Storm Clouds Gathering in Washington Threaten to Rain on Wall Street's Parade

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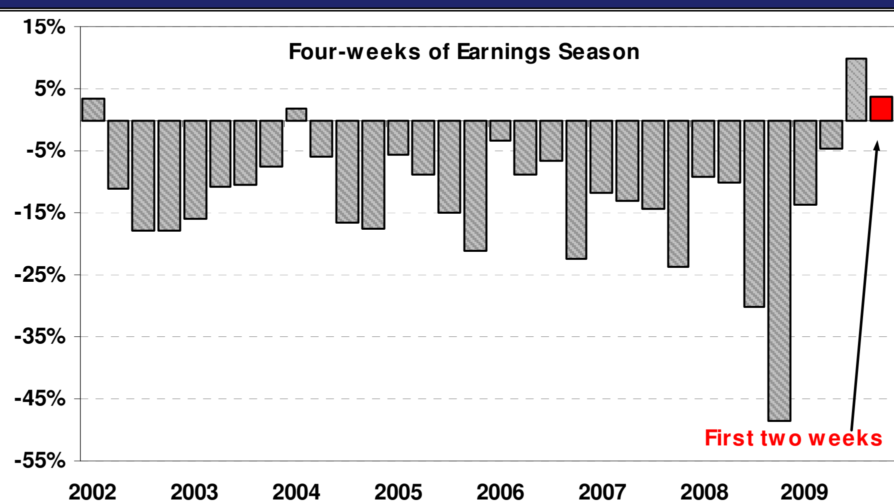
The political climate in Washington has become progressively more hostile. President Obama unveiled plans to impose a special tax on big banks two weeks ago, and last week he proposed an overhaul of financial regulations with new restrictions on the size and scope of activity for large banks. Ronald Reagan, our 40th President and famous political philosopher, may have captured the White House's attitude best when he said, "Government's view of the economy could be summed up in a few short phrases: If it moves, tax it. If it keeps moving, regulate it. And if it stops moving, subsidize it."

It appears to us that President Obama's proposals would intensify the financial sector's problems because they would lower profits, increase uncertainty and lessen credit availability without benefiting economic growth. The wave of anti-Wall Street sentiment sweeping through the White House and the halls of Congress is deeply distressing to investors. As detailed in this report, stocks have traditionally reacted violently to the type of anti-business rhetoric flowing from Washington and the odds of a politically driven bear market are rising.

Although erratic stock market performance is likely to continue as a result of this political uncertainty, we maintain our positive perspective. Profit trends seem to support our optimistic strategy. Fourth quarter earnings reports have exceeded elevated expectations by a huge margin, corporations are raising guidance for the second straight reporting season (see chart below) and we believe S&P 500 profits could increase an additional 20% in the next four quarters. As a consequence of strong profit performance, companies are generating extraordinary amounts of surplus cash, which is increasingly being used to repurchase shares and to make acquisitions.

Net Percent of Companies Raising Earnings Guidance



Source: Bloomberg, Mizuho Securities

Please refer to page 9 of this report for important disclosure and analyst certification information.

