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FINANCIAL CONCEPTS, INC. – QUARTER 2 - 2012

MARKET RESEARCH & INVESTMENT COMMENTARY 18:

Dear Clients:

The first half of 2012 once again confirms our consistent theme of looking at the long term and not to be consumed by the current media reported events – whether they imply “market favorable” or “market unfavorable” sentiments. Our attention remains tightly focused on the long term and, as we have frequently mentioned in the quarterly commentary, it is important not to “take our eyes off the ball” and be influenced by emotional shifts based on recent headlines by the media.

As noted in the last few quarterly summaries, investors are well advised not to be blinded by the bright lights of good news just as we caution investors now not to overreact to the justifiable concern emanating from slower and subpar first half U.S. growth, the “fiscal cliff” potential risk exposure at year-end, and the turbulent European environment.

Despite its volatility and some givebacks, the stock market as defined by broad index measures have been trending upward through the end of July, building on the strong first quarter. As we look to the second half of 2012, the four “E”s should draw investor attention: earnings, economy, Europe and elections.[1]

Our long term approach requires a focused attention to what economic data and the markets are telling us. Based on that perspective, we pay great attention to understanding data and the market signals. Only after deliberate evaluation will adjustments be made, for example, identifying market conditions where locking in gains is advantageous and selectively moving to new opportunities for incremental risk-managed returns.

The philosophy has served us well across the market environments of the last several years. These considerations have and will continue to inform our strategy, and we have every expectation that such a perspective will continue to offer favorable risk-adjusted returns to our clients across cycles.

The Financial Concepts operating philosophy is based on being long-term investors and highly focused on capital preservation. The reasons for caution remain housing, employment market challenges, the deadline for extending the lower dividend and capital gains rates and the risk of the European crisis moving closer to a “tipping point.”

The resilient corporate earnings, stock price metrics and low rate environment, and the assiduous management to date by both the U.S. and European central banks have kept the markets on the generally favorable trajectory. Even taking into account the substantial headwinds, the U.S. is arguably the best performing, especially in the developed world, economy.

We continue to adhere to three long-term themes:

1. Volatility is part of today’s investment environment and that risk should be acknowledged and managed.
2. The focus on capital preservation and portfolio stability while selectively looking for growth opportunities.
3. Developing and maintaining a longer term strategy and perspective for managing our client’s assets.

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[1] *The “4 E” reference is adapted from USA Today, July 2012 reporting*

With these concepts foremost in mind, more than ever, we make every effort to remain diligent and proactive in monitoring economic 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 implementation are driven by protecting the clients' 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. Indeed, our quarterly commentaries are intended for you to gain insight into our approach…

This philosophy is incorporated in the FCU Model Portfolios that are diversified using a macro view, rather than concentrated in any one area or asset class. Our goal is to invest in places that can offer favorable risk-adjusted rates of return, and we view the world as fertile ground for identifying such opportunities.

Above all, we believe that wealth creation is only possible by avoiding a permanent impairment of capital. The most effective and perhaps only certain way to accomplish this objective is to structure investments with a margin of safety that allows for capital preservation. This requires a more patient time horizon and not blindly mimic or duplicate broad equity indexes, including the S&P, Dow, and NASDAQ.

These benchmarks tend to be highly concentrated and tightly correlated to the present business cycle. We diversify away risk, using multiple asset classes. Only through such diversification can solid long-term risk-adjusted return performance be accomplished. Our diversification extends across market sectors including government, corporate and global fixed-income sectors and equity investing (value and growth) styles.

We take pride in staying committed to who we are and always look to protect the downside. Therefore, we may lag the returns of leading benchmarks in a particular period but produce solid and more consistent investment results. Investing is about looking objectively at data, information and markets and understand but not be consumed by the latest headlines.

THE OUTLOOK

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

- Attention to finding a European growth crisis resolution among the European and multinational finance agencies.
- Solid corporate profits and shareholder friendly strategies for investing the cash-rich corporate balance sheets.
- Continued commitment by the Federal Reserve to step in more aggressively as needed remains in place.
- Initial signs of a housing recovery from its bottom with GDP growth remaining in positive territory.
- Return of investor risk appetite and historically moderate P/E (price to earnings) ratios.

