KANOS CAPITAL MANAGEMENT, LLC

March 2010 Investor Letter

First Quarter Market Conditions

The US stock markets traded down through January and early February, reflecting uncertainty in the US and European economic recoveries and the political problems of the Obama Administration and Democratic-controlled Congress most easily illustrated by the election of Republican Scott Brown as new senator from Massachusetts. However, the economic growth in Asia, coupled with the surprisingly strong recovery of the US economy in the fourth quarter of 2009 (with the announcement that GDP rose 5.9%) led to a rally in mid-February and March that led the stock markets to new highs for the recovery, reaching levels not seen since October 2008.

Commodities advanced in price through the quarter, ending higher after many up and down episodes during the quarter. Increased economic activity drove industrial materials and energy prices slightly higher, while precious metals were mixed and natural gas dropped to new lows due to oversupply.

The bond market was dominated by the turmoil around Greece's financial deficits, and US Treasury bonds rose, acting as a safety position for those exiting European sovereign bond positions and for banks looking for safe loan positions. In spite of these tailwinds, US Treasury bonds ended up slightly down for the quarter, as signs of growing inflation in the emerging world and unease over the US Government's worsening financial condition pushed down bond prices in March. Corporate bonds were better performers, as traditional investors in sovereign bonds moved capital to a heavier weighting in corporates due to nervousness about European and US government bond rating warnings. By the end of March, European bond markets stabilized, as Greece sold bonds (albeit expensive bonds compared to other euro bonds), and world stock markets extended post-recovery highs. Investor euphoria led to continued buying of popular momentum stocks (technology and financial issues, mostly), and a stock market that was up almost 5% during the quarter led to across-the-board advances in most stocks. Commodity stocks lagged as traders bought "high beta" technology, consumer discretionary and retail stocks (which are thought to benefit most during true economic recoveries).

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Precious Metals

Precious metals spent the 1st quarter "digesting" their huge price gains of late 2009, testing gold's $1,050/oz breakout point a couple of times but ending on a stronger note at just over $1,100/oz. Silver was much more volatile, falling into the mid-$15/oz but climbing back by late March to $17/oz. Platinum and palladium, which are much less highly traded, showed strength during the quarter, from investment demand and increased worldwide automobile manufacturing (in which they are used for the catalytic converters in exhaust systems). Precious metals stocks did not perform as well as the underlying metals, losing or gaining less than 5% during the quarter for most companies. These stocks reacted to the Fed's continued warning of future tightening of interest rates, which make precious metals less desirable because of increased interest costs to finance metals positions. However, with employment showing little recovery, we believe the fears of higher short-term interest rates (as dictated by the Fed) are misplaced and metals stocks are currently undervalued.

Energy

Oil prices swooned during late January and early February as fears of world economic malaise (spawned by European economic fears and caused in part by China's tightening of interest rates) caused weakness in economically sensitive commodities and industrial equities. However, successive reports of continued strong growth in Asian and South American economies and steady recovery in the US caused energy, industrial commodities and equities to bounce back during late February and March, with crude oil ending the quarter at $83.76/barrel, the highest price since October 2008. In spite of a colder than normal winter in eastern North America and Western Europe, natural gas prices fell during the quarter, ending at multi-month lows below $4/MMBtu as exploration successes in shale gas and looming increase of worldwide LNG (liquefied natural gas) supply led to continued price weakness in natgas. Energy equities followed oil prices, weakening through mid-quarter and bouncing back by late March, even many natural gas stocks. The "oily" stocks did well in late March and are continuing to show strength into April. Like metals stocks above, to us it appears that oil stocks are undervalued compared to oil prices, while we believe many natural gas stocks are either fairly valued or possibly overvalued compared to natural gas' near-term prospects (over the next 18 months).

General Stock Market

Financials, consumer discretionary, retail and industrial companies led the stock rally, while more defensive sectors like utilites, telecom and healthcare lagged. Our main focus, materials stocks (along with energy stocks), under-performed as traders bet that the Fed would engineer a "Goldilocks" [not too fast, not too slow] exit from the extreme monetary stimulus in effect for the last eighteen months, meaning inflation would not ignite and prices for materials and energy products would be kept “under control”, assumedly at current price levels. Most surprising, information technology companies were laggards for much of the quarter, with only the very large companies (Apple, Google and a few others) managing to have good quarters.