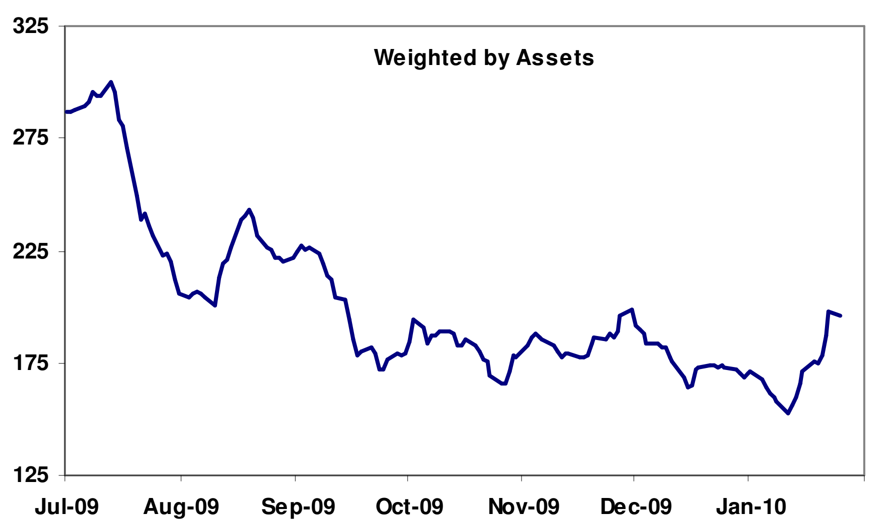
Obama Takes On Wall Street, Again

We view President Obama's plan to impose a special tax on banks and to overhaul financial regulations as an unequivocal negative for stocks. It appears to us that the President's proposals would intensify the financial sector's problems and derail the banking recovery. These planned changes would lead to lower profits and increased uncertainty and would lessen credit availability without benefiting economic growth.

Unquestionably, increased taxes and restrictions on size and scope of activities will reduce bank profits. Obama's proposed levy on non-deposit liabilities was designed to raise $90 billion over 10 years from about 50 of the largest banks, while the trading restrictions would have a considerably larger negative impact on profits of big banks. Doubts about future earnings power inject another dimension of risk into an already highly uncertain and complicated outlook for financial stocks.

By adopting a tougher line, the administration may be frightening off the very capital that is critical to restoring the health of the banking sector. Investors are wary of the new policy initiatives and may become increasingly reluctant to invest in financial institutions as new legislation is debated in congress. Indeed, when the proposals were announced, stock prices of many of the nation's largest financial institutions spiraled downward, and our proprietary index of credit default swap spreads of major banks and brokers soared (see following chart), which attests to the riskier climate. The more hostile political climate will make the capital that is required to offset soaring credit defaults less available and more expensive. We fear that a protracted congressional hearing on the proposed regulations would heighten uncertainty and reduce liquidity in the financial system.

Mizuho's Financial Sector CDS Index



Source: Bloomberg, Mizuho Securities

Understandably, investors are concerned that the tougher stance on financial institutions is being driven more by political motivations than careful consideration of the needed financial reform. As many in the press have pointed out, the new proposals do not address the problems at the root of the Financial Crisis of 2008. That is, banks' proprietary trading did not contribute to the near meltdown of the financial system and the institutions at the center of the crisis: Bear Stearns, Lehman Brothers, AIG, Fannie Mae and Freddie Mac were not banks. Furthermore, there are barriers between insured deposits and trading activity, with restrictions on how banks can use their deposits.

The root causes of the crisis included a housing and credit bubble, liberal monetary policy, excessive use of leverage by financial institutions and households, inadequate capital standards, regulatory failures, mark-to-market accounting rules and failed oversight for Freddie Mac and Fannie Mae—not the lack of Glass-Steagall-style restrictions on bank operations.

To some investors, new proposals are a transparent attempt to lash out at Wall Street. What troubles us most is that political grandstanding can resurrect something a bit more sinister than Glass-Steagall, namely, that treacherous beast that terrorized investors and brought many banks to the brink of insolvency a year ago—the bear.

Indeed, history shows that stocks have reacted violently to the type of anti-business rhetoric flowing from Washington. Consider the stock market during the early days of the Obama administration when the President laid out his ambitious social agenda and adopted a hostile attitude toward financial institutions. Investors became deeply distressed about the administration's efforts to place blame for the entire financial crisis on banks and Wall Street, and stock prices spiraled downward, giving rise to what became known as the Obama Bear Market. In the first 52 days of the presidency, the S&P 500 fell 20% and the KBW Bank Index dropped 38% (see table below).

