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FINANCIAL CONCEPTS, INC. – QUARTER 1 - 2011

MARKET RESEARCH & INVESTMENT COMMENTARY 13:

Dear Clients:

The long winter now looks to be over from both a calendar and economic perspective, with recessionary talks in the rear view mirror, placing investors another year removed from the 2008 financial crisis. Corporate profits were at a record level in the fourth quarter of last year and are expected to maintain an upward trend when earnings are formally tabulated.

The equity indices are near highs for the year and have averaged in the 5 % to 10 % range as momentum seems to be stronger, driven by profits and economic fundamentals while shrugging off headlines such as the U.S. budget deficit and global political tensions. With fundamentals improving, we must never lose sight of the importance of using prudent risk management tools in investment portfolios, and having the humility to accept the fact that the future may be uncertain.

We should not discount the benefits of the extension of lower capital gains and the dividend tax rate for investors that legislators enacted at the end of last year. Forecasts by leading economists call for rising economic fundamentals, business capital investment, consumer spending increases, and finally broad based sustainable private sector job growth.

As we try to assess the notable stock market performance of prior months and come up with strategies for the future, our investment staff here at Financial Concepts, Inc. is always looking for new opportunities with these perspectives in mind:

THE OUTLOOK

Prudent financial market policies and the collective wisdom of investors have put the economy in a much more favorable situation compared to the events that unfolded just a few years back. The financial markets are starting to progress, with advances being made in both corporate bonds and equities. The business cycle has also been supported by export growth and improving use of excess capacity, noted by the stock market's return and positive earnings announcements.

Here are some of the macro trends that we are looking at with favorable indications:

- Monetary policy actions by the Fed via quantitative easing strategies.
- Return of investor risk appetite and weakened deflationary threats.
- Consumer spending gains and a much wiser use of personal debt.
- Employment gains showing signs of sustainability now and later.
- Record business profits and cash rich corporate balance sheets.

- Global growth from emerging markets and developing countries.
- Economic growth accelerating and reduced recessionary fears.

We still have some dark clouds on the horizon that suggest prudence and caution:

- Inflationary threats rising from a very low level for the first time in several years.
- Currency instability as reflected in higher gold prices, and a weaker U.S. dollar.
- Volatility in the housing market complicated by ongoing foreclosure issues.
- Policy uncertainties regarding financial reform, health care, and the deficit.

Retail Investor Sentiment: Investors Returning to the Market

American households have been sitting on close to $ 7 trillion dollars in cash and liquid assets earning a minimal return based on data from the Federal Reserve's Flow of Funds statement, a figure that barely moved for all of last year.[1] The liquidity level is likely to come down as the market momentum continues and investors begin to re-purchase assets.

Institutional Investor Sentiment: Is the Heightened Appetite for Risk a Concern?

First quarter hedge fund activity, including net inflows and pending searches (new business), totaled $ 18 billion, the highest since the intense investment pace of 2007, which saw $ 25 billion plus. Investment activity in the quarter ended March 31 was up 38 % from the same quarter of 2010, when levels totaled just $ 13 billion. The view these days is very much like that before the credit crisis of 2008, as investors more aggressively managed liquidity within their portfolios.[2]

ECONOMY

Growth Gains

The economy grew for the seventh consecutive period in the fourth quarter by 3.1 % compared to 2.6 % in the third quarter and 1.7 % in the second quarter.[3] The beginning of this year is expected to be the eighth consecutive quarter of economic growth, but at a more modest clip of around 2.5 % following the exceptionally strong patterns of consumer and business spending, which are emerging as larger drivers of the economy in comparison to government expenditures.

The consensus view is for GDP to potentially grow at around 3 %, or close to the long term U.S. growth rate in 2011, with employment growth picking up as we progress through the year but not by enough to put a significant dent in the jobless rate which is likely to stay in the 8 % to 9 % range.[4] Compared to the number of people out of work just one year ago when the jobless rate reached almost 10 %, this recent reduction is a notable improvement.

While a "double dip" recession was a common media topic not long ago, there is scant mention of inflation among economists and business journalists today. Should growth exceed expectations, interest rates could rise sooner than anticipated. Indeed long term rates began to rise late in 2010 and picked up again in the first quarter but short rates should remain low until the Fed begins to reverse its accommodative strategy which should continue through this year.

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[1] Federal Reserve's Flow of Funds Data.

[2] Pensions and Investments – April 2011

[3] U.S. Department of Commerce Data.

[4] Bond Dealers of America Economic Survey.

