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Dear Client:

Market volatility, uncertainty, societal strife mark the world of 2011. Businessmen, investors, and the general public look for government's direction. Office holders ponder what economic policies will maintain them in office. Your portfolio, your standard of living, your retirement issues are critically involved. What follows should provide a better understanding of the issues and concludes with very general comments as to what can be anticipated from the generic areas of investment: stocks, bonds, cash, real estate and commodities.

Commerce of the world is highly integrated. It operates through what is termed the production cycle. Successful operation of that cycle depends on the protection of the world's governments. The success of your investment portfolio depends on the business acumen and motivation of the men who operate in the investment cycle, on the companies in you have invested, on what these companies produce and on how government relates to their activity. Government interaction may be complex encompassing regulation and taxation, impacting the psychology of the various actors in the production cycle and the financial capability and outlook of your company's consumer.

Historically, the United States has been the primary advocate of laissez faire capitalism. Capitalism is built upon competition. If individuals were engaged in achieving a similar end, the most successful would survive. Socialism built upon centralized planning. The state could and would determine how the production cycle would evolve to achieve the desired end result. China was a leading advocate of socialism yet seemed to modify the system in the late eighties when it began to permit elements of capitalism to enter its system. Centralized planning still directs the allocation of capital and labor but elements of democracy are permitted at the local level. The United States adopted increasing elements of centralized planning throughout the twentieth century, particularly under the leadership of FDR. Now, Obama administration can be seen as significantly advancing the efforts initiated by FDR as shown by the appointment of industry czars, healthcare legislation, increased federal efforts on behalf of the labor unions, the Dodd Frank finance law.

These Obama initiatives are major legislative and executive efforts. With them, the President and Congress have indicated that areas of law to be addressed and sometimes the ends to be achieved. The actual rule making authority has been delegated to the administrators and Czars who will add to the already massive Code of Federal Regulations. Massive areas of tax law, healthcare, financial and labor laws are thus subject to change and will, in the near future, likely govern corporate and individual actions. How these rules are written will have immense financial impact in determining how business is conducted in the future.

Change or the threat of change may not immediately impact a particular industry but can threaten another industry critical to its operation. As a result, not knowing what the law will be, business slows. Commitments stall. Potential jobs go unfilled. The consumer does not buy. Businesses keep their money in the till. Workers go unemployed.

Such uncertainty is not only in this country but is apparent elsewhere. At issue is the role of government. Society has advanced from where the sole purpose of the law was to protect the cycle of production. That legal purpose may advance the material wealth of the nation but does nothing to advance its cultural achievements or to provide a safety net for its citizens. Those benefits require centralized (or, possibly under our Constitution) state planning. Yet, to what extent can the capitalist model be amended by a central planning system. And who is to be appointed to determine what the appropriate minimum standard of living is for the individual. Set too high, the individual citizen comes to opt for the entitlements provided by the state rather than being motivated by what the free enterprise system may ultimately offer.

In the West, where the electorate is free, a critical split has evolved. The massive collection of law that is in place in good part reflects the results of past lobbying and surrender to special interest. To maintain their office our representatives have appealed with government largesse, increased salaries and fringe benefits for public employees, health and retirement benefits for other citizens. Over time, the empirical costs to the government (read taxpayer) and to the employer have become unsustainable. Governments have financed the increases from borrowed money.

The beneficiaries have become accustomed to their windfall and look to the entitlements that present law provides. When cutbacks are suggested in order to finance the expanding debt, anger and public demonstrations ensue. One can see much in common when considering the workers who demonstrate on the streets of Athens and the union members who demonstrate on the streets of Madison, Wisconsin. Both sets of demonstrators are there looking for entitlements.

The problem for western governments is debt. For the United States, the cost of the entitlements is popularly measured in the press as over fourteen trillion dollars. But that (may be) a huge under assessment. When the costs associated with Medicare and Medicaid and with the liabilities required for future salary and pension payments are calculated, the sum rises to over 100 trillion dollars. The debt issue bankrupted the government of Iceland and has recently caused the government of Greece to agree to draconian austerity measures. It threatens to spread, endangering the governments of Portugal, Ireland, Italy, Spain, the life of the European Union, the status of the American dollar as the reserve currency of the world.