Sector Performance: Policy Related Pullbacks

	January 20, 2009 To March 9, 2009	January 20, 2010 To January 22, 2010
Consumer Discretionary	-22.8%	-4.3%
Consumer Staples	-15.9%	-2.8%
Health Care	-16.7%	-3.9%
Industrials	-31.3%	-4.9%
Technology	-12.7%	-6.2%
Energy	-17.1%	-5.8%
Materials	-20.3%	-7.9%
Financials	-35.6%	-6.2%
Utilities	-22.6%	-4.6%
S&P 500	**-20.4%**	**-5.1%**

Source: Mizuho Securities, Bloomberg

The only other time in recent history that a president adopted such an explicitly hostile attitude toward business was over 45 years ago during the Kennedy administration. In early April 1962, President Kennedy attacked major steel corporations for increasing prices, and the stock market fell into a steep slide as investors became worried about the new administration's attitude toward business. In the weeks that followed, stock prices moved relentlessly lower as the Justice Department ordered a grand jury investigation of possible antitrust violations by the steel companies and President Kennedy made clear his intention to become deeply involved in the wage and price policies of other major industries. Over a three-month period, the stock market fell 23%.

Based on our view that President Obama's proposals would lower profits and reduce the ability to raise capital, we recommend investors reduce exposure to large banks.

The following table compares the performance of the stock market in the first two years of each new presidential administration dating back to Herbert Hoover. In first year of President Obama's presidency, the S&P 500 surged by 33.9%, the second best performance over that time. Unfortunately for investors, history shows that following such strong gains the stock market is likely to fall in the second year of the presidency.

First & Second Year of New President and S&P 500

President	Inauguration	First Year	Second Year	Both Years
Herbert Hoover	Mar 4, 1929	-8.9%	-26.3%	-32.9%
Franklin D. Roosevelt	Mar 4, 1933	89.6%	-21.2%	49.3%
Harry S. Truman	Apr 12, 1945	33.5%	-21.6%	4.7%
Dwight D. Eisenhower	Jan 20, 1953	-1.0%	36.4%	35.1%
John F. Kennedy	Jan 20, 1961	15.0%	-5.2%	9.1%
Lyndon B. Johnson	Nov 22, 1963	20.5%	6.9%	28.8%
Richard M. Nixon	Jan 20, 1969	-12.0%	4.4%	-8.1%
Gerald Ford	Aug 9, 1974	5.5%	20.7%	27.2%
Jimmy Carter	Jan 20, 1977	-13.4%	11.0%	-3.9%
Ronald Reagan	Jan 20, 1981	-14.2%	26.9%	8.9%
George H.W. Bush	Jan 20, 1989	18.2%	-2.0%	15.8%
Bill Clinton	Jan 20, 1993	9.2%	-1.7%	7.3%
George W. Bush	Jan 20, 2001	-16.0%	-20.0%	-32.8%
Barack Obama	Jan 20, 2009	33.9%	--	--
Median		7.3%	-1.7%	8.9%
Percent positive		57%	46%	69%
Positive First Year				
Median			-2.0%	15.8%
Percent positive			15%	54%
Negative First Year				
Median			7.7%	-3.9%
Percent positive			31%	15%

