

**INVESTMENT STRATEGY OVERVIEW**

The stock market finished 2010 with strong momentum and optimism. As we enter 2011, a majority of market analysts have a bullish forecast for the year.

	<u>Value</u>	<u>December</u>	<u>3 Months</u>	<u>2010 YTD</u>
DJIA	11577.51	+ 5.2%	+ 7.3%	+ 11.0%
S&P 500	1257.64	+ 6.5%	+ 10.2%	+ 12.8%
NASDAQ Comp.	2652.87	+ 6.2%	+ 12.0%	+ 16.9%
Value Line 1700	372.21	+ 7.4%	+ 13.1%	+ 20.5%
Russell 2000	783.65	+ 7.8%	+ 15.9%	+ 25.3%

Notes: S&P 500 and DJIA Index returns exclude reinvested dividends.  
Source: Thomson Reuters Baseline

The market averages closed 2010 with a strong finish as the various indices approached two year highs with double digit gains in the fourth quarter. As we entered into the fall of the year, investors had several worries on their minds. These concerns included the European sovereign debt crisis involving the PIIGS countries, inflationary concerns for some and deflation concerns for others, high unemployment, falling housing prices, geopolitical news surrounding the upcoming election, as well as whether the Fed would implement QE2 and what effect that would have on the economy. All of this and more led to probably the biggest concern, a double dip recession.

As we moved through the fourth quarter the prospect of a double dip recession diminished as corporate profits and revenues continued to advance. The outlook for 2011 remains very constructive, although growth will likely be below average (2% to 3.5%). The modest growth rate will allow corporate earnings to continue to expand next year. The low level of capacity utilization will continue to make job creation and unemployment reduction problematic. Likewise, housing and commercial real estate will struggle for a while longer.

Commodity prices were very strong in the quarter and for the year. Surprisingly energy prices rose in the mid-teens, while food commodity prices rose in a range of 30% to 90%, with wheat topping the year, increasing 90.5%. Investors point to higher commodity prices as a sign of worldwide demand as growth is expected to remain robust throughout the world, and especially in the emerging markets. If prices for commodities continue to increase at an above average rate, domestic growth will be impacted as profit margins and consumer spending will be constrained in the future. In addition, these same prices will impact world markets.



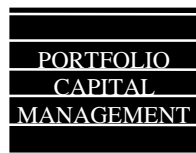
The increase in commodity prices has not shown up in any meaningful way in the Consumer Price Index (CPI). In the last 12 months the CPI has increased less than 1.25%, while the Producer Price Index (PPI) has increased at 4.26% over the same period. We will continue to monitor prices to see if there is a flow through to the consumer. The Federal Reserve has stated they can react to any pricing pressure that develops without impacting growth. This has proven difficult to manage in the past and with the amount of money the FED has added to the financial system, managing price stability may prove more of a challenge for the FED.

### Stock Market Outlook/Strategy

As mentioned earlier, the stock market finished 2010 with an exceptionally strong fourth quarter. The S&P ended the year at 1257 while the DJIA and NASDAQ finished at 11577 and 2652 respectively. Our outlook for 2010 was described last year at this time as skeptical. Thankfully, we were wrong. There were several reasons why we were skeptical and for three-fourths of the year, the market bore that out. Entering into the fall, some of those “clouds” dissipated and the markets rallied as investors looked to move their money into more risky assets.

