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FINANCIAL CONCEPTS, INC. – QUARTER 3 - 2011

MARKET RESEARCH & INVESTMENT COMMENTARY 15:

For those superficial observers of the economic scene focused only on the short term, recent market events must bear a close resemblance to the scary holiday we all know as Halloween. The third quarter was a tumultuous one in the financial markets and for investors. First, there was mixed economic data with much of it on the downside during the quarter including disappointing consumer spending, housing and employment numbers.

Second, there was what pundits describe as "headline risk," the effect of adverse events that sometimes receive great attention and even overreaction from the media, notably the S&P U.S. rating downgrade and the continuing European sovereign debt crisis saga. Not to understate the importance of both economic data and global market events, but we have stated frequently it is important to account for information and recent events but not to be consumed by them. Our quarterly commentary has consistently addressed three themes:

1. Volatility is a part of today's investment environment and that risk should be acknowledged and managed.

2. Focusing on capital preservation while selectively looking for opportunities that may offer potential growth.

3. Developing and maintaining a long term strategy and perspective for our clients in managing their assets.

We have been discussing heightened market volatility in these quarterly commentaries for some time. Exactly a year ago, quoting from our third quarter commentary,

> *Volatility and transition continue to carry the day in the markets and the economy. The statement by Chairman Bernanke supports our view that the current environment may reward a steady and experienced hand to safely steer through the hard to predict economic "tail winds" and "head winds," while attempting to identify investment opportunities along the way towards the long term objectives of growth and stability. The market conditions may place a premium on understanding and managing shorter term risks.*
>
> *Important vulnerabilities and substantial risks remain in the post-financial crisis "new normal" investing environment. As we round out the final turn and towards the 2010 finish line, we believe that the markets may be in a much better place than two years ago.*

We still adhere to that view and our commitment is, if anything, stronger a year later, that is, in late 2011. With these concepts foremost in mind, more than ever, we make every effort to remain diligent and proactive in monitoring world events and have not been in the habit to even be remotely tempted to engage in short-term speculation or market timing.

Rather, our investment philosophy and its execution are driven by the objective of preserving client's principal. We will continue to stick to our firm's core philosophy and focus on investment fundamentals while working to keep a tight rein on emotion and reactions to the "noise," generated by the latest headlines.

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THE OUTLOOK

Our longer term investment perspective was well rewarded by the apparent return to a less stressful environment at the end of October compared to the roller coaster third quarter. The third quarter GDP growth rate of 2.5 % exceeded expectations and quieted, at least for the moment, the discussion of a recession. Citigroup produces an Economic Surprise Index which is probably a testament to today's news cycle driven market environment.

The index was in positive territory - above "0" - for the first time since April after the strong GDP report came out.[1] On the global market front, substantial progress and agreement may have been made on finding a solution to the European debt crisis.

Prudent financial market policies and the collective wisdom of investors may have put the markets in a more favorable place a month after quarter-end. Yet, we remain focused on the long term and capital preservation, understanding the inherent market volatility not to mention what the 2011 experience has taught us.

We are focused on managing portfolio risk prudently and, after careful research and analysis, investing selectively when we are satisfied that the investment return potential exceeds our assessment of the investment risk.

These are some of the trends that we are looking at:

- Supportive financial market and monetary policy and a continued commitment by the Federal Reserve.
- Return of investor's appetite for risk and controlled inflation outlook supported by lower energy prices.
- Surprisingly strong third quarter GDP numbers and fading sentiment of probable recessionary threats.
- Signs of stability in the economy[2] and the progress consumers have made to shrink their debts.
- Increased likelihood of a European debt crisis solution and a more proactive stance by EU officials.
- Record business profits and cash rich corporate balance sheets may set the stage for more hiring.