Since hitting a peak in the summer of 2008, household debt has fallen by roughly $ 500 billion, with most of this coming from lower mortgage payments owed to lenders and banks. Credit card debt has not grown during this period, but has stayed relatively constant at around $ 2.5 trillion, yet consumer balance sheets still look stretched on multiple measures.[5]

Despite, overall consumer debt being reduced by $ 0.5 trillion, unfortunately household wealth has also dropped by more than $ 10 trillion. Credit balances are starting to show signs of rebounding and reversing the downward trend which could be an extra source of consumer spending growth. The Federal Reserve recently found that debt levels rose this quarter.[6]

Housing Correction Still Has a Way to Go

Almost 6.7 million U.S. homes were lost to foreclosure, short sales or returned back to lenders between the years of 2000 and 2010, according to Moody's Analytics. Growing evidence suggests that another 3.6 million residences could meet the same fate all the way up through 2013. Residential home ownership figures have dropped from pre-crisis peak levels.[7]

Prices continue to slide in most regions as we progress into 2011. According to the widely followed S&P Case Schiller index 19 out of 20 major metropolitan areas had housing price declines and the average price fell during the fourth quarter. Keep in mind that housing is local – for example, the comparatively recession-proof Washington, D.C. market was the one of the few key real estate markets that the Case-Schiller index actually posted a gain in the fourth quarter.

Historically, the housing sector would help an economic recovery after a recession as lower interest rates typically have a tendency to spur higher demand for loans and financing. Much of the ongoing troubles are centered around determining the creditworthiness of prospective borrowers and the integrity of disclosures and documents that are part of this process.

On a more positive note, the sales figures of homes have begun to recover since mid-year when the statistics were the lowest in more than a decade following the expiration of the tax credit. First quarter existing sales were ahead of the fourth quarter of last year and have risen six of the last eight months including the most recently reported month, March.[8]

Will Relaxed Lending Standards Lead to More Business Volume?

Recently, the Federal Reserve released its quarterly lending survey that indicated that credit availability may be improving as banks have eased standards on commercial and industrial business financing, after the last several quarters of more stringent tightening. The survey also reported small business loan demand is on the rise.[9]

Balance Sheets are Cash Rich and are a Source of Hope for Economic Expansion

Corporations are still cash-rich, buoyed by record corporate profit levels in the first quarter and expectation of another solid second quarter profit reporting season, as businesses appear to be more willing to invest and hire additional staff.
The ISM index, the primary measure of business spending plans, shows 20 consecutive months of planned corporate expansion and the most recent reading.[10] The profit trends numbers clearly demonstrate that corporations have the potential to deploy cash and thus accelerate the pace of economic recovery.

Inflation Should be Monitored as Energy and Commodity Prices Warrant Scrutiny

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[5] Yahoo Finance – April 2011

[6] http://www.federalreserve.gov/releases/G19/Current/

[7] Wall Street Journal – March 2011

[8] http://www.realtor.org/press_room/news_releases/2011/04/rise_march

[9] http://www.federalreserve.gov/boarddocs/snloansurvey

[10] http://www.ism.ws/ISMReport/MfgROB.cfm

The March CPI was 2.7 % (but just 1.2 % in the core CPI measure excluding food and energy)[11], driven by energy prices but unadjusted for seasonal factors, up from 1.0 % in February. It is too early to determine a trend or merely a one-month "blip." Rising energy as well as food costs combined are hitting the "headline" inflation numbers. Inflation remains historically low but is on the minds of investors. Last year's CPI index was 1.6 %, within the Fed's 1.0 % to 2.0 % target.

China is starting to build strategic reserves in several leading rare earth metals, an effort that could give Beijing increased power to influence global prices and supplies in a sector it already dominates. This is in response to the demand for raw materials and agricultural commodities have risen from many regions surrounding Asia and other emerging markets.

It is worth stating that China controls more than 90 % of the current global supply of rare-earth metals, a group usually classified as 17 elements that are known for their importance in such high-tech applications as weapons and hybrid technologies. Mining and drilling companies around the world have responded by taking steps to increase production.[12]

Global Growth Contrasts: Emerging Markets Growing But with Inflation Risk

Policy makers in several leading emerging markets are taking numerous steps to contain inflation, as analysts and strategists worry about dampened demand for exports and global growth, further slowing progress in developed countries. The Chinese government introduced policy tightening early in 2010 and have continued this year in response to rising consumer prices. Benchmark 1 year deposits and lending rates by a quarter point to 3.25 % and 6.31 %, respectively.[13]

We continue to be persuaded by the research that suggests emerging economies with growth generated through internal consumer demand – such as India – may outperform external growth oriented economies – such as China – which are dependent on growth in the developed markets. Long term, emerging (and frontier) markets are the engine of growth.