Meanwhile, the Chinese whose economy has mushroomed since the late eighties are coming to see financial problems of their own. Will China start to encounter a credit/banking crisis as so many emerging market countries have had in the past? Will real estate and infrastructure overbuilding and a general misapplication of capital lead to overcapacity and a glut of empty buildings, roads and factories. China's growth rate has recently significantly declined. There is a real fear among its leaders that the populace will rise up to demand ever more representative government and an improved standard of living. China's economy continues with very significant growth but has slowed. Will China continue to be viewed as the financial engine of the world?

Virtually every nation's production cycle is increasingly dependent on the operation of other nations businesses. The following prominent examples are for illustration only: (1) Manufacturers rely on parts and services that may come from without our borders. The Japanese tsunami, for example, significantly impacted the automobile supply service, and jobs, in this country. Cars became less available and more expensive. Parts were not available for mechanics and service attendants to sue in automobile repair. Jobs were lost. (2) the manufacturer depends on the transportation industry to bring its product to market. Consider the increase in cost to the transportation industry when the fossil fuels that power their conveyance increase in cost. Limited fuel availability can increase that cost. It matters whether we "drill baby drill" or power our transportation vehicles with fuels obtained and priced from foreign distributors (3) Wage levels impact our domestic market. Labor performed in Washington State may be more expensive than labor performed in South Carolina. Labor performed in another country may under cut the cost of labor domestically. The manufacturer must consider these price differentials in his production cycle. Increased labor costs may mean his product will be priced out of the market. Consider the number of every day products you use and what percentage come from China where the cost of labor is low.

What are the legitimate claims of the worker, the retiree, and the unemployed to the wealth of government? Resolution of this entitlement issue will have definite impact. Presently western governments are distributing middle level salaries and benefits to public employees whose private counterparts receive much less. Many citizens and even illegal immigrants receive health, education, and welfare benefits without requiring contribution of any nature to the commonweal. The cost is to the employer, both direct and indirect. Sales are lost due to the increased cost of goods to the consumer necessitated by the increased cost of employment.

Similar reasoning reveals the increased direct and indirect cost to the sovereign. More individuals might have found employment had it not been for the additional costs imposed by these entitlements. The cost is borne by the stock holders, the bond holders, those who loan the employer or its country money.

Regulations that restrict or dictate business operations are costly in a similar way. They, too, involve a chain of expenditures both due to the direct costs of compliance and the indirect costs from the limitation on the chain of production for both business and nation. Ultimately the cost to the nation is reflected in the national debt in what we as a nation are required to borrow.

We are or have been the world's wealthiest nation. But this standard is decreasing. Fifty or sixty years ago we provided nearly two thirds of the world's goods and services. Today, that percentage is less than twenty-five percent. Wealth is obtained by the production of goods and services. Why have we lost this competitive advantage? Could it be that we no longer wish to compete for a number of jobs that many of the world's blue collar jobs are beneath the dignity of our new generation of workers. Could it be that not all of our younger generations have the natural talents to benefit from a college education, that we need more laborers, artisans, and blue collar workers? Is our society and education system discarding these wealth creating occupations to foreign talent. When we pay for this foreign labor rather than performing the tasks ourselves are we promoting a society of entitlement at the risk of bankrupting our treasury? If the necessary tasks can be obtained most reasonably outside this country, isn't this the incentive for jobs and industry to go elsewhere? If so, we have lost money as a nation.

What is to be the role of government? It's not an easy question. It's not a question susceptible to simple answers. Many in the United States look upon today's governing law, particularly the Internal Revenue Code and the Code of Federal Regulations, as being an unwieldy collection of social engineering. To amend the law piecemeal would prove unmanageable. But amendment is now the subject matter of the Obama-Boehner budget discussions. Note that almost nothing is known as to the specific provisions being discussed. But this is quite reminiscent of what was happening in 1986 when the last significant broad amendment was made to the Internal Revenue Code. I'm sure that the business class is familiar with this similarity. Thus, as has been well documented, business after business is sitting on substantial cash accumulations waiting to see if what emanates from the closed door meetings will meaningfully impact the way they conduct business.