The clouds on the horizon suggest prudence:

- The longer term risks associated with a shorter term Europe debt crisis solution and related recessionary threats.
- Currency instability and global crises as reflected in higher gold prices, a volatile dollar and emerging markets.
- The continuing correction in the housing sector complicated by foreclosure documentation and servicing issues.
- Less fiscal stimulus as the focus shifts to deficit reduction and stressed state and local government budgets.
- Weaker business and consumer confidence in the sustainability of economic growth which has reduced payrolls.

Retail Investor Investment Sentiment

American households have been sitting on almost $ 7 trillion dollars in cash and liquid assets earning a minimal if any return based on data from the Federal Reserve's Flow of Funds statement, a figure that barely moved over the past year.[3]

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[1] *Washington Post, October 30,2011*

[2] *Moody's Analytics, October 2011*

[3] *The Federal Reserve's Flow of Funds data combines individual and nonprofit organizations in their tabulation.*

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The liquidity level is likely to come down as the market momentum picks up, and employment stabilizes. Decline in net worth as well as risk aversion in the weaker investor environment undoubtedly contributed to the retail investor preference of staying liquid. The tough quarter has affected individual balance sheets. According to Federal Reserve data, known as "flow of funds" report, the U.S. household's net worth fell to $ 58.5 trillion in the second quarter, the most recent quarter available, down $ 149 billion from the first quarter.

Declining home values and the drop in the stock market suggest that the figure is probably lower at the end of the third quarter. Household net worth, the value of houses, stocks and other investments, minus debts – peaked at $ 65.9 trillion in 2007. Consumer debt did decline, at an annual rate of 0.6 % in the second quarter. The good news of reduced consumer debt is tempered by the fact that some of the lower consumer debt is the result of some homeowners walking away from their existing mortgages.

ECONOMY

Stronger than Expected GDP Growth Spurt but Remains Frustratingly Slow

The economy has now grown each quarter for over two years, including the third quarter by the 2.5 percent compared to 1.3 percent in the second quarter[4]. The private sector – business investment and consumer spending – are becoming larger drivers of the economy relative to government spending. The 2.5 % rate approaches the economy's long-term potential growth rate and is the strongest quarterly growth rate in over a year. The consensus view is that GDP probably would do well to match that rate in the fourth quarter.[5]

Employment growth will need economic acceleration to pick up to put a significant dent in the unemployment rate which is likely to stay close to a 9 percent range.[6] Even that historically high number is a significant improvement of the 9.7 percent unemployment rate of a year ago. Furthermore, while a "double dip" recession was a common media topic not long ago, the upbeat third quarter report probably reduces this potential threat. Should growth exceed expectations, interest rates could rise sooner than anticipated.

Under such a scenario, the Fed potentially would be able to reverse its accommodative strategy. The Fed presently is committed to keeping the target interest rate at close to 0 % until mid-2013. The consumer is the economic "king" accounting for 60 percent to 70 percent of our economy. Consumer spending which gained 2.4 % in the third quarter was a major driver of GDP growth in the quarter. As noted above, the deleveraging consumer in the form of reduced consumer debt is a positive for the spending capacity of consumers.[7]

Despite these positive data trends, longer term, the consumer is still going through a period of deleveraging, which places a ceiling on consumer spending. Since hitting a peak in the summer of 2008 through August, non-mortgage household consumer debt has fallen by roughly $ 100 billion or 4 %.[8]

Although the recession ended in 2009, unemployment remains weak in 2010, with a national employment gain of slightly less than 100,000 in September. Meanwhile, the jobless rate remained up, declining to 9.1 % in mid-2011 from 9.4 % at the end of 2010 from a peak of 10.1 % registered during 2009. Real median income for family households fell by 1.2 % to $ 61,544 in 2010, while nonfamily household's income dropped 3.9 % to $ 29,730. [9]

A gauge of consumer sentiment rose to 57.8 in the preliminary reading for September after tumbling to a nearly three-year low 55.7 in August, according to Friday reports on the gauge from Thomson Reuters/University of Michigan. Economists polled by CNN had expected a slight rise to 57.3 with stock volatility and weak employment maintaining downward