Investing Going Forward

While we will discuss below in our Commentary section the dichotomy between the strength of financial markets and the relatively anemic recovery of the US economy, we would like to give you some thoughts about the direction of the stocks we own.

We have overweighted portfolios in precious metals stocks because we believe: 1) the companies we own have finally overcome mining difficulties, higher energy prices and political obstructions to produce sustainable and growing earnings, enhanced by rising metals prices, 2) the stocks are undervalued because the market is still “gun shy” toward them, not having seen more than a couple of good quarters of earnings growth from many of them. The market is currently valuing most mining companies as if gold trading at a much lower price (<$1,000/oz), 3) energy prices, while high, are no longer killing profit margins at mining companies, as happened in 2008, and 4) we believe larger miners will start to look at smaller miners as growth vehicles, leading to increased merger activity [and we have already seen some – Brett Resources is being acquired and Lihir Gold has just turned down a buyout offer; some Kanos portfolios own both companies].

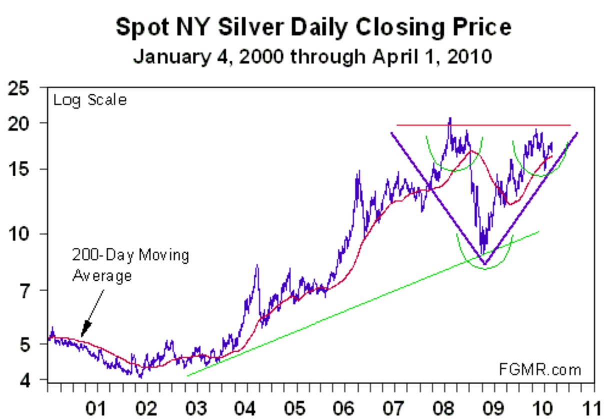
Meanwhile, we think there are technical reasons for gold and gold stocks to do well. Gold is typically traded by traders who look at technical analysis indicators for short-term market moves. Gold and gold stocks appear to be exhibiting some technical chart patterns that point toward rising prices in the near future.

The first chart is one of the gold price that shows a consolidation pattern called a “triangle consolidation”; the red lines show how the price action has narrowed to a point that will “resolve” itself either up or down. Typically, triangle consolidations resolve themselves by moving the way they were before the consolidation – so in our case, that means the gold price had been rising, then consolidated, and the chart pattern said it should start to rise again, hence the red arrow on the chart.

The next chart is one of the GDX Market Vectors Gold Miners ETF which contains most of the large gold mining stocks traded in the US. This chart also shows a triangle consolidation pattern forming which might be expected to resolve itself by going higher.

Finally, a chart of Newmont Mining, which many of our clients hold in their portfolios, shows a "head-and-shoulders" technical pattern (in this case, it is upside down). In this case, a low was set in late December 2009, a lower low occurred in late January 2010, and a higher low (at approximately the same price as the first low) was established in late March. Once the price rises above where the pattern first started [which is called the "neckline" in the head-and-shoulders pattern] (in NEM's case, approximately the $52/share price), the price should move further in the direction away from the neckline; so in NEM's case, to rise above $52 – which the chart shows happened on April 1, 2010, the first day of the new quarter.

Even silver shows a multi-year, upside down head-and-shoulders pattern with a neckline at just under $20/oz. Resolution of this pattern could push silver prices over $25/oz. in the next few months.



These charts are meant to show that technical indicators are now starting to reinforce more fundamental reasons for rising precious metals prices. The fundamentals, which we've talked about in past letters, include 1) high and still-rising money supply in all of the major world economies, led by the United States Government and the Federal Reserve, 2) flagging confidence in currencies increasingly thought to be vulnerable to devaluation due to oversupply and pressured by huge fiscal deficits and growing sovereign debt, 3) lower gold mine production over the past few years, 4) increasing demand for investment purposes, and 5) resurgent demand from the jewelry industry. The Bombay Bullion Association, the Indian gold business association, estimates gold imports for March 2010 to be 23-28 tonnes, compared to just 4.8 tonnes last year [which was a multi-year low for India], showing the recovery of gold demand in the world's largest gold jewelry market. As an adjunct of increased investment demand, world governments/central banks have virtually stopped all gold sales and are now buying gold again as a reserve store of value. As an example, the Russian Central Bank has continued to buy Russian mine output, and in the 1st quarter of 2010 bought 800,000 oz of gold (500,000 oz in March 2010 alone). Physical silver has been withdrawn from the SLV exchange traded fund over the past few weeks as buyers looking for large amounts of silver have instead bought SLV shares and redeemed them for physical silver. These shows investment demand for physical metals had picked up as more and more constituencies see paper money reserves as vulnerable and continue to convert currency reserves to physical metal positions.

