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ECONOMIC & INVESTMENT SUMMARY JULY 2011

The stock market hit new post-recovery highs during the second quarter despite worries related to the pace of economic growth, rising oil prices and European sovereign debt problems. The impressive strength in earnings has been a key factor driving the market higher in the face of macroeconomic data that has been tepid in recent months. Expectations for low double-digit earnings growth have held steady despite downward revisions to U.S. GDP growth, weaker than expected employment reports and diminishing consumer confidence. Positively, the index of leading economic indicators remains favorable and the pressure from rising oil prices may be temporarily relieved by the release of strategic petroleum reserves. At this time, the moderation in the economy appears to be a temporary slowdown. Periodic corrections will occur as investors focus on risk and we advocate using these opportunities to build positions in quality small and medium sized growth companies as the long-term outlook for equities remains favorable. A summary of index returns through June 30, 2011 is as follows:

Dow Jones Industrials	+8.6%	Russell 2000	+6.2%
MSCI EAFE	+5.0%	S&P 500	+6.0%
NASDAQ Composite	+5.0%	Wilshire 5000	+5.1%

THE ECONOMY

Global GDP growth (ex. U.S.) is projected over +4% in 2011 and +5% in 2012. Emerging markets are leading with +6.5% growth in 2011 supported by +2.0% growth in developed markets. This year, China, Germany and the U.S. are the primary engines among the largest economies with growth of +9%, +3% and +2.3% respectively. Japan is contracting slightly due to the impact of its earthquake and nuclear crisis, but is expected to rebound in late 2011 and 2012. Expectations for U.S. growth have moderated recently due to higher oil prices, a slowdown in hiring and a continued weak housing market. But GDP growth of +2.3% remains likely due to increases in consumer spending, business equipment spending and net exports. The consumer's resilience has been impressive with +2.4% spending growth projected for this year despite the impact of consumer deleveraging, lower housing wealth and unemployment. Business equipment spending is expected to grow +10% this year. Higher corporate profits and the desire to invest for productivity gains combined with tax incentives for depreciation are creating the beginning of a capital equipment spending cycle. Job growth is gradually improving, but the slow pace of progress is causing concern as recent employment reports reveal weaker trends. For example, private payrolls grew +1.5% year-over-year at a pace of 158,000 jobs per month in the first half of this year versus 72,000 last year, but June's report was weaker with only 57,000 new private jobs created. Additionally, the unemployment rate in June increased to 9.2% after declining to 8.8% earlier this year. We believe the job situation will gradually improve as excellent corporate profitability continues and business

confidence strengthens. Importantly, there is pent-up demand within businesses to add labor and capital to support future growth. History shows a lagged response between profit growth and new investments and we are approaching the timeframe when we can expect increased investments. Positively, there should be a near-term acceleration in second half vehicle production because of the slowdown due to Japanese-related supply shortages. On balance, the underlying fundamental trends are positive and we believe the economy has self-reinforcing strength, but temporary weakness is clouding the picture.

MANUFACTURING RENAISSANCE

We believe that the U.S. has begun a manufacturing renaissance that will gradually become more apparent in future years. The advantage of foreign manufacturing is declining as production costs are rising dramatically compared to domestic production. For example, the gap between U.S. and Chinese wages is narrowing rapidly with Chinese wages rising about +17% per year and the value of the yuan appreciating. Meanwhile, flexible work rules and a host of government incentives are making many states – including Alabama, Mississippi and South Carolina – increasingly more competitive. Furthermore, shipping and logistics costs weigh heavily in the decision for certain types of products destined for sale in the domestic market. Products that require less labor and produced in modest volumes, such as appliances and construction equipment, are likely to shift to U.S. production. Goods that are labor-intensive and made in high-volume, such as apparel, consumer electronics and textiles, will likely continue to be produced overseas. The Boston Consulting Group projects similar net labor costs for manufacturing in China and the U.S. in 2015. A manufacturing renaissance will be welcome after five million manufacturing jobs disappeared in the last decade. It is important to note that increasing manufacturing productivity helped displace many of those jobs and they were not all lost to offshoring. Positively, about 250,000 jobs have been created since late 2009. The U.S. is still the world's largest manufacturing country in the dollar value of manufactured goods and employs 9% of its workforce in manufacturing, representing 11% of GDP. In comparison, Germany has 22% of its employees in manufacturing equal to 25% of GDP. America has a rich manufacturing tradition and there is significant opportunity for revival due to our wealth of natural resources, skilled labor supply, sophisticated transportation network and a culture of innovation and productivity.