The clouds on the horizon suggest prudence:

- Risks associated with a shorter term Europe debt crisis solution, and related recessionary threats.
- Slowing global economic growth as Emerging Market (EM) and China's growth rate subsides.
- Less fiscal stimulus as economic policy shifts to deficit reduction as we proceed toward 2013.
- Restrained business investment and potentially slowing of "top line" revenue growth.
- Below-trend U.S. economic growth and slower consumer spending.
- Elevated unemployment rates and modest employment growth.

Retail Investor Investment Outlook Trending Positive

The individual investor remains liquid based on holding nearly $7 billion held in cash and liquid assets as reported by Federal Reserve data through its "flow of funds" report. [2] The stock performance in the first quarter and more stable housing prices raised the household net worth position by nearly $3 trillion, the largest increase since 2004.[3] Another element with an interpretation that can vary from pessimistic to optimistic is the fact that first quarter U.S. savings rate rose relative to the portion of personal income going to consumer spending.[4]

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[2] *The Federal Reserve's Flow of Funds data combined individual and nonprofit organizations in their tabulation. http://www.federalreserve.gov/releases/z1/current/z1.pdf*

[3] *http://www.bloomberg.com/news/2012-06-07/household-worth-in-u-s-rose-by-2-83-trillion-in-first-quarter.html*

[4] *Washington Post, July 28,2012*

ECONOMY

GDP Growth Positive but Much Slower, Job Growth is Still Subpar

The economy continues to grow as it did for each quarter in 2011 and the first quarter.[5] However, the rate of GDP growth slowed to a relatively anemic 1.5% from 1.9% in the first quarter and the slowest rate of growth since the third quarter of 2011.[6] The private sector – business investment and consumer spending – are now the largest drivers of the economy.

The consumer is the economic "king" accounting for 60 percent to 70 percent of our economy but the shine on the "king's crown" dimmed with consumer spending growth slumping to about 1.5% in the quarter from 2.4% in the previous quarter.

Households are still going through a period of deleveraging, which places a ceiling on consumer spending. Yet, that trend could be waning at least temporarily as non-mortgage consumer debt outstanding has risen approximately 5% over the last year through May 2012.[7]

A study published earlier this year determined U.S. households may have two more years of deleveraging left which means people are choosing to divert funds from spending, which is limiting consumer spending growth.[8] Consumer confidence has been declining in recent months as reflected in the Conference Board indices.[9]

Employment is still below its pre-recession peak of 145 million.[10] The jobless rate remains elevated holding at 8.2 percent since March from 8.5 percent in December and 9.1 percent in mid-2011 and from a peak of 10.1 percent in 2009.[11] June employment increased by 80,000 compared to 120,000 in March.

Faster economic growth is necessary to reduce unemployment which is likely to stay in the 8% range through this year.[12]

Housing Correction Ending or At Least Weakening?

As measured by the closely followed S&P Case-Shiller index, as of January, the national housing price decline had slid by more than 3 percent lower from the prior year.[13] The S&P/Case-Shiller index edged up in February and March, reversing the multi-year trend. The median nationwide asking home price in May rose 3.2 percent from last May but the number of homes for sale dropped 20 percent based on data from Realtor.com.[14]

Many leading economists are expecting signs of recovery finally taking hold for housing this year.[15] One positive indicator for housing is long term mortgage rates remain near record lows and have been well below 5 percent for virtually the entire year and at 4 percent or below for much of the year. But lenders typically require homeowners to have equity in their homes to refinance and lenders are generally limiting approvals to borrowers with high credit scores.[16]

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[5] *Washington Post, January 28,2012 and July 28,2012*

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

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

[8] *Source – Yahoo Finance – May 2012.*

[9] *Source – Market Watch – June 2012; http://www.conference-board.org/data/consumerconfidence.cfm*

[10] *Washington Post, January 28,2012*

[11] *http://www.tradingeconomics.com/united-states/unemployment-rate*

[12] *http://www.bls.gov/news.release/empsit.nr0.htm*

[13] *http://www.standardandpoors.com/servlet*

[14] *Reuters June 2012*

[15] *U.S. Commerce Department – February 2012.*

[16] *Fortune – February 2012.*

Foreclosure starts did rise in May for the first time in more than two years, according to RealtyTrac, a widely quoted industry source, despite falling on a month-to-month basis. Short sales were up in the first quarter of 2012 to a multi-year high; lenders can often gain a higher effective price in a short sale than through sale of repossessed real estate.[17]

Will Relaxed Lending Standards Lead to More Business Lending?