Oil, as mentioned above, broke out of a multi-month range (between October 2009 and March 2010) when it closed at $83.76 on March 31, indicating a new upward direction could be expected (see chart below).

In addition, the Obama Administration announced on March 31st that it would open up some areas to offshore drilling, including parts of the US East Coast and Florida; however, a lesser noticed part of the announcement CLOSED some formerly open (and very promising areas) to further development in Alaska, which actually means that the net result of the initiative is to "push" production from the new areas later into the next decade, and the new areas have much less known about their potential oil and gas reserves. Loren Steffy, financial writer for the Houston Chronicle, made some salient points in his 4/2/10 article entitled, **Dodge, Baby, Dodge on Drilling Issue**: "Billed as a compromise, Obama's policy is really an expensive trade-off, shutting down access to fields of known reserves in favor of some very expensive question marks….[t]he headlines, of course, were that Obama was opening parts of the East Coast and eastern Gulf of Mexico to new drilling, but most of that is just a political dance to woo Republicans for a climate bill…..[w]hat's more, unlike Louisiana and Texas, the East Coast has no drilling infrastructure to speak of — no storage facilities, pipelines, hubs, equipment yards, or transportation system for shuttling workers to and from the rigs." This means that even if oil and gas is found off Virginia, Maryland et al, whole new areas of infrastructure will have to be established, meaning it will be far more expensive than comparable Gulf of Mexico production.

Finally, Mexico and Venezuela have seen their production fall to less than 50% of peak production seen within the last five years, meaning nearby, inexpensive sources of crude oil which have historically supplied the US are dwindling, causing refiners to have to source crude supplies from farther away and many times from political hotspots in West Africa and the Middle East. The main beneficiary of these industry movements is Canada, and more specifically, the Canadian oil sands companies, who are able to maintain relatively constant (and thus dependable) production levels with plans for increased production in the next few years.

Thus, we believe that the dynamics of the oil industry are continuing to get better. We have confined most of our oil investments to Canadian oil sands companies, US independents with a more "oily" production profile, deepwater drilling companies, and major oil companies with oil-centric prospects and well-supported dividends on their stocks.

As mentioned before, we are still very concerned about natural gas prices in the next eighteen months, and thus have thinned or eliminated positions that were most dependent on higher natural gas prices for appreciation or income. While we believe the oversupply problems of US natural gas + LNG is only medium-term in nature, we have seen oversupply of natural gas in the last 20 years push prices down below $1/MMBtu at times of extreme supply-demand imbalances. We will continue to avoid natural gas until we feel like there is some resolution in our minds of true cost of shale gas in North America and the supply-demand balance for new LNG projects coming on-line during 2010/2011 and how they will affect US gas prices.

Commentary

"The Great Dichotomy"

One huge question facing the financial markets is how "real" the economic recovery in the United States/the developed world is. There are legions of proponents on both sides; many saying that we are in a classic recovery from a recession, while others are supporting an argument that we are in an anemic "bounce back" from a huge slump, which could peter out during the first half of 2010. The stock market so far seems to be following the "real recovery" camp, ignoring the various financial and political problems that still plague many parts of the US. Thus, we thought we would update our thoughts on the US and world economies and use these thoughts to help project where we believe the financial markets will be heading during the rest of 2010.

The bulls on the economy point to the patterns of past recessions and project how a large US economy will mean that this recovery will be much stronger than people think. Bulls point to the resurgence of the US manufacturing segment, which has recovered from its near free-fall in late 2008 to post months of improving results: climbing GDP, higher monthly industrial production trends, an ISM (Institute of Supply Management) survey in February that was above 60 (a reading above 50 shows an expansion of US manufacturing, a reading above 60 shows real sustained strength).

Bulls point to the growth in non-OECD countries such as China, India, Korea, Brazil, Argentina, Columbia, etc. who saw only slowdowns and did not exhibit true recessions. These economies continue to grow, and they need US raw materials and manufactured products, which should, with a weaker dollar, allow faster US economic recovery.