Much of the accumulation now collected in corporate treasuries can be attributed to government's stimulus policies commenced under President Bush and continued by the current administration. These policies involved the United States government issuing new currency without appropriate backing in capital, service or labor. The most recent of these programs was referred to as quantitative easing. Under this program the Treasury purchased 600 billion of government notes monthly from the Federal Reserve. The purchases helped to restrain any increases in interest to be paid on the notes thus helping to stem additional interest payments from our treasury. Since the dollar is viewed as the

exchange mechanism for the world's financial transactions, the Treasuries of other governments found a need to maintain their supply. With the treasury program coming to a halt on June 30, it was and is feared that the interest that must be paid from the treasury will increase as will the costs for funding business. The reduced cost of borrowing enabled corporations and individuals to borrow, to refinance outstanding obligations at reduced cost, and to stock their treasuries with cash reserves; will the increase in interest rates that many now anticipate cause business to slow?

Just as quantitative easing ended, the strategic oil reserves of this country and Europe were tapped to release reserves that had been stored for military defense purposes. It is hoped that the significant reserves being released will so lower fuel costs essential as to make up for any risks. Fuel cost make up a substantial element in doing business. Thus the release of these reserves by the western governments may at least partially make up for any business slowdown attributable to the end of quantitative easing.

With what has just been reviewed, let's examine what it may mean for your portfolio by briefly examining five generic classes of investment. Although they may differ in the manner or form by which they are held, virtually every asset falls into one of these five categories:

CASH AND CASH ALTERNATIVES: For you, the American investor, the dollar has typically been held for liquidity, to use in instant commercial transactions. It's the international standard for trade. It's supposed to represent a percentage of the country's accumulated capital and work product. But, as additional dollars have been printed without equivalent additions to the nation's store of wealth, the purchasing power of cash is anticipated to decline. Already, certain countries are refusing to utilize the dollar in their trading contracts. Inflation is being predicted. With inflation, more dollars would be needed to complete your purchases and more would be required to finance your retirement.

BONDS: Bonds are evidence of a loan that has been made to the bond issuer. In return the bondholder will receive the dollars he lent and the interest he hopes to receive in the future. To enter the bond transaction, the lender will want to assess the issuer's ability to meet his financial obligation according to the bond's terms and determine whether the bond terms will be sufficient in purchasing power to compensate for his capital forbearance.

In this country we are most familiar with bonds whose interest and principal will be paid in terms of the American dollar. Recently the largest bond fund manager in this country has indicated it will short United State government issued bonds preferring to hold corporate or foreign issues or municipals for the bond that fund will hold. Other prominent bond authorities have called attention to what they see as unusual values among the municipal and corporate issues now available. They see unusually attractive terms. Obviously there are bond issuers outside this country who agree to pay in their local currencies. They are attracting significant attention.

STOCKS: Stocks represent a percentage ownership in the issuing company. Traditionally, the investor has closely examined the corporate balance sheet, business income potential, and the management acumen of his issuer's executives. Now, more than ever, the investor must speculate as to how the government will interact with his business.

The executive branch has unelected administrators writing the law that will govern your issuer in areas such as employee benefits and compensation, working conditions, tax and finance.

Many companies have significant capital accumulations. Analysts expect a third quarter pick up in mergers and acquisitions. We anticipate last quarters earning reports to be good. The big question will rest with the consuming market, whether government or individual. Where will the money come from to complete the production cycle. Who will purchase. The individual has a considerable debt burden as has the government. Will the government borrow again to make the acquisition? Will the government extend new loan programs to finance the individual purchasers? It's the third year of a Presidential term and traditionally the time for positive answers to these questions. Conditions appear favorable for business to do well running up to the 2012 elections.

REAL ESTATE: Real estate is most often held for future appreciation not for present liquidity. The threat of future inflation coupled with the anticipation of demographic growth can make real estate appear a most attractive investment. In many locations the absence of recent land development and a fall in real estate prices increase the attractiveness. As ever the most important considerations for choosing real estate are the anticipated holding period and location, location, location.

