BRIAN D. LOWDER, INC.

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FINANCIAL MARKET OVERVIEW

The first quarter of 2011 posted the best first quarter performance since 1998. How confusing and frustrating investors must feel when the world looks as it does today and the stock market still climbs higher. The overall U.S. stock market was up 6% during the first three months of the year in spite of ongoing conflicts in the Middle East and Northern Africa, a U.S.-led attack on Libya, an earthquake, tsunami, and nuclear nightmare in Japan, and the largest deficit this country has ever experienced.

Likewise, how strange it seems with all of the worldwide turmoil that the price of gold was down 0.6% during the first quarter. Another favorite and often-cited category for superior long-term performance is emerging markets (smaller or less-developed countries). Emerging markets barely posted a positive return of 0.5% during the first quarter.

Small and mid-size U.S. stocks continued to post the best stock market performance relative to large-company and international stocks – a repeat of superior performance during the entire 2010 calendar year. Energy, commodities and natural resources stocks and mutual funds had the best relative performance during the first quarter ranging from 12% to 15% due to the decline in supply of grains, increase in food prices and the jump in the price of oil due to rising conflict in the Middle East and Libya. Lastly, the U.S. dollar declined in value modestly during the first quarter.

Overall, the U.S. stock market was buoyed by continued great *expectations* for economic recovery and a perceived safe haven to invest compared with the rest of the world. Whether the recovery is truly underway is still subject to debate.

The following chart displays sample returns of various asset categories during the fourth quarter and the entire 2010 calendar year:

Year 2010	1st Qtr. 2011	Index Return (*includes dividends reinvested*)
+ 14.1%	+ 7.1%	**Dow Jones Industrial Average**
+ 15.1%	+ 5.9%	**Standard & Poor's 500 Index**
+ 17.5%	+ 6.4%	**DJ U.S. Total Stock Market (Broad Market)**
+ 14.8%	+ 5.2%	**Large-company stock-Growth**
+ 13.0%	+ 5.9%	**Large-company stock-Value**
+ 25.9%	+ 8.2%	**Mid-Size Stocks – Growth**
+ 22.4%	+ 7.1%	**Mid-Size Stocks – Value**
+ 27.6%	+ 9.4%	**Small-company stock- Growth**
+ 26.0%	+ 6.9%	**Small-company stock- Value**
+ 10.7%	+ 3.1%	**International (excludes U.S.)**
+ 19.5%	+ 0.5%	**Emerging Markets**
+ 27.6%	+ 6.2%	**Real Estate Investment Trusts**
		Fixed Income
+ 3.0%	+ 0.2%	**Short-term U.S. Treasury** (*includes appreciation*)
+ 5.6%	+ 1.3%	**Intermediate U.S. Treasury** (*includes appreciation*)
		Alternative Investment Category
+ 27.2%	- 0.6%	**Gold**
+ 21.3%	+ 12.7%	**Natural Resources**

SPENDING, INFLATION AND FINANCIAL MARKETS

Government Spending

In our previous newsletter, we identified unemployment as the biggest *short-term* problem and entitlements ("free" money and government program spending) as the biggest *long-term* impediment to achieving a sustained economic recovery. The unemployment picture seems to be improving at a very slow pace, but the long-term problem of excessive entitlement/government spending is getting worse and is dangerously close to careening out of control. It's depressing to hear so many people taking political sides, yet they do not truly understand the damage and the growing

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economic consequences we will face in the near future if reductions are not implemented. The majority of Americans do understand the consequences when their personal debt levels grow too large and their incomes decline – they have to cut back, and forego purchases and other non-essential expenditures.

But when our governments at all levels – federal, state, county and city overspend and must cut back on previously affordable, but currently excessive or non-essential expenditures, public employees and recipients of entitlement programs (who will be impacted by the necessary reductions) view the change(s) as a personal offense or violation of their rights. Further, politicians love to hand out someone else's money (taxpayers) or increase their taxes, but they don't like to make the difficult decisions to reduce expenditures when expenses exceed revenues.

On the other hand, corporations and their employees must deal with revenue and expense imbalances on a regular basis. As the economy, increased competition or higher costs force corporations to adjust their expenditures and workforce (by downsizing or requiring employees to share a larger percentage of healthcare costs), it is a reality that corporations must address or eventually go out of business. Similarly, families affected by these changes must make difficult decisions (reduce expenditures, move, or seek employment elsewhere) and they do make the necessary adjustments.