There have been interest rate increases in Australia, New Zealand, and China over the past few months, and recently India raised interest rates – all these countries' actions indicate economic activity that is sustainable, thus removing the need for low interest rates. Bulls point to US joblessness not getting worse as evidenced by flat to falling weekly initial jobless claims, months of rising "leading indicators" from The Conference Board that economists use to project future economic growth, and rising retail sales in the past two months as evidence of US economic recovery.

While bullish commentators don't often use this in their arguments supporting robust recovery, the strong move up in commodity prices from their bottoms in the last 18 months is an indicator of renewed growth. Economically-sensitive commodities like zinc, lead, nickel, iron ore and copper have almost doubled (in some cases, more than doubled) in price since their trough prices, and this shows the demand from infrastructure projects around the world, but especially in the BRIC (Brazil, Russia, India, China) and neighboring countries.

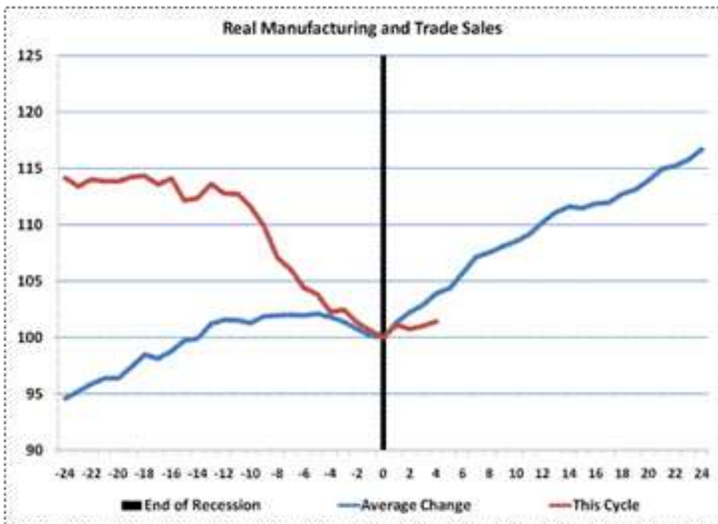
On the other hand, there are also numerous bearish points of views of the state of the US economy.

The view that the developed countries' economies are still in trouble still prevails in a number of corners of the financial market. David Rosenberg, formerly chief economist at Merrill Lynch and currently chief economic analyst at the Canadian economics firm Gluskin Shelf, summed things up well recently with the following:

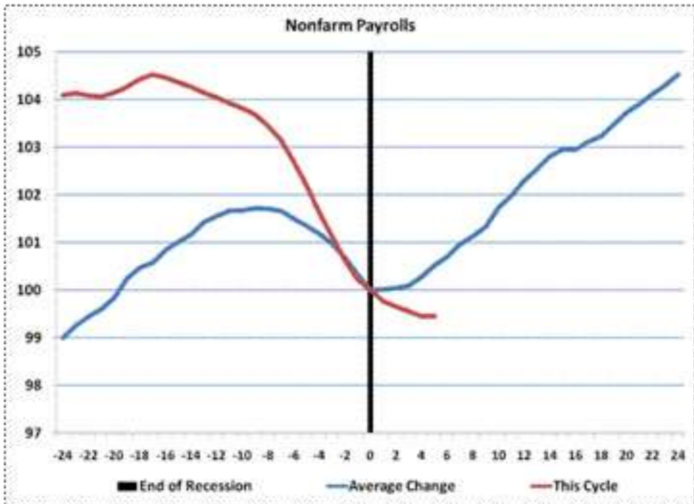
- More than 5 million US homeowners are behind on their mortgage [payments];
- Over 6 million Americans have been unemployed for at least six months, a record 40% of the current jobless;
- Private capital stock [corporate assets] is growing at its slowest rate in nearly two decades;
- Roughly 30% of US manufacturing capacity is sitting idle;
- Nearly 19 million residential housing units, or about 15% of total stock, is vacant;
- One-in-six of American workers is either unemployed or underemployed;
- Commercial real estate values are down 30% over the past year;
- The average American worker has seen his/her wealth plunge $100,000 over the past two years, [in spite of the large rise in equity markets since March 2009];
- Bank credit is contracting at an unprecedented 15% annual rate so far this year as lenders sit on a record $1.3 trillion of cash;
- Unit labor costs are down an unprecedented 4.7% over the past year, and what has replenished household coffers has been the federal government, as **transfer payments from Uncle Sam now make up a record 18% of personal income [emphasis mine KS]** (and the Senate just passed yet another jobless benefit extension bill)."