Source: Mizuho Securities, Bloomberg

Among the Best Earnings Seasons Ever

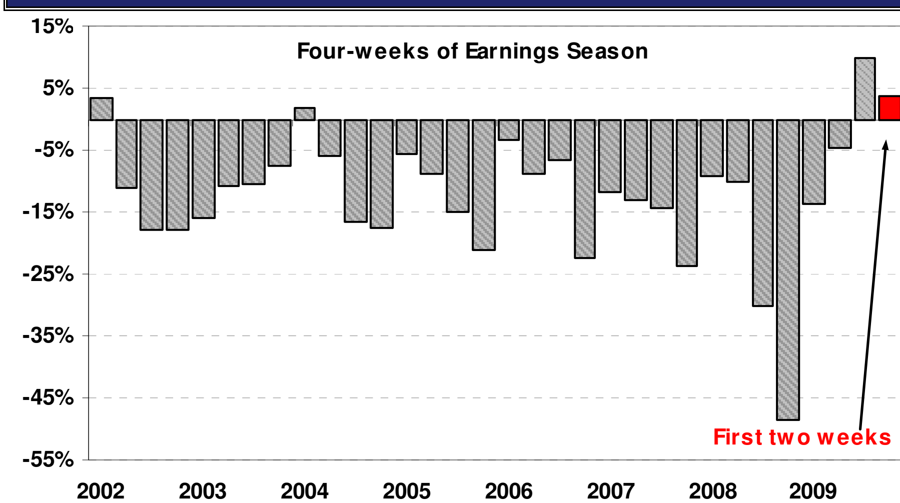
President Obama's bank reform proposals have overshadowed good news on the earnings front. The first wave of fourth quarter earnings reports exceeded expectations by a large margin for the third consecutive quarter. Based on data from about 30% of the capitalization that has already reported, fourth quarter earnings are exceeding analysts' projections by about 12% for the S&P 500, excluding financials, which is a bit above the 10% to 11% surprise margin recorded in the prior two quarters.

The results signal that revenue growth is beginning to replace cost cutting as the driving force behind the profit recovery. A large number of companies in technology and capital goods are reporting rising sales and expanding order backlogs. Some companies, especially in technology, are asserting that the pickup in demand goes beyond replenishment of depleted inventories and represents an increase in customer shipments.

So far, reported results for sales of non-financial companies are exceeding expectations by 3.3%, which is an improvement over the previous two periods when sales in line with expectations. When the reporting cycle is complete, we expect to see aggregate revenues for non-financial companies rising by 8% over the previous quarter, albeit partially influenced by seasonal effects.

What makes this reporting season profoundly different than most past cycles is that companies are beating elevated expectations and are guiding forecasts higher. For the past few months, analysts have been raising estimates at the highest pace in years and yet earnings reports are beating those forecasts by a substantial margin. In the first two weeks of earnings season, 53% of reporting companies issued positive earnings guidance, which is 3.8 percentage points higher than the 49.2% of reporting companies that lowered guidance. The following chart shows that the positive spread is the second highest reading since 2002.

Net Percent of Companies Raising Earnings Guidance



Source: Bloomberg, Mizuho Securities

Based on results so far, we see no reason to change our $80 estimate for 2010 S&P 500 operating earnings. Optimism is called for as we are in the early stages of the margin expansion phase of the profit cycle and the economy is expanding. Additionally, overseas profits are strengthening, currency translations should be positive for a quarter or two and productivity gains should remain relatively robust as companies are slow to hire workers. We project that S&P 500 profits could increase an additional 20% in the next four quarters. In short, we are on track for one of the best profit recoveries in history.

Revisions in Earnings Estimates: Last 4 Weeks

	Percent Estimate Revisions			Net
	Up	Down	No Change	Up-Down
Consumer Discretionary	62%	27%	10%	35%
Consumer Staples	41%	39%	20%	2%
Health Care	47%	45%	8%	2%
Industrials	56%	26%	19%	30%
Technology & Telecom	56%	27%	17%	29%
Energy	63%	37%	0%	26%
Materials	79%	21%	0%	57%
Financials	45%	49%	7%	-4%
Utilities	46%	49%	6%	-3%
S&P 500	**54%**	**35%**	**11%**	**19%**
Excl. Financials	**56%**	**33%**	**11%**	**23%**