Uncertain Outlook for Fiscal Discipline

The economy faces another year of $ 1 trillion plus deficits and indeed the forecast is for record deficits in the coming year. Regardless of its merits, the bi-partisan tax deal extending investment tax rate reductions (as well as unemployment benefit extensions and the cuts in payroll taxes) last-year likely adds to the short-term deficit. There is a public consensus for restraining the budget deficit but the degree to which it can be translated into action, is the critical issue.

The President's Commission of Fiscal Responsibility and Reform reported its recommendations late last year; the question is the extent to which policymakers will implement the recommendations, and may be a tough sell. The political will is a critical variable. Perhaps the recent "negative outlook" S&P action on the AAA U.S. debt rating may spur action.

Based on the still-developing and fragile economic growth trend and moderate inflation as reported in the notes of recent Federal Reserve's Open Market Committee meetings, the Fed will continue to keep rates at the current low level for an "extended period," very likely until at least the end of 2011, and possibly into 2012. The growth and inflation trends are likely to push the Fed into a more hawkish position as we reach the end of this year (i.e. raising rates).

The State and Local Finance Drag on Economic Prospects May Be Moderating

A downside risk for much of the last year has been the financial affairs of state and local jurisdictions. Unlike the Federal government, most states are required to balance their budgets, but the economy and related tax revenues have hit state budgets hard. There are also concerns of local and state government's capacity to finance looming pension obligations.

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[11] http://www.bls.gov/cpi/cpid1103

[12] Traders Magazine – March 2011

[13] Investor's Business Daily – March 2011

Local governments are just starting to feel the full brunt of the real estate bust. Sales tax revenues have fallen in step with consumer spending during the recession and are now beginning to bounce back. Cities typically rely heavily on property taxes and these receipts held up during the recession since houses were not being reassessed at lower valuations.[14]

In addition to the local government effect on the national economy, the state and local finances of course have implications for municipal bond prices and credit quality. The markets are increasingly differentiating between financial strong and weaker municipal bond issuers, and there have been concerns about the municipal bond market in general.

MARKETS

Rally Dependent on Continued Profits and Fed Policies: Fundamentals Need to Support

The stock market, especially technology, has rallied across almost all sectors to post strong gains, as the three major broad indices recorded double digit increases last year and have built upon these gains this year. The market also anticipates the economy as a "leading economic indicator" and thus the run up in prices recently is a positive expectation.

First, there is the corporate profit growth with earnings and cash flows at record levels. Second, the expectation of Fed policy makers to keep the recovery on track and manage inflationary threats. Third, is the expectation of growth picking up as we proceed through 2011. There should always be prudence in market strategies, ensuring that values represent fundamental trends and considering the risk potential in energy prices and the European sovereign debt outlook.

Bonds: Is the Sector Peaking?

Liquid balance sheets and positive profit trends reduced fundamental corporate credit risk. The rally raises questions of how much more appreciation, and there is a case to be made that corporate bonds are approaching full value. Rising supplies eventually will have price implications. Finally, the highly liquid corporate balance sheets are likely to be pared down when corporations put the cash to work in response to shareholder demands.

The International Bond Perspective

A number of European governments are undertaking programs that could significantly reduce their budget deficits. Many leading emerging markets are implementing various steps to deal with global capital flows without undermining international trade and investment. The success of these actions could have an important impact on whether 2011 brings further economic recovery and financial market progress.

While the European Central Bank leadership has stated that the height of the European debt crisis has passed, and its bond program support is being pared down, the markets need to be fully convinced. The discussion of a permanent European fund speaks to the continued concerns as well as periodic "crises." The riskier European sovereign credits still fetch extremely high yields reflective of elevated default probabilities. The euro currency will remain exposed to downside risk until there is clear evidence that the series of periodic crises are permanently subsiding.

Europe still needs to address its longer term structural issues, and there remains a widely held view that a European default is a distinct possibility during the next few years with Greece the most often mentioned candidate. Analysts see more European bond turbulence in 2011.[15]

Nevertheless, the Euro-zone economy has picked up. The ECB is attempting to balance debt market risks with inflation exposure. ECB recently became the first monetary authority in a major developed economy to raise interest rates since the global financial crisis struck, a sign that the long period of easy credit is beginning to come to a close. Inflation is more clearly a threat in Europe than other developed countries, as these member nations have progressed closer to full

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[14] CBS Market Watch – February 2011

[15] Google/Agence France Presse – December 2011

employment. The differences in monetary policies partly reflect altering views among the world's largest economies, and this can be derived largely from national and regional cultures and the degree of inflationary fear.[16]

Gold

The price has more than doubled in value since late 2006 and by more than 30 % over the past year driven by the investor concern about risk after the series of financial crises in recent years and national currency vulnerability, reaching $ 1,500 in April.[17] Three factors are at play – near term factors including the European debt crisis aftermath; Mideast instability; how much is being bought and sold by national central banks; and long term fiscal and monetary policies.