Banks have eased standards on business lending for the last several quarters after an extended period of tightening, according to the Federal Reserve's quarterly senior lender survey. Furthermore, loan demand was reported as rising. [18] The Fed survey is closely watched as a barometer of the business lending market.

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

Business willingness to invest and hire is a function of consumer demand and confidence in the global economy. The corporations are still cash heavy, buoyed by continued corporate profit levels. Earnings and investable liquid funds are a source of potential economic expansion once invested. Investors are looking to companies now for activity that would boost their holdings until there is a business capital investment expansion — in particular stock buybacks, dividend increases or mergers and acquisitions - in view of the weaker to uncertain global economy.

Inflation Remains Controlled, Energy Prices Slow

Inflation remains historically low. The most recent CPI index reading as May and June rose 1.7% year-over-year and virtually flat on average month-over-month over the last four months. Excluding energy and food, the core CPI rate year-over-year was about 2.2% as of June with month-over-month increases running about 0.2%. With excess capacity and a soft labor market, core inflation appears to be under control.

The price of oil around the globe has fallen, as markets continued to react to disappointing economic news across continents. Signs of a slowdown in manufacturing activity in China, Europe and the United States have keep prices from appreciating in the near term.[19]

Global Growth Affected By Emerging Market Growth Moderating, Europe

Global manufacturing activity has been subdued this year with the euro zone's industrial sector showing recent declines, and Asian factory activity mixed. The timing of the Chinese interest rate cut by monetary authorities concerned investors, raising fears the cut was a signal of impending negative economic data. One problem facing Chinese banks is restrained lending capacity with a recent drop in household deposits. [20]

Longer term, despite the pullback, we continue to see the emerging (and frontier) markets as engines 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 markets affected by the European economic disarray and recessionary or at least growth pressures.

Lower Investment Tax Rate Uncertainty; Monetary Policy Commitment to Low Rates

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 this fiscal year.

While borrowing rates still remain low, there is no assurance that the markets will continue to keep yields on U.S. government debt low and the thus the cost of financing the deficit at the current levels. Longer term, entitlement and especially Medicare expenses are looming.[21]

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[17] *Reuters June 2012*

[18] *http://www.federalreserve.gov/boarddocs/snloansurvey/201111/default.htm*

[19] *Wall Street Journal – June 2012*

[20] *Market Watch April 2012*

[21] *CNN – Money November 2011*

Barring Congressional action, the broad tax cuts, including lower dividend and capital gains tax rates, adopted during the Bush administration will expire at the end of the year (i.e. the "fiscal cliff" risk), with the top income tax rate rising to 39.6 percent, which undoubtedly will have a dampening effect on the markets as the year progresses. [22]

The Fed reiterated the intent to keep its target rate low or close to 0% but extended the time period from mid-2013 to the end of 2014 earlier in the year. Federal Reserve policymakers leave open the possibility of additional asset purchases. [23] A group of U.S. bankers that advises the Federal Reserve urged the central bank to reduce the "confusion" posed by the most recent "stress tests."

The Fed on June 8 proposed capital rules under the terms of Basel III. Bankers consider some aspects of U.S. and global regulatory reform resulting in a "consistent bias" against non-U.S. sovereign debt could disrupt "global efforts to mitigate systemic risk." [24]

The State and Local Finance Drag on Economic Prospects Moderating, Revenues Rising

Unlike the Federal government, most states are required to balance their budgets, and slowing tax revenues have hit state budgets, leading some states to raise tax rates and dip into their "rainy day" funds and other one-time sources.[25] Total state tax revenue, however, is forecast to rise 4.1% in the 2013 budget year, according to a survey by the National Governors Association and the National Association of State Budget Officers. The gains in revenue are somewhat uneven. Tax receipts in 23 states are projected to remain lower than five years ago.[26]

The state and local finances of course have implications for municipal bond prices and credit quality. Although municipal securities have recovered since early 2011, the markets are increasingly differentiating between financial strong and weaker municipal bond issuers, especially with the removal of bond insurers from the marketplace and a few municipalities at or close to default.

