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Dear Client,

Market Review for the First Quarter 2011

In January and February, markets saw a continuation of last year's positive sentiment. This was spurred by solid corporate profits and a broad consensus that the global economy would experience an ongoing, moderate recovery.

March did see a setback. The earthquake and tsunami in Japan on March 11, which took a dreadful toll in human life, have also clearly reduced short-term prospects for the global economy. The turmoil in North Africa pushed oil prices higher and also had a negative impact on markets due to concerns about the effect on consumer demand.

Notwithstanding these events, developed markets generally saw gains at the end of the first quarter that put them on track for solid performance in 2011. The market, as measured by the S&P 500 [1], saw its best first quarter performance in 12 years, rising about 5.5%.

Learning to live with uncertainty

If they operate efficiently, stock and bond markets incorporate all the available information at a given point in time. That's why, when sovereign debt problems emerged in Greece early last year, other European countries, perceived as having potential problems along the same lines, saw an immediate spike in the cost of insuring their debt. Even though they hadn't run into problems yet, the market factored in this possibility.

Market analysts spend many thousands of hours each year looking at these kinds of issues. With enough time and research, slow-forming problems, like government debt issues, can be analyzed beforehand.

What can't be anticipated are developments that are, by their nature, unpredictable. We've had at least four such events in the past year:

- Last April's volcanic eruption in Iceland that spewed ash in the air, shut down 100,000 transatlantic flights, and cost the airline industry $2 billion
- Also, last April, the explosion of the Deepwater Horizon oil rig in the Gulf of Mexico
- Commencing in December, street protests resulting in changes of leadership in a number of countries in North Africa, leading directly to the current military action in Libya
- And, of course, the earthquake, tsunami, and nuclear-reactor crises in Japan

In light of episodes like these, investors need to expect the unexpected.
The only way to deal with uncertainty and manage the impact of unforeseen events is to build strict risk controls into portfolios, similar to those used by the most sophisticated pension funds. While the risk of one-time incidents can't be eliminated, through diversification and risk

management we may be able to limit the damage when negative events occur - whether they be massive frauds such as Enron, sudden bankruptcies like Lehman Brothers, volcanic eruptions, oil rig explosions, or earthquakes.

I thought it might be useful to provide an overview of my approach to risk management in portfolio construction. There are three steps in this process:

Step one is to identify the target mix of stocks, bonds, and cash that, based on historical precedent and current valuation levels, will over time have a high likelihood of providing the returns you need to achieve your long-term goals with a level of volatility you can live with along the way.

In step two, we, and the money managers we work with, carefully diversify your portfolio by placing limits on the exposure to any one company, industry sector, or region. For individual holdings, it's typically an absolute percentage of your portfolio. For example, no one stock should make up more than 10% of your equity holdings, and no one bond should represent more than 3% of your fixed-income exposure.

In the final step, at least once a year, we conduct an in-depth analysis of each portfolio. Over time, asset classes, industry sectors and individual stocks that do well will increase their presence in your portfolio and bump up against the risk control limits.

At that point, your portfolios need to be rebalanced back to the target asset allocation, and some of the positions that have outperformed might be trimmed to stay within risk control limits. Some investors find this very difficult; after all, you're selling exactly those investments that have done the best.

But, it's the only way to stay truly diversified and control the risk that accompanies overexposure to any one stock, industry sector, or geographic region. And, it's also the only way to get some protection from things that simply can't be anticipated.

As always, if you would like to discuss this in greater detail, please feel free to call or email me. I am looking forward to Spring!!

Sincerely,

Mike Ovshak, CFP®

[1] All indices are unmanaged and investors cannot invest directly into an index. Past performance is not indicative of future results. The S&P 500 Index is a broad-based measurement of changes in stock market conditions based on the average performance of 500 widely held common stocks. Diversification does not assure a profit or protect against a loss in declining markets.