Certainly, a case can be made for gold and other commodities in a diversified investment portfolio. While prices have surged over the past year, however, gold prices can be volatile. In the 20 years through early 2010, precious metals funds tracked by Lipper, Inc, returned an average annual 6.15 %, less than all major sector fund categories tracked over those two decades.[18]

Real Estate

Commercial real estate typically follows economic cycles, and as the labor markets improve, so do the numbers of occupancies, which then result in rising rents with generally a lag of a few quarters. Property prices fell in 2008 and 2009 as financing became very difficult to obtain coupled with job losses. Due to the ever increasing population in the United States, demand for real estate should eventually lead to increases in occupancies and rents that will drive up property income.

Most REITs have been raising equity over the past two years and a commercial buyer with cash is able to purchase a property. The loans that banks and insurance companies are willing to make are at much lower leverage levels, currently 50 % to 60 % loan to value as opposed to 75 % to 85 % in more conventional real estate market environments. As commercial real estate prices have fallen, this particular asset class is more attractive to buyers than two years ago. Finding properties with quality tenants and longer term leases is the key to earning a steadier stream of cash flows .[19]

The U.S. FTSE EPRA/NAREIT REIT index bounced back in 2009 and 2010 to recover the 2007-2008 losses (up 18 % in 2010 globally and 25 % in the Americas). The rebound enabled REITs to recapitalize and gain favor with dividend-motivated and distressed asset investors. The index was again positive in the first quarter. Yet, underlying commercial real estate fundamentals are only beginning to show recovery signs and in some markets still weak but perhaps stabilizing depending on the sector.

Over $ 1 trillion in commercial mortgages will need to be refinanced by 2015, and delinquencies are at historically high levels (Foresight Analytics). Similar to corporations, REITs are cash rich, and until the commercial real estate sector firms up, look for industry consolidation among providers and focus on dividend payments that are paid out to shareholders.

FINANCIAL MARKET DATA AND STATISTICS FOR MAY 2, 2011

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[16] CNN Money News – March 2011

[17] http://www.goldprice.org/

[18] Investor's Business Daily – June 2010

[19] Financial Advisor Magazine – March 2011

Year to Date Statistics*	Current Rates*	Current Yields*
DOW – ▲ 10.60%	Oil Price @ $113 barrel	Federal Funds @ 0.25%
NASDAQ – ▲ 8.00%	Gold Price @ $1556 ounce	30 Y Mortgage @ 4.80%
S&P 500 – ▲ 8.20%	Euro per Dollar @ 0.6743	10 Y Treasury @ 3.290%
Russell 2000 – ▲ 9.10%	Core Inflation – ▲ 2.68%	5 Y CD'S @ 2.00%
CBOE VIX – ▼ 9.90%	Unemployment @ 9.20%	Money Market @ 0.65%

- Year to date statistics, current rates, and current yields are from the Wall Street Journal -- May 2, 2011.

Financial Concepts Unlimited Approach

Financial Concepts Unlimited continuously monitors and assesses its investment strategy, informed by market valuations and trends along with the underlying data. FCU will evaluate the events and variables as summarized throughout this document. It will then act with prudence upon clear market signals, taking account of potential risk exposures.

We continue to stand by our philosophy of capital preservation and are always looking to manage client wealth with attention focused on the downside. The asset classes and managers we have chosen to provide diversification within our portfolios continue to offer what we think to be an excellent benefit as we incrementally invest our way back into the stock market. This approach to diversification continues to serve us well and continues to drive our firm's philosophy.

In closing,

I wanted to thank you again for your continued support and state that we remain confident in the enduring power of the financial market's ability to create wealth over the long term, despite the challenges and risks that are a necessary part of the investment process. The overall sentiment from the investment community is increasingly positive as reflected in recent trends.

The economic recovery in the coming year may certainly experience challenges, but several measures are showing signs of improvement and even increased stability. We must never forget that opportunities for creating wealth are constantly evolving, and as part of our commitment to managing your assets, we are always looking for the best way to implement them.

Finally, as the Spring moves into full bloom, we want to take this opportunity to wish you a happy and prosperous 2011.

Sincerely,

Michael S. Standridge
Portfolio Analyst

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