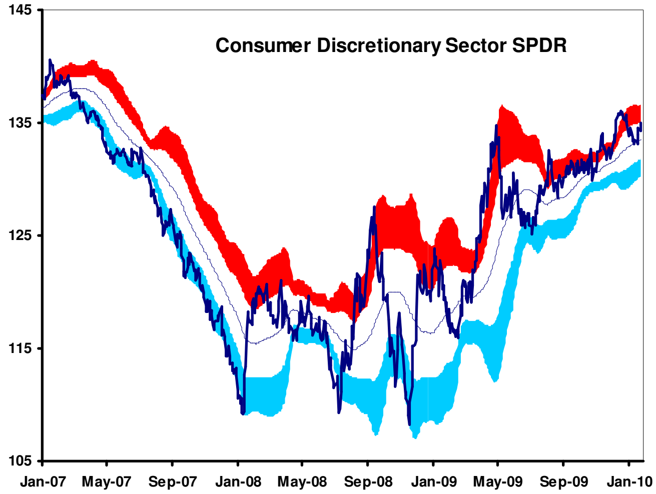
Source: Mizuho Securities, Zacks

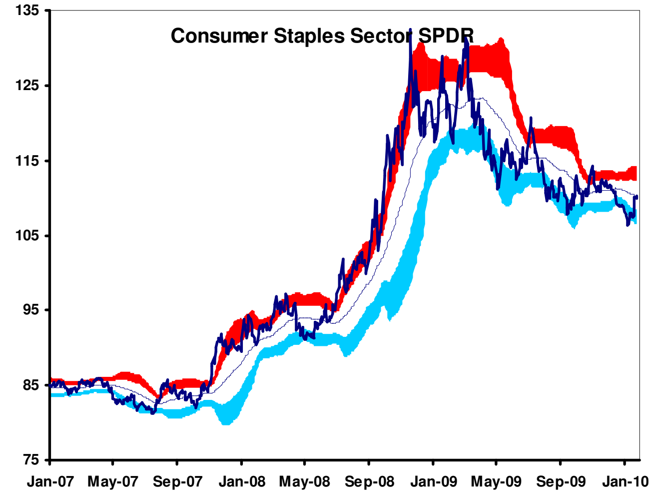
Sector Valuation: S&P 500

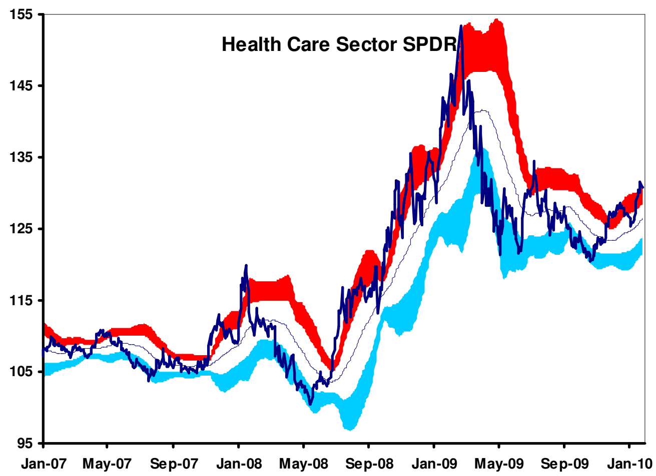
	P/E Valuation		Estimated Growth		Est. Chg.	Growth	
	2010E	2011E	This Year	Next Year	Last 4 Wks	Next 5 Yrs	Yield
Consumer Discretionary	16.4	13.5	21.6%	21.1%	1.3%	11.8%	1.4%
Consumer Staples	14.0	12.9	10.2%	8.5%	-0.1%	10.0%	2.9%
Health Care	12.0	10.9	8.6%	10.1%	-0.1%	8.4%	2.0%
Industrials	16.2	13.7	10.5%	18.9%	0.4%	10.2%	2.2%
Technology & Telecom	16.2	14.2	22.8%	14.4%	1.1%	13.3%	1.6%
Energy	12.4	9.7	48.3%	27.4%	1.0%	6.5%	2.1%
Materials	16.5	12.8	71.9%	28.5%	3.7%	10.0%	1.9%
Financials	13.9	9.4	115.0%	47.5%	-0.8%	14.5%	1.2%
Utilities	12.0	11.3	5.8%	6.5%	-0.4%	4.9%	4.4%
S&P 500	**14.3**	**11.9**	**28.0%**	**20.5%**	**0.6%**	**10.5%**	**2.0%**
Excl. Financials	**14.4**	**12.4**	**19.8%**	**15.9%**	**0.9%**	**10.1%**	**2.1%**
Excl. Financials & Energy	**14.7**	**12.9**	**15.8%**	**13.9%**	**0.9%**	**10.5%**	**2.1%**