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[4] *U.S. Department of Commerce data*

[5] *Bond Dealers of America economic survey, for example, bdamerica.org*

[6] *The Bond Dealers of America Economic Survey, for example, November 1, 2011, bdamerica.org*

[7] *U.S. Department of Commerce, Bureau of Economic Analysis, http://www.bea.gov/*

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

[9] *CBS Market Watch September 2011*

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pressure on consumers' sentiment. In August, sentiment had reached the lowest level since November 2008 with Washington's protracted debt-ceiling negotiations taking a toll on consumers.[10]

Housing Correction Still Has a Way to Go: Prices and Credit Standards Hold Back Housing Recovery

Almost 6.7 million U.S. homes were lost to foreclosure, short sales or turned back to lenders between 2000 and 2010, according to Moody's Analytics. Growing evidence suggests that another 3.6 million could meet the same fate all the way up through 2013. Residential home ownership has dropped from the pre-crisis peak levels.[11]

Moody's Analytics further commented that the housing market was "weaker than expected" in 2011. Moody's expects the housing market to "bottom out" in 2011 and recover in 2012 depending on mortgage rates and employment trends.[12]

As measured by the closely followed S&P Case-Shiller index, as of August, national housing prices were back to the mid-2003 level and only Detroit and Washington, D.C. showed positive returns over the past year. However, national housing prices, according to the measure, rose between July and August.[13]

The one positive indicator for housing is long term mortgage rates are near record lows and have been below 5 % for all but two weeks this year. The average rate on a 30-year fixed loan is now close to 4.10 %. But lenders typically require homeowners to have equity in their homes to refinance and lenders are typically approving most borrowers with high credit scores. Together with foreclosure overhang and negative equity mortgages, these credit standards are holding back any sustainable housing recovery.

While about 2.3 million homeowners could have refinanced their mortgages last year, strict underwriting standards and "underwater" mortgages have resulted in a large homeowner market segment unable to refinance. During the peak of the housing finance boom, many of the homeowners obtained loans under lax lending standards. Core Logic estimates that about a fifth of mortgaged properties are now "underwater" or mortgage balances higher than the value of the actual property. [14]

The Federal Housing Finance Agency has recently indicated that it is reviewing a program it launched two years ago to expand access to mortgage refinancing. The program, called Home Affordable Refinance Program, or HARP, lets people whose homes are underwater by up to 20 percent refinance at lower rates. The administration has indicated support for the strategy.[15] During the last few months, U.S. mortgage lending declined amid weak demand and tight credit standards, according to the Federal Reserve. In its annual analysis of mortgage data, the Fed found that lenders originated 7.9 million loans in 2010, down 12 % from 2009, and compared to 7.2 million during 2008.[16]

Will Relaxed Lending Standards Lead to More Business Lending?

Commercial credit availability may be improving. Banks have eased standards on commercial and industrial business lending for the last several quarters through the most recent survey period after an extended period of tightening, according to the Federal Reserve's quarterly senior lender survey. This survey also is reporting rising business loan and consumer real estate loan demand. [17] The Fed survey is closely watched as a barometer of the business lending market.

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[10] *CNN Money September 2011*

[11] *Wall Street Journal – March 2011*

[12] *Moody's Analytics October, 2011*

[13] *S&P/Case-Shiller, October 25, 2011, press release*

[14] *http://www.corelogic.com/*

[15] *Source – Yahoo Finance – August 2011*

[16] *Pensions and Investments – September 2011*

[17] www.federalreserve.gov/boarddocs/snloansurvey

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Cash Rich Corporate Balance Sheets, Profits Remain the Source of Hope for Accelerated Economic Expansion

Businesses ability to invest and hire is a function of consumer demand and confidence in the global economy. The corporations are still cash-rich, buoyed by continued corporate profit levels through the second quarter and based on initial third quarter earnings reports. Corporate profits and investable liquid funds are among the economic bright spots as a source of potential economic expansion once invested.