Another interesting position is presented by William Hester of the Hussman Funds in his February article, "A View from the NBER Recession Indicators." In this article, Hester examines the four factors used by the USA's NBER (the National Bureaus of Economic Research) – the non-profit organization whose "Business Cycle Dating Committee" examines economic statistics and states (after the fact) when recessions began and ended), and where each indicator currently stands. The NBER defines a recession as a "significant decline in economic activity spread across the economy, lasting more than a few months, normally visible in production, employment, real income, and other indicators." The four primary indicators used by the NBER are: Industrial Production, Real Manufacturing and Trade Sales, Real Personal Income Less Transfer Payments, and Nonfarm Payrolls. Hester has graphed how this recession compares to post-World War II recessions since 1953 and has set the graphs to coincide at their economic troughs (in our case, he has set the trough of economic contraction at June 2009) to judge the strength of this recovery. The graphs of the four indicators are below:


Industrial Production
120
115
110
105
100
95
-24 -22 -20 -18 -16 -14 -12 -10 -8 -6 -4 -2 0 2 4 6 8 10 12 14 16 18 20 22 24
End of Recession
Average Change
This Cycle


Real Manufacturing and Trade Sales
125
120
115
110
105
100
95
90
-24 -22 -20 -18 -16 -14 -12 -10 -8 -6 -4 -2 0 2 4 6 8 10 12 14 16 18 20 22 24
End of Recession
Average Change
This Cycle


Personal Income Less Transfers
109
107
105
103
101
99
97
95
-24 -22 -20 -18 -16 -14 -12 -10 -8 -6 -4 -2 0 2 4 6 8 10 12 14 16 18 20 22 24
End of Recession
Average Change
This Cycle



As you can see from the four graphs, Industrial production is the only one which shows a typical post-war recovery. Real Manufacturing & Trade Sales as well as Personal Income Less Transfers show almost no growth, which is much weaker than a typical recession. And finally, Nonfarm Payrolls show continuing deterioration. Since GDP is only released quarterly, the Committee does not use it, and relies most heavily on Personal Income Less Transfers and Employment to determine the month of recessions' beginnings and endings. Thus, with those indicators showing no recovery, we believe that the NBER still believes we are in recession, and the Fed, whose dual mandate includes using all its "tools" to support "full employment", is likely to keep policy accommodative in order to try to help recovery in payrolls.

One last set of indicators: Dennis Gartman, market commentator and technical analyst/money manager, declared the recession to be over in the June/July 2009 timeframe. He bases his analysis on a few indicators, most notably: 1) when Weekly Initial Jobless Claims "spike down" significantly from their high recessionary levels and then work their way lower as the recovery accelerates, and 2) The Conference Board's ratio of Coincident Economic Indicators to the Lagging Economic Indicators bottoms and heads higher. His work says that these two things occur within a month or two of the end of the bottoming phase of recessions, indicating when recoveries start, and these things did occur in June/July 2009. However, after their initial spike down, Weekly Initial Jobless Claims have held stubbornly in the 450-475,000 range, not falling as typically happens during recoveries. In addition, after climbing since last summer, the ratio of Coincident-to-Lagging Indicators has turned back down this winter, possibly indicating further economic weakness.

Therefore we have what we are calling the Great Dichotomy. Many economists, money managers and traders see the US (and to a lesser extent other developed countries) in a post-recession recovery while a number of others see recessionary conditions persisting, in spite of a post-bottom bounce due to inventory restocking. We believe that the recession, while possibly having "ended" by getting no worse after last summer, seems to have kept a vise grip on many elements of the economy, showing almost no recovery more than six months later. We believe that employment, personal income and discretionary spending will show anemic growth at best over the next few months as recessionary conditions linger from an overhang of consumer and government debt, oversupply of labor, lack of significant innovation in technology and little catalyst for job growth.

