FINANCIAL SERVICES ADVISORY
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Rockville, MD 20850 800.235.4567 www.fsainvest.com

Spills, Bills, and Thrills

Second Quarter Market Review From Your Portfolio Management Team—July 6, 2010

Investors had a great deal to think about during this second quarter, which evidently overwhelmed most people, so they just decided to take their money and go home. As you can see from the table below, stocks returns, both here and abroad, were sharply negative. Bond investments fared considerably better as investors sought their relative safety.

Index	*Q2 Return*	*YTD Return*
S&P 500	-11.4%	-6.7%
Dow Jones	-10.0%	-6.3%
EAFE	-11.2%	-7.3%
Barclays Bond	3.5%	5.3%
90-Day T-bills	0.0%	0.1%

Source: Ned Davis Research
Note: EAFE represents the MSCI index of foreign stocks; Barclays Bond represents the Barclays Capital Aggregate Bond Index. Q2 Return covers the period from 3/31/10 – 6/30/10. YTD Return covers the period from 12/31/09 – 6/30/10.

What is going on? First of all, an oil rig explosion off the Louisiana coast in late April has spewed millions of barrels of oil into the Gulf of Mexico, and onto the neighboring beaches. With the prevailing gulf current, there is speculation that even the beaches along the Carolinas could see oil in the coming months. The environmental impact, as well as the financial impact, on those living in that region is unimaginable, and we offer our prayers and well wishes to anyone with connections to that area.

From an investment standpoint, the spill has brought into question whether we want to continue with our deepwater and environmentally sensitive drilling efforts. However, with our dependence on foreign sources of oil growing, we are in an awkward position to make any significant changes if we want to recover fully from the recent recession.

Secondly, the House of Representatives recently passed its version of a sweeping financial reform bill. The bill attempts to avoid a repeat of the recent financial mayhem by imposing tighter regulations on financial firms. It will also create a consumer protection agency designed to prevent consumers from being misled by unscrupulous credit card or mortgage firms. Investors are typically suspicious that new regulations will stifle innovation, as well as the free flow of capital to its most productive use.

Finally, most of the world has been distracted by the ongoing World Cup soccer match in South Africa. The pace seems a little slow to us Americans, but most of the world goes a bit crazy during this time. In some ways it is similar to the college basketball tournament, with some surprise exits by traditional powers, (this year the list included France and Italy—recent winners of the Cup), as well as some plucky contenders making it deep into the tournament (namely Ghana—who was defeated over the weekend). The U.S. team made a decent showing but was disappointed not to get to the quarterfinals.

Portfolio Review

At FSA, we are not so easily distracted, and in spite of the myriad headlines hitting the airwaves, we remain focused on executing our investment discipline, even during these challenging times.

Below we review the five broad strategies that FSA manages. Keep in mind that your specific portfolio may differ to some degree from the averages, as our portfolios are individually managed.

Conservative Growth

*Current Money Market Allocation: 50%**

Conservative Growth accounts managed to withstand the sharp stock market reversal in fine fashion. With minimal stock fund positions in the portfolios, they were not subjected to the sharp declines found in the stock market. During the quarter, we sold what few stock-oriented funds we owned, and reduced the high yield bond positions. Most of the high grade and municipal (tax-free) bond funds posted gains for the second quarter. The money market allocation has blossomed back to 50% for most accounts, but we are looking to identify some lower risk alternatives for some of that money in early July, so stay tuned. On average, these accounts were down less than 1% for the quarter, and are up almost 2% for the year.

Core Equity

*Current Money Market Allocation: 53%**

These equity-oriented accounts managed to hold up pretty well given the turbulence in the second quarter. As you know, we have held just modest allocations into stock funds this year, and have allowed ourselves the ability to invest in various bond funds. As a result, these Core Equity accounts held up very well versus what one might expect for a more aggressive strategy. As stocks began to sell off, we greatly reduced what allocation we had to stock funds (going from roughly 40% or so, down to 10% or less). In addition, we also reduced our high yield bond positions. At quarter end, we held about 50% in money markets, and are looking for some low risk alternatives to put some of that cash to work, while we wait for the stock market to recover from its recent slump. On average, the Core Equity accounts fell between 2% - 3% for the quarter, and are down less than 1% for the year.

Tactical Growth

*Current Money Market Allocation: 30%**

After trailing a bit in the first quarter, Tactical Growth accounts managed to hold their ground quite nicely during the second quarter. We sold what modest equity positions we held and reduced our high yield bond weightings. These actions increased our money market allocation to roughly 30%. As we enter the third quarter, we own an inverse real estate fund (which will tend to go up in value when the stock market is falling in value). In addition, we own a government bond fund, which should also provide some stability if stocks remain under pressure On average, the Tactical Growth portfolios fell less than 2% for the quarter, and are basically flat for the year.

Income & Growth

*Current Money Market Allocation: 45%**

Income & Growth accounts continue to fare well in this challenging environment. During the quarter, we reduced the equity position, so that the only position left is an eclectic fund, which among other things, owns gold bullion (20% of its assets). In addition, we sold the high yield bond funds in the portfolio. The remaining bond funds are behaving quite well. On average, the Income & Growth accounts slipped less than 1% for the quarter, and are up over 1% for the year.

Income
*Current Money Market Allocation: 33%**
Not surprisingly, this strategy is posting the best returns for the year since these accounts generally avoid any stock market investments. During the quarter, we sold the high yield bond positions as those funds were weakening, and also added a short-term global bond fund to boost the yield a bit. For the quarter, these portfolios managed to eke out a slight gain and are up roughly 3% for the year.

*These allocations represent the money market levels of our various strategies, including trades through June 30, 2010.

Looking Ahead

There seems to be two broad courses of action for the economy and thus the stock/bond markets as we enter the second half of 2010. In scenario 1, the global recovery continues to occur, with the government stimulus having its desired effect. In that scenario, we would expect for bond yields to rise, stock returns to remain positive, and commodity returns to also be positive. In scenario 2, the economy falters—in spite of the stimulus—and we have the dreaded double dip recession. Under this scenario, we would expect a rough time for stocks and commodities, while bonds (government bonds in particular) should do quite well.

Some of the recent economic statistics are suggesting to some observers that the economic recovery is in jeopardy. The employment numbers remain anemic, Consumer Confidence had a sharp drop in June, and factory orders fell in May—among other reports. These recent releases added to the angst over the ongoing cleanup in the Gulf of Mexico, as well as the new financial reform bill. The other looming issue for investors is the potentially dampening effect of higher taxes, which are set to occur in 2011, unless Congress acts to modify the current law.

Given the issues facing Americans today—high consumption, low savings, wage stagnation, higher taxes, increased regulation—we were skeptical of the sharp market rebound in 2009. On the other hand, we are not convinced that a new bear market is upon us. We expect the economy will continue to muddle along well enough to keep both the bulls and the bears anxious through the summer.

For now, bond investments offer the best combination of positive returns and relatively low risk, and we are comfortable leaving our portfolios with heavy weightings in that area.

Please let us know if there is anything we can add to these monthly reports that would help you better understand what is happening in your accounts.