The profit trend numbers clearly demonstrate that corporations have the potential to deploy cash and thus accelerate the pace of economic recovery. However, the weakened global economic outlook is now reducing the fourth quarter profit expectations.[18] The ISM index on manufacturing, the primary measure of business spending plans, had a reading in September indicative of manufacturing sector expansion for the 26th consecutive month. There was an increase of 51.6 ("50" is considered "break-even.") rising one percentage point higher than August.[19]

Corporations have a higher share of cash on their balance sheets than at any time in nearly half a century, as businesses build up reserves instead of investing in new plants or hiring additional workers. Nonfinancial companies held more than $ 2 trillion in cash and other liquid assets at the end of June, with cash accounting for 7.1 % of all company assets, everything from buildings to bonds, the highest level since 1963.

Tech companies have the most on hand, with $ 388 billion as of the end of the second quarter, followed by healthcare providers and industrial companies, with preliminary estimates stating that the companies in the S&P 500 stock index have enough cash to operate for 73 months. All of this excess cash flow has created public pressure on corporations to invest and hire. The liquidity does provide an important cushion for U.S. companies if European banking problems escalate.[20]

Inflation Still in Moderate Range but should be Monitored; Energy Prices, Commodity Prices Deserve Scrutiny

Inflation remains historically low but is now on our radar. The 2010 CPI index was 1.6 percent, within the Fed's 1 percent to 2 percent target range. Rising energy as well as food costs combined are hitting the "headline" inflation numbers which had the CPI rate of 3.9 % for the twelve months in August. The CPI rate had declined again to a rate of 0.3 % in August versus June. Excluding food and energy or the "core" rate was 2.0 % for the past year and 0.2 % in August. [21]

With excess capacity and a soft labor market, core inflation appears to be under control. Another escalation of energy prices is the inflationary concern. While the price of oil is down from earlier in the year, it is 14 % higher than a year ago and remains volatile especially in view of Middle East political uncertainty.[22]

Raw materials have risen amid strong demand for commodities from many parts of Asia. 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.

China controls more than 90 percent of current global supply of rare-earth metals, a group usually classified as 17 elements that are known for their importance in high-tech applications such as weapons and hybrid technologies. Mining companies around the world have responded by taking steps to increase production.[23]

Global Growth Contrasts: Emerging Market Growth vs. Inflation Risk

Emerging market policy makers are taking steps to contain inflation including capital controls. Inflation fighting strategies in emerging markets lead analysts to worry about dampened demand for exports and global growth, further slowing

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[18] Christopher Versace, http://thethematicinvestor.com/?page_id=2

[19] http://www.ism.ws/ISMReport/MfgROB.cfm?navItemNumber=12942

[20] Source – Fortune Magazine – August 2011

[21] http://www.bls.gov/cpi/cpid1109.pdf

[22] Moody's Analytics, October 2011

[23] Traders Magazine – March 2011

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progress in developed countries. The Chinese introduced policy tightening early in 2010 and have continued with initiatives this year in response to rising consumer prices.[24]

Longer term, the emerging (and frontier) markets are the engine of global growth. We continue to be persuaded by the analysis that says that 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 world.

Need for Fiscal Discipline; Deficit Reduction is on the Table

On the fiscal side, there is a public consensus for restraining the budget deficit but the degree to which it translates into action is the critical issue. The economy faces another fiscal year of $ 1 trillion plus deficits and indeed the forecast is for record deficits in the upcoming fiscal year.

Regardless of its merits, the bi-partisan tax deal extending investment tax rate reductions (as well as unemployment benefit extension and cuts in payroll taxes) last-year likely adds to the short-term deficit. 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 such programs, and these specific recommendations may be a tough sell. The political will is a critical variable. Perhaps the recent "negative outlook" that S&P actions have had on the AAA U.S. debt ratings may spur action.