So, why are the US stock markets doing so well over the past twelve months? Markets typically anticipate economic moves, as investors and traders find that indicators are getting "less worse" as they bottom out at the ends of recessions. The "bottoming out" process occurred last spring and summer, and the markets, having fallen so far that pervasive bearishness was overdone, rallied, anticipating the second half of 2009 beginning of the recovery. But this does not explain the continued moves up in the markets last fall and winter. A number of factors have combined to push the market back to 19 month highs during March: 1) earnings growth, which almost **had to** grow (and show good year-on-year comparisons) after "falling off a cliff" in late 2008/early 2009, 2) the Fed's continuation of "cheap available credit" for financial institutions [described by the Fed as "very low short-term interest rates for an extended period of time] which encourages investment of borrowed funds into financial instruments like stocks, bonds and commodities, 3) the perception that no inflationary pressures are evident due to soft labor markets and little increase in food and fuel costs, 4) positive investment momentum and favorable technical indicators, and 5) statistics "headed in the right direction" (unemployment numbers less bad, consumer spending inching up, home sales increasing slightly), just like happens in a typical recovery.

Why aren't those factors enough for a sustained bull market? Why are we still wary about the markets, and why aren't our investment portfolios more diversified? One big reason is that there is still so much government influence on things: 1) Historically low short-term interest rates and a historically high spread between short- and long-term interest rates allow banks to "get" profits directly from the government – borrowing at Fed-determined 0.25% and lending to the government (through buying US Treasury bonds) at 3.75%. At the same time, heightened levels of mortgage guarantees from US Government controlled entities: Fannie, Freddie and FHA [all of which are currently insolvent without government backing] are all that is keeping the mortgage market active, through their purchase of conforming mortgages; non-conforming mortgages cost approximately 2% more and are more difficult to find and obtain. Meanwhile, mortgage rates (and to a lesser extent long-term US Treasury bond rates) have been held down through Quantitative Easing, the Feds' program which purchased $1.2 **trillion** dollars of US mortgage bonds and $300 billion of US Treasury bonds. Finally, the FDIC increased protection for deposits from $100,000 to $250,000 in late 2008, which is causing bank failures to be much more expensive as large depositors are given 150% more protection and banks are accumulating more cheap deposits in their capital base. None of these factors are usual and customary – all are generational or historical occurrences – meaning that without these extraordinary supports (some of which could be ending soon), the economy and more possibly the financial markets, could suffer fairly quickly upon their withdrawal.

One last point: a large percentage of expected S&P 500 earnings growth for 2010 is contributed by the financials, which are benefitting hugely from the "government carry trade" referenced above (borrowing short, lending long-term) which allows them to make a large amount of relatively risk-free profits (as long as the spread between short-term and longer-term interest rates stays at current or higher levels). If the US economic recovery continues to improve, short-term interest rates will have to be raised and financials' earnings will be hurt, pushing down their earnings and the S&P 500 earnings, which will put pressure on US stock prices. Of course, if the recovery falters, short-term interest rates will stay low, but long rates may drop, hurting financials' profits somewhat but the resulting lack of economic vigor will hurt profits of many US companies, potentially pressuring S&P 500 stock prices. Thus, the stock rally is predicated on another "Goldilocks" type of recovery – not too much, not too little, which will be very difficult to achieve.

Thoughts for the Future

What are the long term implications of this US Government support; or in other words, where did all this support come from and why hasn't it proven more inflationary so far? Scott Burns, financial newspaper writer, in his recent article **Today's Interest Rates Rip Off 'Solvent Seniors'**, senior citizens with shorter lifespans have seen their cash investments' returns shrink to almost zero. Big banks, through their low deposit offerings [big banks don't have to pay much for deposits because they can always borrow extra at near 0% Federal Funds rate as maintained by the Federal Reserve] have attracted near costless capital. However, these low interest rates are devastating to savers. During 2007, money market funds yielded as much as 5% on cash balances; for the year, they have yielded around 0.50%, **a drop of approximately 90% in income for savers in cash accounts [Emphasis mine – KS].**

> As Burns says, "What neither political party nor the Federal Reserve will admit is that every dime our banking system is making through low deposit costs is coming out of the pockets of savers. Some would call this theft, even though it isn't being done with a gun. Others may say it's a tax that doesn't have to be called a tax. You decide." He continues, "Based on $7 trillion of bank deposits, what is happening amounts to a gigantic income transfer. The income goes straight from Solvent Seniors and others to the bankers. No bullets fired, no blood on the floor, no awkward displays of public carnage. But that's not all. While income is down this year, the longer this goes on, the greater the long-term impact. Here are a few of those impacts:

• "More seniors will go broke. If the Solvent Seniors don't reduce their spending, they will run out of money before they die.

