risks include burdensome regulation, geo-political conflicts, more protectionism, sharp increases in taxation and terrorism. Periodic corrections will occur as investors focus on risk and we advocate using these opportunities to build positions in quality growth companies as the multi-year outlook for equities remains favorable. Our positive outlook is based upon the economy and corporate profits sustaining their favorable momentum, but we recognize new risks can create unexpected outcomes and will remain vigilant as we review our investment strategy over the intermediate term.