Much is in the hands of the bipartisan Congressional committee to address the deficit issue established as part of the debt limit expansion deal this summer. What is clear is that deficit reduction is the focal point of economic debate and other topics such as expansion are largely off the table.

Economic policy "stimulus" is on the monetary side. The Fed has indicated the intent to keep its target rate low or close to 0 % through mid-2013. Federal Reserve policymakers also left the door open to another round of asset purchases in the near future, according to minutes of their most recent meeting or a third round of quantitative easing, namely QE3.

At the two-day meeting that concluded September 21st, the Fed unveiled plans to engage in the "operation twist" strategy to sell short-dated instruments and buy longer-term debt, in an effort to keep interest rates low without pumping additional money into the economy.[25]

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

A downside risk for much of the last year has been state and local finances. Unlike the Federal government, most states are required to balance their budgets and the economy and related tax revenues have hit state budgets particularly hard. Add to those concerns about some local and state government's capacity to finance looming pension obligations.

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, especially with the removal of bond insurers from the marketplace.

<u>MARKETS</u>

Equity Markets Dependent on Continued Profit, Fed Policy, Economic Growth and European Crisis Management

The three major broad indices were lower for the quarter after 2010 and early 2011 gains. The positive economic news and news from Europe sparked the late October recovery. To give a sense of price volatility, during the August to October period, the S&P fell by early October to a little over 16 % from levels reached in August. The S&P equity index was at its highest level since August 1 and climbed 14 % by October 28th .[26]

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[24] *Investor's Business Daily – March 2011*

[25] *Wall Street Journal, October 2011*

[26] *Washington Post, October 30, 2011*

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There are three dominant factors that may affect future equity market performance at least in the near term. First, there is the corporate earnings growth with profits at record levels but with a soft economic growth outlook not withstanding third quarter GDP growth results. The second pillar is the expectation of Fed policy to keep the recovery on track and "remove the punchbowl" at the correct time to manage any inflationary threats.

The third is the outcome to the European debt market situation. There should always be prudence in market strategy and outlook, ensuring that expectation of values be grounded in underlying fundamental trends and taking into account the risk potential and underlying effects of the European sovereign debt outlook.

Bonds

United States

As lower credit risk bond yields have fallen and prices appreciated, there could be heightened interest moved up the "risk curve" in order to generate yield and thus the attraction of corporate bonds. The liquid balance sheets and positive profit trends reduced fundamental corporate credit risk.

Going forward, a few investment considerations need to be taken into account: whether corporate bonds are approaching full value and supply to take advantage of low funding costs eventually may have some 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 and public policy pressures. In addition, weaker economic growth could affect especially high-yield credit quality. Default rates have been scaled back based on rating agency metrics to the lowest rates since 2008.[27]

The International Bond Perspective

A number of European governments have to introduce austerity programs that could significantly reduce their budget deficits in response to the sovereign debt issues. Many leading emerging markets are implementing various steps to deal with global capital flows without undermining international trade and investment, for example, higher interest rate policies in Brazil and China. The success of these actions could have an important impact on economic global expansion.

Much rests on the outcome of the European negotiations, including the expanded European rescue fund. The current agreement as of October 28 increases the fund's size to $ 1.4 trillion and a voluntary 50 % voluntary Greek bond write-down, is viewed as a short-term solution as "it reduces the immediate risk to the market," according to a fund manager.[28]

Europe still needs to address its longer term structural issues regardless of the short-term agreed strategy over the next few weeks, and there remains a widely held view that a European default is a distinct possibility in the near future with Greece the most often mentioned candidate but concerns present among the other "PIIGS" – Portugal, Ireland, Italy, and Spain.[29]

Gold

The price has more than doubled in value over the last 5 years, by more than 30 percent over the past year, and 85 percent over the last month driven by the investor concern about risk after the series of financial crises in recent years and national currency vulnerability, hitting $ 1,740 at the end of October[30]. 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.