• "Premiums for long-term-care insurance will rise. Investment income is an important part of what makes such insurance work. Policy premiums earn investment returns. If insurance company portfolios earn less, they will have less in reserves against future benefit payments. Result: higher annual premiums. More seniors will drop their policies because their income is down and their premiums are up.

• "More seniors on Medicaid. Combine the two, and more seniors will find themselves in nursing homes on Medicaid, adding substantially to future government expenses.

"But make no mistake about it: A government can raise "taxes" on one group (Solvent Seniors) and transfer income to another group (bankers and their banks) without ever calling it a tax. How? Just do what the Federal Reserve has been doing: holding short-term interest rates well below the rate of inflation."

Burns' article highlights one of the causes of recent strength in US stock markets: the need for yield which has been stripped from savers. Forced investing to find yield is often a risky rationale for investing in stocks. Three other occurrences during March however point toward future weakness in the financial markets:

1) Shockingly, the Congressional Budget Office (CB)) said in mid-March that the Social Security program is expected to be ***in a cash deficit this year***, in the amount of $29 billion, due to the unforeseen consequences of the recession's reduction of jobs (people paying into social security) and the early call on Social Security assets by younger seniors out of work and requiring income. The Social Security Trust Fund was not supposed to show deficits until at least 2016, but now the CBO says the fund will run deficits for 2010-2013, at least. In our minds, this event really shows the precariousness of governmental obligations.

2) For the first time in many, many years (and possibly ever), United States Ten-Year Treasury bonds ***traded at a premium*** to corporate bonds of comparable ratings as represented by what is called the "swap spread" during the last week of March 2010 (an continuing into April 2010). The financial press passed this off as people moving from "ultra-safe Treasuries" to "higher yielding corporate assets"; however, this is also another symptom of less appetite from investors for US Treasuries and indicates the growing oversupply of Treasury bonds. Regular auctions of Treasuries during the last week of March showed worse results than recent auctions, pushing up interest rates on 5-, 7-, 10- and 30-year Treasuries, reconfirming the swap spread indicator discussed above. The Treasury has to refinance 44% of its borrowings this year (much of that is Treasury Bills, or 1-week to 3-month T-Bills that have been very popular after the 2008 financial

meltdown), and the market is increasingly looking at the large supply to come and slowly pushing down bond prices, which cause borrowing costs to rise.

3) We note small (and large) banks were forced by government regulators to prepay three years of FDIC insurance protection in order to keep the "FDIC bailout fund" solvent in the short-term. It was projected to go into deficit during the first quarter due to so many bank rescues, and the FDIC forced all banks, healthy and maybe-less-than-healthy all to "pony up" capital for the fund. This, of course, forces potentially productive capital that could be used to make loans or buy bonds by small banks to instead go to cover losses of banks that continue to fail in alarming numbers. Again, this shows how politics trumps good economics – even while legislators are complaining that banks aren't lending enough, they are making banks pay for the sins of their reckless brethren so that politicians can claim that "the American people" did not cover bank failures.

All of these events show the weakness of US government-supported programs. The market has seen overarching governmental reach into private business at the same time as deteriorating government budgets since the 1960s, but the US economy has always shown resiliency and renewed vigor after each crisis, allowing officials and the public to feel like things returned to normal. Our latest crisis, however, occurred at a time of extreme overleverage in the private sector, and the government's taking on a much higher debt load to support the deleveraging private sector has led to an unthinkably large fiscal shock during a time of high unemployment and low interest rates. The rising issuance of US government debt and the recovering world economy will put pressure on long-term interest rates, threatening US economic recovery and even fostering the discussion of the possibility of the US government losing its AAA credit rating in mainstream financial conversations.

John Hussman, financial writer, mutual fund manager, and former economics professor, ended his 3/29/2010 commentary with a "refrain" he has used in past years and has had to state again during 2010: "As of last week, the Market Climate for stocks remained characterized by strenuous overvaluation, overbought conditions, overbullish sentiment, and hostile yield pressures. [Hussman's] Strategic Growth Fund remains fully hedged, with the same [hedge] position[s] we had at the 2007 [stock market] peak….." We think he has done a good job of expressing a view of the current stock market through a more traditional, historical-valuation framework market analysis.

The Managers of Kanos Capital Management