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Bulls Take Control

First Quarter Market Review From Your Portfolio Management Team—April 16, 2012

To be an investor in stocks these days, one needs to adopt the attitude of a salesman. While trying to get new business, they often have to endure rejection after rejection, and yet keep an optimistic spirit that the next visit will bring them success. So it is with investing. 2011 was a brutal year for stock investors due to the high volatility, coupled with repeated rallies and sell-offs. Not to mention that 2010 was similar, as well. And who could forget that just three years prior we went through the most brutal year in stocks since the Depression? And yet, in spite of this recent history, investors were able to shrug off all those bad memories and push stocks to one of their best quarterly results in 15 years. There have only been 11 occasions over the past 15 years when the quarterly return of the S&P 500 index has managed to increase double-digits. It was the best first quarter return since 1998.

Things were much more sedate in the bond world, with returns only slightly positive. High Yield bonds, which share some characteristics with stocks, managed a nice gain for the quarter, rising 4% - 5%.

Index	*YTD*
S&P 500	12.6%
Dow Jones 30	8.1%
EAFE	10.2%
Barclays Bond	0.3%
90-Day T-bills	0.1%

Source: Ned Davis Research
Note: EAFE represents the MSCI index of foreign stocks; Dow Jones 30 represents the Dow Jones Industrial Average; Barclays Bond represents the Barclays Capital Aggregate Bond Index. YTD covers the period from 12/31/11 – 3/31/12.

So, what's going on? Is this rally doomed to fail like other recent attempts over the past few years, or might this be the beginning of a more sustained uptrend? Of course, no one can answer that with any certainty. The big-picture issues of runaway national deficits, coupled with a dysfunctional Congress, will continue to cast a shadow over any attempts to rebuild a solid financial foundation for the country. Nevertheless, with the economy continuing to grind along, gradually pulling down the unemployment rate, and with solid corporate profits, there are reasons to be more optimistic in 2012 than in 2011.

Portfolio Review

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: 12%**

Conservative Growth accounts started 2012 with a defensive posture, consisting of a 40% money market position and roughly 60% in bonds. As stocks broke through resistance in the first quarter, we deployed much of that cash to more aggressive assets. As we enter the second quarter, the portfolios have 15% in rather conservative stock funds, as well as 20% in high yield bonds (which also tend to move with stocks). On average, these accounts recouped their slight losses from 2011 in the first quarter.

Core Equity

*Current Money Market Allocation: 16%**

Core Equity portfolios were also defensively positioned as we entered the first quarter, with 50% - 60% in money markets. During the quarter we pulled the cash position down to roughly 20% by adding a number of sector funds, including real estate, transportation, and gold. After a strong start to the year, gold bullion has weakened to the point where we have reduced and even eliminated the position in some accounts. We may look to re-establish that position later this year if given the opportunity. These accounts recouped most of their losses from 2011 in the first quarter.

Tactical Growth

*Current Money Market Allocation: 9%**

In our most aggressive strategy, we continue to look for opportunities in stocks, bonds, commodities, and even inverse funds. These accounts entered the first quarter with roughly half of the portfolio in money market. As the market rallied in the first quarter, we added small cap and overseas positions to these portfolios. We also added a silver bullion position. As the quarter progressed, we sold the silver position and bought the inverse silver position. This fund, along with the long dollar position, provides some protection during market sell-offs. For the quarter, these accounts recouped their losses from 2011.

Income & Growth

*Current Money Market Allocation: 4%**

These accounts maintained a defensive posture all quarter, shunning stock funds until mid-March when we added an income oriented equity fund. We also added a high yield position to provide more lift to the portfolios. In this strategy, we will be content to maintain our heavy emphasis on bonds (80% - 85% of the portfolio) until they finally begin to trigger our FSA Safety Nets®. Because of its conservative nature, these accounts are at or near all time highs.

Income

*Current Money Market Allocation: 4%**

We brought the money market position down in these accounts, as well. To take some advantage of rising stock markets, we added some high yield bond positions in the qualified accounts, while adding some tax-free municipal funds in the taxable accounts. This strategy continues to deliver returns above a money market or CD with only modest volatility.

*These allocations represent the money market levels of our various strategies, including trades through March 31, 2012. Performance numbers for FSA portfolios represent composite results and do not include the semi-annual fee of roughly 0.6%, which was deducted in February. A complete Performance History of all FSA strategies is available upon request.

A Look Ahead

Another interesting year in the making. Stocks have a strong start to the year, helping people forget the trauma and turmoil that marked 2011. And yet, there are still net outflows of money from stock funds, coupled with continued inflows into bond funds. It appears that the retail investor continues to shy away from stocks, preferring the consistency (even with lower returns) of the bond funds. The pundits in the media have been urging the retail investor to venture back into stocks by arguing that stocks are cheaper than bonds, given how well bonds have done over the past ten years, versus stocks. But, the typical investor is not listening to the arguments because of the utter lack of trust with so-called experts on Wall Street.

The big issues facing this country (and much of the developed world, as well) are as present today as four years ago:

- The government has not reined in its spending to match its income;
- There is too much leverage in the financial system that needs to be released;
- How do we solve our health care issues?
- How do we bring back accountability to Wall Street?
- How do we fix the lopsided incentives on Wall Street to reward risk-taking but punish greed and bad decisions?

In addition, there is a Presidential election that always promises to throw an interesting spin on the stock and bond markets.

As always, keeping the portfolios out of trouble is our first objective, but looking for prudent opportunities on the upside is a close second when the market environment is favorable. If the bulls really do control the market for 2012, we want to make sure we have the portfolios in a position to benefit.