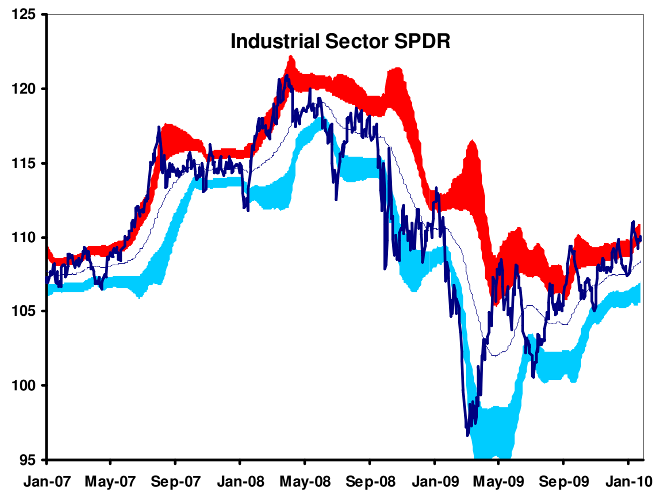
Source: Mizuho Securities, Zacks, Bloomberg

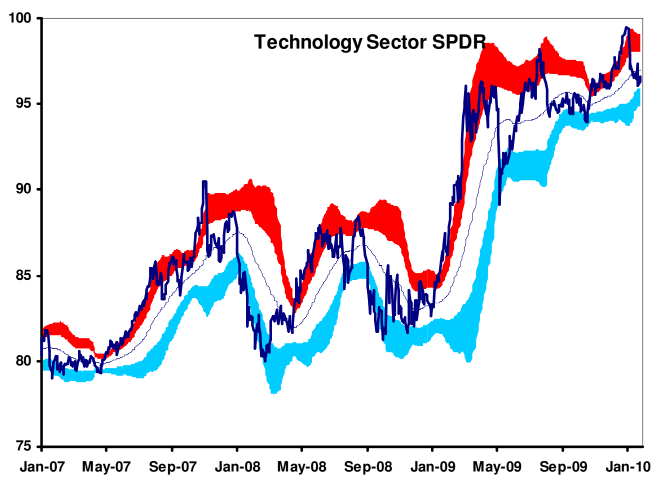
Price Relative to S&P 500

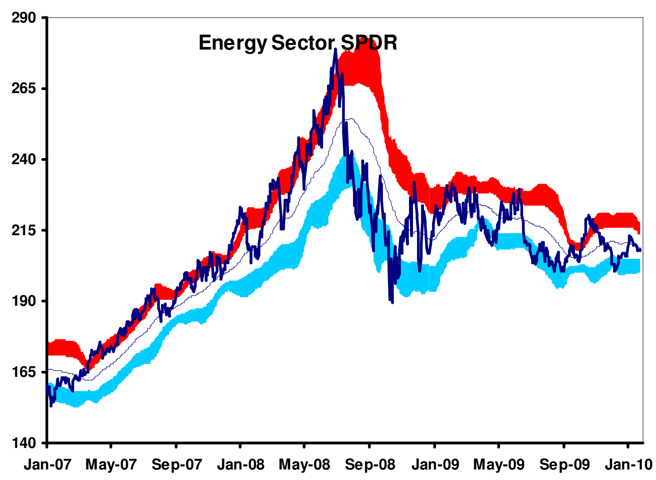