Real estate is sometimes held for income. The recent lack of new development and an increasing population have combined to make a number of REITS and REOCS do well. An appropriate selection may combine a nice cash flow with the prospect of appreciation.

COMMODITIES: Since 9/11 this newsletter has continually highlighted the value of commodity investment including petroleum, agriculture, water, various metals and gold. Each of these areas has done well although most recently there has been a drop in their value which we anticipate to be temporary.

Energy price analysis deserves particular attention. Middle East conflict can be anticipated to bring an upward price bias to oil. For some, this makes restrictions of our domestic drilling difficult to understand. Environmental issues including the Gulf spillage and environmental emission concerns are the reasons most often advanced. We have significant oil reserves that are not being drilled.

The recent discovery of new drilling procedures particularly fracking have highlighted our domestic potential for liquid natural gas. We may well have the world's largest reserves of this energy producer. Together with coals it now provides by far the bulk of our electrical output. If industry is permitted to drill for this important reserve and to fully exploit its potential, it could answer many of our energy concerns. Present energy prices would be lowered considerably.

Gold has increased from approximately \$290 per ounce when we started these newsletters in 2001 to its present \$1500. The recent decline is again thought to be temporary. The price of gold stocks has, surprisingly, not climbed this past year to keep pace with gold. We may see a sudden appreciation of this stock.

Floods, fires and other natural disasters that occurred last year resulted in significant crop damage and a need for increase in world food supplies. Anticipation of a record corn crop harvest in the Midwest will do little to allay this need. We may see continued increase in agriculture and agricultural commodities. Although it has been difficult to find stocks that concentrate directly on the market for seeds and crops, fertilizer and machinery companies should do well.

Conclusion: The market collapse of 2008 was a wake up call to the world's governments. As they address the question of how to repay their debt, the underlying issues are: What obligation does the government bear for the welfare of its citizens? What is the obligation that government may legitimately require of its citizens? The response to those questions may threaten to replace the United States as the issuer of the world's economy. It may threaten to collapse the European Union. Although China is not a debtor nation, the solution in the west threatens to imperil that nation's system of government. For the American investor, the market will be more volatile and unpredictable than usual.

Certain issues are apparent. America will, at least for the next few years, be the engine of the world's economy. In that role it can anticipate increasing competition from Brazil, Russia, China and India. How the European Union will evolve remains a question but certain countries, led by Germany will play a vital role. The American presidency stretching to the limits of its powers, able through its Czars and administrators to determine the evolution of law in many of our most essential business areas.

The investor must remain flexible well diversified and very alert. We hope to assist with him in this endeavor.

Best regards,

- The information contained in this report does not purport to be a complete description of the securities, markets, or developments referred to in this material.
- Any information is not a complete summary or statement of all available data necessary for making an investment decision and does not constitute a recommendation.
- Any opinions are those of William Haas and Michael Kertyzak and not necessarily those of RJFS or Raymond James.
- Investments mentioned may not be suitable for all investors.
- Past performance may not be indicative of future results.
- Real estate investments can be subject to different and greater risks than more diversified investments;
- Declines in the value of real estate, economic conditions, property taxes, tax law and interest rates all present potential risks to real estate investments;
- Precious metals, are subject to special risks, including but not limited to: price may be subject to wide fluctuation; the market is relatively limited; the sources are concentrated in countries that have the potential for instability; and the market is unregulated.
- Commodities are generally considered speculative because of the significant potential for investment loss.
- Commodities are volatile investments and should only form a small part of a diversified portfolio.
- There may be sharp price fluctuations even during periods when prices overall are rising.
- Bond prices and yields are subject to change based upon market condition and availability.
- If bonds are sold prior to maturity, you may receive more or less than you initial investment. Holding bonds to term allows redemption at par value. Bond prices and interest rates have an inverse relationship.
- Investing in oil involves special risks, including the potential adverse effects of state and federal regulation and may not be suitable for all investors. Investing in the energy sector involves special risks, including potential adverse effects of state and federal regulation and may not be suitable for all investors.