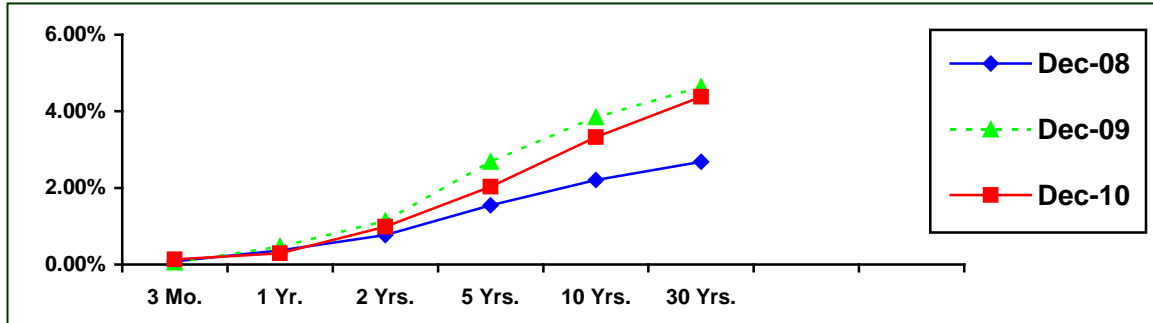
Our outlook for 2011 is hopeful, however, there are concerns that we’ll keep in view. We believe companies should sound more optimistic in 2011 than they have in the last couple of years. Companies have hoarded cash, cut expenses, and cut inventories over the last 12-24 months and with capacity utilization below 75%, they have all the room they need to increase production, productivity and profits. Furthermore, companies will look for ways (organic growth, merger and acquisitions, and corporate stock repurchases) to spend some of their cash in order to increase their earnings which would be bullish for the market. One concern that we’ll mention is a contrarian theory. With so many analysts/experts positive on the markets for 2011, one can’t help but be a little leery.

During the fourth quarter we added only stocks to the portfolios as we felt compelled to leave the portfolios fully invested. We purchased EMC (EMC) and McKesson Corp. (MCK) while adding to our position in Nucor (NUE). We do anticipate placing several trades in the first part of the year. Those trades would include capturing some profits we have in stocks while reinvesting the proceeds into new stocks or adding to an existing position.



### Fixed Income Outlook

As depicted below, the yield curve is little changed in the last twelve months; however, that doesn't tell the whole story. With the combination of prospects for better economic conditions and inflationary concerns, the 5, 10, and 30 yields have risen over 75bp (3/4 of 1.0%) in the last three months. The most recent press release from the Federal Open Market Committee (FOMC) indicated the committee voted to keep rates near zero for an "extended period of time" and stick with their plan to buy \$600 billion in Treasuries through June 2011. The FOMC statement stated, "The economic recovery is continuing, though at a rate that been insufficient to bring down unemployment."



	<u>12/31/08</u>	<u>12/31/09</u>	<u>12/31/10</u>	<u>2009 Change</u>
3 Mos.	0.08 %	0.05 %	0.13 %	0.08 %
1 Yr.	0.37 %	0.47 %	0.29 %	- 0.18 %
2 Yrs.	0.77 %	1.14 %	0.63 %	- 0.51 %
5 Yrs.	1.55 %	2.68 %	2.03 %	- 0.65 %
10 Yrs.	2.21 %	3.84 %	3.33 %	- 0.51 %
30 Yrs.	2.68 %	4.64 %	4.38 %	- 0.26 %

Source: Thomson Reuters Baseline

We will continue to be cautious, believing that the exit strategy by the Fed will be more difficult to implement and that will allow inflation to rise faster. Although Fed Chairman Bernanke fully believes the Fed can/will control the inflationary pressures, we are not as optimistic. We anticipate the Fed to keep rates lower longer and to continue to infuse cash into the economy by buying Treasuries longer than what is probably necessary. This stimulus mentality is understandable, but one that will most likely increase inflationary pressures. We continue to be selective in our purchase of bonds and prefer the shorter term maturities in the face of rising rates.

The market commentary was written by Portfolio Capital Management and the opinions stated are that of the author. The information contained within is for review purposes only and it is not intended to cover all aspects of a particular matter. Some of the information contained within is derived from sources believed to be accurate; however, we do not guarantee its accuracy. The information provided is not written or intended as tax or legal advice and may not be relied on for purposes of avoiding any federal tax penalties. Past performance is not a guarantee of future results.