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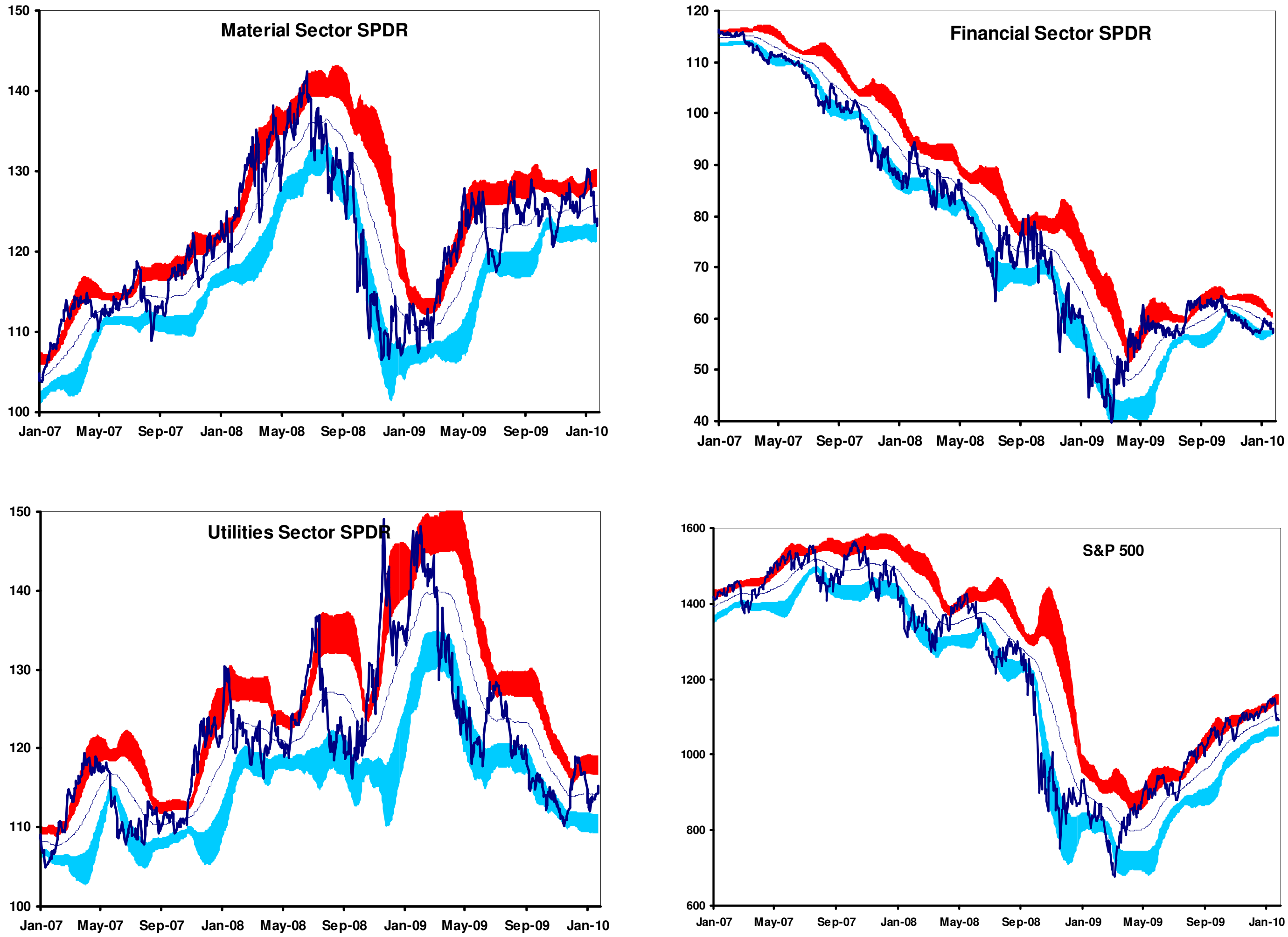

Source: Mizuho Securities, Bloomberg

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