



SECOND QUARTER 2011 INVESTMENT UPDATE

Dear Friends and Clients,

One of our clients recently enquired to me about how we develop our investment letters and reflected how he felt that the last update in May was particularly good because it was more informative from a general financial perspective rather than a specific investment point of view. I immediately explained to him that the May letter was a special investment update, whereas the quarterly investment updates are actually developed throughout the entire quarter and then finalized during the end of the quarter. We accumulate data for our quarterly investment letter so that we, as investors will have a better idea of determining which direction the economy is heading.

After a buoyant start to the year, U. S. Markets sustained a six-week slide that showed no signs of relenting until mid-June, setting up a summer of stock trading likely to be dominated by gyrating commodities prices, U. S. growth concerns and European sovereign debt fears. For the Dow, that meant an April rally of nearly 4% which was followed by a collapse that lasted through mid-June, taking stocks down 7% and then back-and-forth swings in the final weeks. The Dow finished the quarter up 94.61 points – its fourth quarterly gain in a row and eighth out of the past nine. The Standard & Poor's 500-stock index lost 0.41% for the quarter. Crude oil on the New York Mercantile Exchange slid 16% from a high hit April 29 to finish down 11% for the quarter at \$95.42 per barrel. Also, the U. S. dollar was on its own roller-coaster against the euro and ranged between \$1.38 and \$1.49.

You sure cannot blame investors for feeling nervous. There is plenty of ugly stuff going on in the world right now – from geopolitical troubles in Libya and Yemen as well as Afghanistan to the long litany of financial concerns: the Greek debt crisis's; quake – ravaged Japan's struggle to rebuild; lingering high unemployment in the United States and the epidemic of foreclosures; the bitter budget standoff in Washington; and on and on. However, throughout the decline from the most recent (April 29) top, the market has taken a gentler, more orderly path than it did during last year's spring/summer sell off.

As far as our investment strategy is concerned, we continue to maintain our standard two-pronged strategy, which is to continue to maintain a substantial exposure to common stocks (and mutual funds) as long as there is a reasonable prospect for double-digit returns. Furthermore, we will continue to take profits more frequently so that we could gradually increase our weighting in the fixed income portion of our portfolios.

As far as the equity portion of our portfolios during the quarter, we added a few undervalued stocks such as Vail Resorts, Inc. (MTN), Microsoft Corp. (MSFT), Sealed Air Corp (SEE), Tata Motors (TTM), Bank of NY Mellon (BK) and The Travelers Company (TRV). In

the mutual fund area, we added the Gabelli Equity Income (GABEX) fund and sold the Dodge & Cox Stock Fund (DODGX), which racked up big profits in the 2002- 2007 bull market but stumbled badly in 2008, due to heavy overweighting in financial stocks like AIG and Wachovia. We feel that DODGX's management team really hasn't done much to reduce the fund's volatility.

As far as the fixed side of our portfolios for the quarter, bond yields sank to their lowest level of the year in June, with the benchmark 10-year Treasury slipping as low as 2.87% on June 24 before climbing to 3.16% at the end of the quarter. The yield on the 10-year Treasury note was at 3.57% in early April. Accordingly, we sold one-half of our position in Power Shares Build America Bond Portfolios (BAB) for a nice gain. While Build America bonds do not behave exactly like Treasuries, their long maturities makes them susceptible to a significant price decline should interest rates rise sharply.

Income investors have enjoyed a thrilling ride in the past few months as bond prices have streaked skyward. However, interest rates are nearing an inflection point and we should recognize that the gravy train is coming to an end. Since last 2008, bond yields have been in a twilight zone. Mathematically, the 10-year Treasury at 3% cannot go on a whole lot lower. The lowest yield ever for a long U. S. bond was about 2% in 1941. On the other hand, the subpar economic recovery and continuing deflationary pressure from the housing market suggests that yields may not back up very far in 2011 or perhaps even 2012.

We want to thank all of you for giving our firm the opportunity to serve you. We thank you very much for the trust and confidence you have placed in our firm as it is always appreciated. Please contact me should you have any questions or comments. Also, we want to invite you to visit our website at www.farmandcpa.com for a quick Retirement Calculator, our latest firm news, and Market Commentary archives.