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[27] *http://www.usatoday.com/money/perfi/stocks/story/2011-10-11/corporate-defaults/50796848/1*

[28] *Washington Post, October 30, 2011 quoting Nick Sargen of First Washington Investments*

[29] *Google/Agence France-Presse December 28, 2010*

[30] *http://www.goldprice.org/*

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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 the first years after the financial market crisis 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.

The U.S. FTSE EPRA/NAREIT REIT index bounced back in 2009 and 2010 to recover the 2007-2008 losses (U.S. index up 27 % in 2010). The index increased but at a more moderate basis year-to-date in 2011 through October at a single percent digit return rate.

The rebound enabled REITs to recapitalize and gain favor with dividend-motivated and distressed asset investors. 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.

FINANCIAL MARKET DATA AND STATISTICS FOR NOVEMBER 4, 2011

Year to Date Statistics*	Current Rates*	Current Yields*
DOW – ▲ 4.00 %	Oil Price @ $ 94 barrel	Federal Funds @ 0.25 %
NASDAQ – ▲ 1.70 %	Gold Price @ $ 1764 ounce	30 Y Mortgage @ 4.21 %
S&P 500 – ▲ 0.30 %	Euro per Dollar @ 0.7235	10 Y Treasury @ 2.065 %
Russell 2000 – ▼ 4.10 %	Core Inflation – ▲ 3.87%	5 Y CD'S @ 1.57 %
CBOE VIX – ▲ 71.80 %	Unemployment @ 9.10%	Money Market @ 0.52 %

- YTD statistics, current rates, and current yields are all from the Wall Street Journal as of Nov 4, 2011.

Financial Concepts Unlimited Approach

Financial Concepts Unlimited continuously monitors and assesses its investment strategy, informed by market valuations and trends along with 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 into account any potential risk exposures.

We continue to stand by our philosophy of the long term perspective and capital preservation and are always looking to manage client wealth with attention focused on the downside. The asset classes and investment 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 capital markets. We believe the approach to diversification helps 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 potential 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 appears to be increasingly positive as reflected in recent trends.

The economic recovery in the coming year may certainly experience challenges, and we take into account market volatility and the risks that it presents. 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 we enter the holiday season, allow me to wish you an excellent year end and prosperous 2012.

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Sincerely,

Michael S. Standridge
Portfolio Analyst
Financial Concepts Unlimited, Inc.

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Lower-rated debt securities, sometimes called junk bonds carry increased risks if price volatility, illiquidity, and the possibility of default in the timely payment of interest and principal. Foreign investments involve special risks including greater economic, political, and currency fluctuation risks, which may be even greater in emerging markets. Indexes cannot be invested in directly, are unmanaged and do not incur management fees, costs or expenses. Investors should be aware that there are risks inherent in all investments, such as fluctuations in investment principal. With any investment vehicle, past performance is not a guarantee of future results.

The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.

Sector investing may involve a greater degree of risk than investments with broader diversification. Be advised that investments in real estate have various risks including possible lack of liquidity and devaluation based on adverse economic and regulatory changes. As a result, the values of real estate may fluctuate resulting in the value at sale being more or less than the original price paid.

Real Estate Investment Trusts (REITS) may fluctuate resulting in the value at sale being more or less than the original price paid. Special risks in investing in REITS include, among other factors, lack of liquidity, possible changes in the real estate market, vacancy rates and competition, volatile interest rates and economic recession. The fees and expenses paid to the adviser, its affiliates, and participation broker/dealers may be higher than some other investment products. There can be no assurance that the Trust's objectives will be met.

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Bonds are also subject to other types of risks such as call, credit, liquidity, interest rate, and general market risks. In general, the bond market is volatile as prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity maybe subject to a substantial gain or loss.

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