J.J. BURNS & COMPANY, LLC

1st Quarter Newsletter, April 2011

"NO FEAR"

As a parent of four children, I often say how my children have "no fear." It's interesting how children learn over time, typically by trial and error. Of course once a child figures out the last time a specific action injured them, it is at that time, fear registers and they rethink the action again.

Unfortunately, we don't have the luxury of trial and error in portfolio management. However, we do have the historic data of all the years of investing under different economic conditions. Similar to the reasoning of past experiences, we can determine how best to proceed so that we may preserve the integrity of our portfolios under various conditions.

Investing can appear to be frustrating and confusing when the world looks as it does today. Often times we look at current economic data but don't take the necessary "step back" to assess the real landscape prior to making the next step. Perhaps the information we will share in this news brief, will help you to gain perspective of this landscape. Late in January seemingly insignificant demonstrations for leadership change in Tunisia spread across northern Africa into Cairo, Egypt. The 18-day political insurrection in Egypt ended in the ouster of President Hosni Mubarak from power. Protesters carried the regime-change demonstrations into Yemen and Bahrain but when the citizens of Libya called for the removal of Libyan leader Moammar Gaddafi's regime, an all out Civil War began. Under the threat of massive genocide, the US military as part of a coalition, stepped in to enforce a no-fly zone that seemed to include tanks and other offensive weapons installations. In the middle of all this, a massive 9.0 magnitude earthquake hit off the coast of northern Japan. As if the devastation from the earthquake were not enough, it was immediately followed by a massive tsunami that resulted in waves 70 feet high hitting the coastline of Japan with such incredible force that it wiped out nearly everything for miles inland, including a major nuclear reactors' cooling system. Recently, it was announced that Japan's nuclear accident is on par with Chernobyl!

The Market Reaction

Commodity prices soared, especially oil which hit $106 per barrel before settling back. Businesses warned of lower earnings due to the higher cost of energy. The stock market fell nearly 7% in a matter of days before recovering. Commodity prices also recovered, as gold and silver as well as

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grains moved to new highs. Interestingly, uranium prices did not recover as future plans for nuclear reactor construction in the country, once supposed to be a big part of our future, were quickly set aside. Now, oil drilling licenses are again being given to drillers looking to increase domestic production.

Where is the FEAR?

Global equity markets have shown positive closes in spite of what is happening around the world. Keep in mind Spain and Portugal are experiencing significant fiscal problems which continue to impact the Euro. Gold is hitting new record highs…..Silver, tin, corn and wheat are all moving higher. Corporate bond spreads show the risk appetite that is out there. Even the Euro Currency is off to its best year since its inception twelve years ago. The pound and Aussie currencies are up as well.

Real Facts Worth Remembering

- All of the monetary easing the Fed has done is sitting on the balance sheets of banks.
- Investor sentiment on stocks is almost as bullish as it was in 2007.
- Energy and food now absorb 23% of US wages and salary. This is a "Red Flag" for the American consumers.
- Real average weekly earnings are turning negative year over year despite the job creation you are hearing about.
- The economy may create some jobs, however, it would take nearly five years to get back to the pre-recession peak in the employment-to-population ratio.
- Typically, at this stage in an economic expansion, the level of payrolls is at a new all time high. This is not the case in the current "recovery."
- The US Economy has slowed to 2.0%-2.5% growth in Q1 from a near 4% increase in Q4; same pace looks likely for Q2.
- Corporate balance sheets are strong but the earnings outlook is not as clear as it as been in past months.
- The US economy is going to feel some major withdrawal symptoms in the second half of the year as Fed easing ends and the government stimulus begins to fade.

Home Prices Still Bottoming

- The S&P 500 Homebuilders are down 13% from this year's nearby peak.
- Unsold inventory of new homes has expanded from 6.8 months' supply in December 2010 to 8.9 months currently
- Both median and average prices for new homes have sagged at over a 60% annual rate!

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- It's still taking over eight months for homebuilders to close the deal on a new home.
- There are over 3.7 million homes that are vacant and are for sale. This is 30% above normal. In addition, there are some 2 million homes that are "distressed" or in the pipeline of foreclosure properties.