Leaders of our federal, state and local governments are not fully disclosing the consequences of continued deficit spending or making the difficult decisions to cut back. Here is a simple explanation of just how severe the problem is. Just the federal government's ***annual*** budget is **3 trillion dollars** this fiscal year. The annual deficit (doesn't include states, counties or cities) – meaning how much expenditures exceed revenues, is ***1.6 trillion*** dollars. The cumulative national debt is a staggering **$14.3 trillion** dollars or the equivalent to *adding $128,500 of debt to each taxpayer*. We do not include the total population, just taxpayers. Only taxpayers will bear the cost of fixing this problem. Can you imagine the consequences of adding $128,500 of new debt to your personal finances?

Deficit spending is the biggest problem and impediment to sustained economic growth in the United States and around the world. We can and will continue to have stock market rallies over short periods of time (i.e. Sept. 2010 to March, 2011), but consistent economic growth and financial market stability will elude us until this problem is addressed. One political side wants to raise taxes; the other side wants to cut expenditures. Either way, the economy is going to be adversely impacted over the short term. However, raising taxes without making significant reductions in expenditures (reform) will only result in increasing our debt and kicking the can (solution) down the road for others to address.

Most other developed countries are experiencing the same deficit spending problem. U.S. total debt as a percentage of GDP (Gross Domestic Product – value of all goods and services produced in a particular year) was 30% in 1980, 60% in 2000, and today 95%! Japan's total debt to GDP is currently 220% and will certainly grow larger under their massive rebuilding challenge. Several countries are included within the consolidated European debt to GDP ratio, but the range there is 50% to over 120% depending upon the country.

This growing deficit problem is our biggest concern and reason for proceeding cautiously with our investment management accounts. Advice: do not take above-average risk at this time.

Inflation

Common sense suggests that rising global debt, rising commodity prices (wheat, copper, gold, etc.), and rising petroleum prices will inevitably lead to inflation. So, where is rampant inflation? The answer is key variables that accelerate inflation are absent, yet certain inflationary variables are present. Recent shortages in grains and spiking food prices have much to do with unique weather patterns. Shortages have developed because of floods and drought around the world – both occur randomly regardless of the economic environment. It doesn't take long to re-balance the food supply with demand. Energy prices (and gold prices) have soared recently (2009-2010) because of unrest in the Middle East and Africa as well as supply disruptions because of man-made or natural disasters.

During past inflationary environments, we have observed higher interest rates, gold prices, commodity prices and real estate values. In addition, *wages* were also increasing and *lenders were making loans* that allow expenditures and investments to grow as well. Today, banks are not aggressively lending money, wages are flat and labor costs to produce the same product or service are declining. These offsetting variables are not making news headlines and are confusing investors. We can't reach a logical conclusion regarding inflation by simply observing a few inflationary ingredients (prices of gold, food items and oil), without considering the entire recipe (declining wages, tight lending).

This current situation won't last in perpetuity. The likelihood of real inflationary pressures will materialize when we experience improvement in job growth and lenders provide easier access to credit as well as improving their financial health. At that time, *there is a real risk (reality) of experiencing rapidly rising core inflation and interest rates. But, we aren't there yet*.

Financial Markets – Our Approach In The Years Ahead

Every BDL investment management client has a "recommended asset allocation" outlined in their investment

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policy statement. The primary reasons for establishing a "target" asset allocation (process of dividing an investment portfolio into various asset classes) are to 1) clearly identify a proper balance between risk and reward for each unique client and 2) to provide a disciplined framework or boundaries for the advisor to stay within. Under somewhat "normal" economic circumstances, clients should expect their portfolios to closely mirror their target asset allocation.

The problem is the financial markets over the past ten years have behaved abnormally and the future appears to be more uncertain than the past ten years. Maintaining a static asset allocation strategy without the flexibility to make meaningful adjustments amounts to a "buy-and-hope" strategy. We have inserted flexibility by creating an asset allocation **range** rather than a specific number. As our confidence and conviction increases or decreases, we make adjustments to the stock, bond and other portions of the portfolio.