INFLATION, INTEREST RATES & MONETARY POLICY

Inflation is moving higher with the consumer price index (CPI) rising +3.6% and core inflation (ex. food and energy) increasing +1.6% over the past year. Inflation measures will remain elevated near-term, but should begin to fall later this year due to stabilizing commodity costs. Currently, inflation is expected to be approximately +2% in 2012 versus approximately +3.5% this year as the economy continues to operate with considerable excess capacity as evidenced by the high unemployment rate and underutilized manufacturing resources. Core inflation is increasing from previously low levels and is likely to stabilize around +2%. Even though commodity prices are expected to stabilize, they will likely do so at elevated levels and restrain spending growth for other goods and services. Importantly, long-term market-based inflation expectations remain well anchored at about 2.75% which partly explains the recent downward drift of 10-year Treasury yields to 3.0% from 3.6% earlier in the year. It is unlikely that runaway inflation will be a concern in the next few years.

In terms of monetary policy, short-term interest rates remain low and the Federal Reserve has decided to keep rates “exceptionally low for an extended period” to give the economy an opportunity

to heal from the damage of the Great Recession. Importantly, the Fed completed the second round of quantitative easing (QE2) on June 30 and explained the likely sequence of monetary policy if we need more or less stimulus in the future. If we need further easing, the Fed indicated another round of asset purchases (QE3) is possible as well as techniques to encourage major banks to lend more aggressively to stimulate credit growth. We believe another round of asset purchases is unlikely at this time. Assuming economic growth accelerates, inflation moderates and unemployment declines, the Fed will likely change the language in their public statements, increase the federal funds rate and gradually shrink their balance sheet by selling its bond holdings as a means of tightening monetary policy. From a longer-term perspective, we believe the odds favor higher long-term interest rates as opposed to further declines.

INVESTMENT OUTLOOK

Strong corporate earnings helped propel the stock market to new post-recovery highs during the second quarter despite a variety of economic and political problems. We believe corporate fundamentals will 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, the coordinated release of 60 million barrels of oil from strategic petroleum reserves combined with increased Saudi production will likely provide consumers with an additional level of stimulus in the form of lower gasoline prices. The stock market appears attractive at 12.7x 2012 earnings considering the outlook for earnings, inflation and long-term interest rates. As a reminder, the stock market has never had a down year during both the third year of a presidential term and economic expansion – we remain on course midway through the year.

America is a bargain, especially when you consider the -10% decline in the value of the dollar over the last year and the -25% decline over the last 10 years. Global investors and foreign companies have an opportunity to buy quality U.S. companies with global scale at attractive valuations with the lowest borrowing costs in a generation. American companies may attract greater attention in a “flight to quality” trade if economic circumstances in China, emerging markets or the European periphery become more difficult. Interestingly, the euro has strengthened about +6% against the dollar during the year despite growing problems in Greece, Ireland, Italy, Portugal and Spain, which may make the euro vulnerable to escalating sovereign debt worries and offer a catalyst for greater interest in dollar based assets.

The market’s technical configuration continues to be favorable, but the S&P 500 has been oscillating between 1370 and 1262 for several months – basically a consolidation phase around the 50 and 200-day moving averages. In addition, the market experienced a correction of -7.2% from April 29 through June 15 followed by a meaningful rebound. Positively, the 50-day moving average remains above the 200-day moving average despite a volatile month in June. Additional positive signs include new highs for both the Dow Transports and the advance-decline breadth indicators. At this time, risks to the outlook include the possibility of an oil price shock, European sovereign debt troubles, a U.S. double dip, a hard landing in China and higher than expected global inflation. Additional risks include the collapse of the euro, U.S. fiscal deficit strains, geo-political conflicts, sharp increases in taxation and terrorism. Clearly, these risks may threaten the sustainability of the expansion, but our optimism is based upon the economy and corporate profits sustaining their positive momentum. We believe many of these factors are overly-discounted by investors and expect the stock market to strengthen as it climbs this “wall of worry.”