Inflation/Deflation

Inflation: is a rise in the general level of prices of goods and services in an economy over a period of time.
Deflation is a decrease in the general price level of goods and services.

The debate on inflation and deflation has been quite lively on Wall Street and around the world of finance. Nearly every media appearance I have been involved with centers around this debate. The below missive is representative of the many recent meetings we have had with our investment team and portfolio managers:

The US Government has been issuing a tremendous amount of debt and financing our economic growth by having the one part of the Government (The Federal Reserve) buy it from another part of the Government (The U.S. Treasury). They are accomplishing this through banks (or other intermediaries as the media states) so essentially it looks better than just giving enormous amounts of money to the politically connected.

The Federal Reserve's Quantitative easing (QE1 and QE2) are slated to end at the end of July, at which time the government will be less able to finance itself internally. While the Fed could choose to step in with further Quantitative Easing, we find that doubtful, at the very least not without material weakness appearing in markets first. The basic problem is that the US still requires external funding, and it seems that our creditors have become all too aware of our money printing tendencies. At this level of self-funding, we are already seeing dollar revulsion, and any further action along those lines will only make it worse. We cannot totally self- fund without an accelerating devaluation of the US dollar.

The Federal Reserve continues to print money. Inventories have risen to high levels. Gas prices in some areas are near record highs. Even the CPI (consumer price index) numbers have been showing high inflation (close to 5%), while alternative, free market measures show something closer to 9%. In order to continue to keep this credit bubble of "economic steroids," we will need even greater sums of money. To get back to 2007 credit conditions we would likely need over $2.5 Trillion. This would likely create $5 gas and cause millions to starve due to high food prices. It's hard to believe, but some market pundits want to re-inflate the last economic bubble.

We have yet to take the potent medicine and solve our fiscal problems. Look at what has happened and continues to happen to some European countries… namely Spain, Portugal and Greece. Interestingly, the stock market is not likely to go down all that much until the "punch bowl" of stimulus begins to limit its servings. It's likely by June we will see this decreased flow of easing, which may affect market values and bring increased volatility.

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It's increasingly clear that credit creation will still be coming from the Federal Government, as even the hard-line budget conservatives are only talking about minute changes in deficit growth. It will come as a likely increase in long term interest rates. This potential increase in interest rates could see stocks fall in the back half of 2011 as the lack of direct government stimulation should at least lead to deflation in the riskier assets (stocks). It's also worth noting that the Fed intends to reduce their balance sheet in the future. They cannot hold the US debt they bought indefinitely, this will likely be an additional headwind that the markets will eventually have to contend with. The JJ Burns and Company Investment Management Team greatly questions how much the Fed will "push" when they see the markets go down even a little. The medicine is difficult to stomach, however, it is necessary.

Economically, America has spent the last 2 years "kicking the can" down the road, and it seems like we're having a harder time doing any more kicking. Perhaps the "kicker" may be higher interest rates. The effect of higher interest rates in itself does not spell disaster; however, the economic sustainability going into 2012 could prove daunting.

Portfolio Management Changes

For now inflation is in charge, so we have been increasing commodities such as gold and other hard assets inside our portfolios. The added layers of diversification are essential keys looking into 2012. Alternatives Assets continue to become a larger part of the overall asset allocation and we see this area growing as it helps to preserve capital and reduce volatility in the portfolio. Most importantly, however, for income based investors, we look toward continued preservation of capital by shortening bond maturities, adding bonds whose coupons will step-up with interest rate increases and, where appropriate, add interest rate hedges to preserve principal while maximizing income. Finally, high quality stocks will continue to be a mainstay of our portfolios, just in a smaller allocation than average. As the economy ebbs and flows, we anticipate market pull backs. We will look to utilize these downturns to add equities that are fairly priced, have long term growth prospects and good management teams.

We must have great resolve to understand that we are far from solving the problems of our economic system. We may see markets rise on no clear fundamentals, or perhaps not contracting on any levels of fear. What is vitally important is to understand and regularly revisit your own personal investment goals over the long run and to make certain your portfolio matches your risk tolerance so you can "sleep at night."

As spring flowers arise, we wish you the blessed joys of a new season, health, happiness and prosperity.

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