In addition to the added flexibility of using ranges within each client's asset allocation model, we believe an optimal strategy for the future is to develop not one, but several contingency-dependent future portfolios for our clients. For example, we have considered what would be an optimal mix of asset classes (stocks, bonds, real estate, natural resources, etc.) if an economic recovery gains momentum in the near term. In addition, we have considered what would be an optimal mix of asset classes if the economy continues to struggle, debt levels increase and conflict escalates around the world. Lastly, we have considered what would be an optimal mix of asset classes (such as gold, natural resources, oil, dividend-paying common stocks, etc.) if inflation and interest rates begin to rise and continue increasing.

The added flexibility to switch from one optimal strategy to another *as conditions change* is not market timing, but rather a response to changing market conditions. We believe the probability of continued growth in the new economies (emerging markets) will continue as growth in manufacturing accelerates overseas. Further, the ongoing erosion of credit worthiness of U.S., Japan and some European countries' government securities is real and accelerating. The likely outcome will be higher global inflation and higher interest rates. Consequently, we have been and will continue to adjust our client portfolios by replacing a portion of the fixed income portion of client portfolios (short and mid-term government bonds, corporate bonds and certificates of deposits earning 1% to 3% interest) with stocks of large, safe, unleveraged (little to no debt), and diversified multinational companies with growing revenues.

We believe the 2.5% - 5% dividends paid by these multinational companies are nearly as safe as or better than the interest income from government and corporate bonds. Examples include water, energy, and other dividend-paying common stocks.

Many clients have called to discuss gold, mining and other inflation-sensitive stocks. We believe these categories and others will represent an important portion of client portfolios when inflation begins to move throughout our economy. The recent jump in gold prices was primarily driven by traders, fear, and expectations that maybe a worst-case economic scenario is near. Chasing commodities and gold prices (for example) directly following a substantial run-up in prices is not prudent at this time. We do expect to build positions in natural resources, mining companies, gold, real estate and inflation-sensitive companies in the future.

The point we are making is that we intend to use our insight and judgment to distinguish between real trends verses emotional and reactive trading. Our clients may have noticed our previous blue recommendation sheets (included in your year-end reports) did include real estate, natural resources and other selections that should perform relatively well as inflationary pressures build. We will **not** include or repeat the same recommendations in the March 31st quarterly package. The earlier recommendations are still valid and may be implemented when we feel the time is prudent to proceed.

ESTATE PLANNING UPDATE

The estate and gift tax rate has been reduced from 45% to 35%. In addition, the **estate tax exemption** amount has been increased from $3.5 million to $5 million. Simply stated, no estate tax is due on estates valued at $5 million or less. The increased exemption amount may require changes to your current estate planning documents.

The **gift tax exemption** amount has been increased from $1 million during your lifetime (or at death) to $5 million. Simply stated, taxpayers may gift up to $5 million during their lifetimes and pay no gift taxes. Taxpayers now have the flexibility to give away up to $5 million during their lifetimes, gift a partial amount or preserve the entire $5 million exemption at death. Parents or grandparents may wish to take advantage of the increased lifetime gift amount by making gifts of appreciated securities, real estate or business interests to children or grandchildren. Finally, any unused portion of the $5 million exemption amount (per person) may be passed on to the surviving spouse, provided the appropriate election is made for deaths occurring in 2011 or 2012.

These changes above automatically expire at the end of **2012**. The favorable estate planning opportunities are only available for the balance of 2011 and 2012.

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ANNOUNCEMENTS

Our property management company has asked us to temporarily move out of our office space for a three-to-fourth month period. The roof and brick siding around the entire building must be replaced due to water damage. While this temporary move will be an enormous inconvenience, the repairs must be completed. There are five buildings in our office complex and our building is the last one on the work schedule to undergo the same re-construction. We will be temporarily moving to one of the adjacent buildings and we expect the mailing address and phone numbers to remain the same. The expected move date is June 2011. We will provide more details as the temporary move date approaches.

COPIES OF INCOME TAX RETURNS

Our clients have already received a full accounting of income and capital gains for the 2010 calendar year. Please send paper or computer file copies of your 2010 income tax returns to our office upon completion. Our investment decisions and income tax management strategies are greatly improved when we have copies of your income tax returns.

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Best regards

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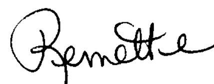
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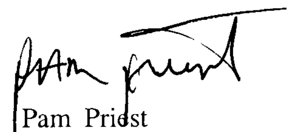
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