MARKETS

Equity Markets Trend Up with Moderate Earnings Multiples: Prospects Depend on Continued Profit and Dividend Levels, Fed Policy, Economic Growth Trends and European Crisis Management

Equities across sectors experienced historically high rates of volatility in 2011 with that volatility showing signs of pick up as we move through 2012.[27] The major broad indices rallied late in July, and most are hovering close to or above double digit year to date gains.[28]

There are three dominant factors that may affect future equity market performance at least in the near term. First, there is the corporate profit growth with profits continuing to be generally solid with a few "upside surprises" but with the slow economic growth in the first half affecting "top line" revenue growth. P/E multiples remain moderate at about an estimated 12-13 times, which has been interpreted by some analysts as mitigating market downward risk exposure. [29]

The profit gains have contributed to substantial dividend growth, boosting stock prices this year. However, the dividend tax rate currently capped at 15 percent is set to expire at the end of this year. Without action from Congress, the maximum dividend tax rate will revert to 39.6 percent.

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[22] *Yahoo – Finance February 2012*

[23] *http://federalreserve.gov/newsevents/press/monetary/20120125a.htm*

[24] *Source – Business Week – May 2012*

[25] *Baltimore Sun, December 2011*

[26] *USA Today Money – July 2012*

[27] *Washington Post, January 29, 2012*

[28] *Market Watch April 20, 2012*

[29] *Larry Kudlow radio program July 28,2012*

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 inflation and inflationary expectation. The Fed's low rate stance communicates continued growth concerns. The third consideration is the outcome to the European debt crisis and global market contagion risks which is the biggest reason for prudence in market strategy and outlook.

Indeed, recent market movements have been largely driven by European crisis resolution prospects. Some 14% of company sales come from Europe, according to S&P data, making this overall effect significant. Prior to the second quarter earnings season hitting full stride, about 85 of the **Standard & Poor's 500** companies warned investors their quarterly earnings would be worse than expected, with most citing Europe or currency movements as a main culprit.

The **euro's weakness** against the dollar has an immediate translation impact on earnings of U.S. based companies with significant European operations.[30]

Bonds

As higher quality (lower credit risk) bond yields have fallen and prices appreciated, there is heightened interest up the "risk curve" in order to generate yield and thus the attraction of corporate bonds. The low rate environment has also buoyed equities, default rates globally were scaled back last year based on agency metrics to the lowest rates since 2008.[31]

Default rates edged up over the last month to above 2.5% but looks to remain no more than (and perhaps less than) long term averages.[32] With benchmark yields lower due to political and economic risks outside of the U.S., corporate issuers have taken advantage of low rates with elevated issuance levels which have now subsided despite new record-low high-grade corporate yields in July. Reflecting the rate environment and slowing economy, investment grade yields are steady at historically low rates but high yield rates recently moved up (and prices down).[33]

Gold

Prices have more than doubled in value over the last 5 years but drifted down this year. The metal's price is at $1,623 [34] at July 27, compared to $1,700 at the end of January[35] Four 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. The recent gold price dip brought with it lessons to gold investors and recognition that there is no such thing as the price of gold always rising.[36]

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. 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 increased by a robust 16 percent year-to-date in 2012 through July 27.[37] The rebound enabled REITs to gain favor with dividend-motivated and distressed asset investors.

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[30] *Thomson Reuters July 2012*

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

[32] *http://blogs.barrons.com/incomeinvesting/2011/12/08/u-s-default-rate-holds-steady-at-2-0-in-november/; http://uk.reuters.com/article/2011/11/21/debt-defaults-ing-idUKL5E7ML2M820111121*

[33] *S&P LCD July 2012*

[34] *http://www.cnbc.com/id/47111664*

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

[36] *Investment Adviser*

[37] *http://returns.reit.com/returns/DomesticReturns.pdf*

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 the long term perspective and capital preservation.

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 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 potential to create wealth over the long term, despite the challenges and risks that are a necessary part of the investment process. 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…

Sincerely,

Michael S. Standridge

Portfolio Analyst
Financial Concepts, Inc.

There is no guarantee that a diversified portfolio will outperform a non-diversified portfolio in any given market environment. The price of commodities such as currency and gold is subject to substantial price fluctuations of short periods of time and may be affected by unpredictable international monetary and political policies. The market for commodities is widely unregulated and concentrated investing may lead to higher price volatility. Fixed income investments are subject to various risks including changes in interest rates, credit quality, inflation risk, market valuations, prepayments, corporate events, tax ramifications, and other factors.

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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