

MARKET TRENDS 6/30/2011

	Total Return	
<u>US Stock Markets</u>	<u>12 Mos</u>	<u>YTD</u>
S&P 500 Index	30.7%	6.0%
S&P MidCap 400 Index	39.4%	8.6%
S&P SmallCap 600 Index	37.0%	7.5%
<u>Int'l Stock Markets</u>		
EAFE Index	33.1%	5.3%
Emerging Mkts Index	29.9%	1.0%
<u>Fixed Income</u>		
Barclays Intermediate Gov't/Credit Bond Index	3.8%	2.5%
Barclays Capital Muni Bond 3 Year Index	2.5%	2.2%
<u>Commodities</u>		
SPDR Gold Shares	20.5%	6.5%
Goldman Sachs Commodities	26.1%	2.7%
<u>Real Estate</u>		
Dow Jones US Real Estate Index	33.4%	10.1%

Sources: Total Returns from WSJ Market Data Group, Standard & Poor's, Barclays

Newsletter – August 2011

MARKET RECAP

The second quarter was volatile without much movement in the market in either direction as investors waited for resolution of the debt ceiling crisis and second quarter corporate earnings. In the second quarter, international developed equity markets led the way with a 1.8% return due to the weakening U.S. dollar. Domestic stocks were flat while mid caps, small caps and emerging market equities all produced negative returns. Year to date through 6/30/2011, domestic mid caps and small caps still have outpaced domestic large caps and international stocks. Towards the end of the quarter, equity mutual funds have started to experience redemptions which has been accelerating in July.

Even as bond investors worried about raising the U.S. debt ceiling, sovereign debt problems in Europe, local and federal government deficits, bonds still produced strong returns across the board with municipals up 3.9% and U.S. 10 Year Treasuries up 2.4% while Treasury yields continue to tumble. Commodities were a mixed bag in the quarter with the Goldman Sachs Commodities Index down 7.9% due to a pullback in oil prices while gold was up 4.5%. In spite of the real estate weakness as measured by the Case-Shiller Index, REITs (Dow Jones US Real Estate Index) posted another strong quarter and are up 10% in 2011.

COMMENTARY

Even though it is now August, 2011, it's as if we are reliving 2010 all over again! Many of the macroeconomic concerns from last year remain with us. Yet valuations and yields on quality stocks have not changed much. We revisited the table we created in last summer's newsletter and found it highly instructive. Not surprisingly, the data we analyzed tells a different story, one that is more assuring than the highly charged headlines and sound bites pretending to be news in the media. We find stocks are undervalued and in many cases offer the opportunity for competitive and growing yields, especially when compared with many other available investment choices.

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	Dividend Yield	Price/Earnings 2010 (est.)	Dividend Yield	Price/Earnings 2011 (est.)	Total Return
Abbott Laboratories	3.65%	11.6	3.71%	11.2	13.5%
Altria Group Inc	7.03%	10.6	5.67%	13.1	44.1%
Chevron Corp.	3.83%	8.7	3.19%	7.5	42.4%
IBM Corp.	2.00%	11.5	1.82%	12.5	30.9%
Kraft Foods Inc.	3.90%	14.6	3.35%	15.5	21.3%
McDonald's Corp.	3.13%	15.7	2.98%	16.0	24.3%
Merck & Co. Inc.	4.22%	10.7	4.40%	9.3	1.3%
Procter & Gamble Co.	3.11%	12.1	3.36%	15.9	6.1%
United Technologies Corp.	2.48%	14.7	2.28%	15.5	27.8%
VF Corporation	3.00%	13.4	2.40%	14.3	44.0%
Vodafone Group Plc.	7.46%	8.0	7.33%	9.8	27.4%
Waste Management Inc	3.75%	15.9	3.70%	16.4	18.6%
	3.96%	12.3	3.68%	13.1	25.1%
S&P 500 Index	2.03%	13.9x	2.07%	12.9x	20.2%
10 Year US Treasury	3.30%	30.3x	2.98%	33.6x	9.7%

Source: Telemet data as of 6/30/11

Note: The above list is for illustrative purposes only and does not represent a portfolio recommendation and should not be considered or relied upon as investment advice.

For the year, the performance of the dividend paying “stock basket” outperformed the broader markets - up 25.1% compared with 20.2% for the S&P 500 Index and 9.7% for 10 Yr. U.S. Treasuries. Even with this price appreciation, the average yield on the stock basket is still a healthy 3.7% - well above the S&P 500 Index’s 2.1% and the 10 year US Treasury’s 2.63% (even lower now!). As for valuation, the stock basket is trading at 13x estimated 2011 earnings or in line with the S&P 500 but well below its historical averages – even with record earnings, low interest rates and inflation. The equity market is still 20% off its 2007 highs! Meanwhile, U.S. Treasuries got more expensive with a 38x earnings yield – so much for efficient and rational markets. Why would investors pay almost three times (38x versus 13x for the S&P 500 Index) for an asset with no upside? Fear, safety and risk aversion are the likely answers. Even with the debt ceiling deadline and huge government deficits, investors continue to buy Treasuries – driving yields further down. The contrarian approach is to research and invest in assets outside of the “safe havens”. At this point, U.S. Treasuries and gold have little allure for us and we are managing portfolios accordingly.

Last year, we wrote – “*The global uncertainty and negative news flow has left investors fearful and too focused on the ‘glass being half full’. It’s easy to lose sight of long-term goals when markets are as volatile as they’ve*

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“We recognize many macro issues exist and that investors are worried. However, we would be more troubled about these issues if they weren’t known.”

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been during the past month. This is a time when investors need to consider their longer-term investment goals while factoring in their appetite for risk”. This is as true today as it was last summer. We recognize many macro issues exist and that investors are worried. However, we would be more troubled about these issues if they weren’t known. Unknown risks are the ones that usually hurt markets the most!

The all-consuming debt ceiling debate in Washington is finally over. However, the agreement was anti-climactic and spending cuts underwhelming as the U.S. faces a possible debt downgrade from “AAA”. The end of year spending reduction triggers seems to be adding new levels of anxiety to investors and the toxic political discourse may be with us into the 2012 election. With the possible US debt default averted, attention is now back on economic growth. GDP growth was very weak for the first half of 2011 and anemic in the second quarter which has renewed fears about a double-dip recession. The U.S. unemployment rate continues to be stubbornly high and job growth has been lackluster. Weak demand coupled with regulatory uncertainty is making companies postpone hiring decisions and their increased use of technology in place of workers could be long lasting. The U.S. housing market seems to be “double dipping” which does not bode well for consumer psychology, spending, housing stocks and job growth. In addition, an economic slowdown in China is again a worry and the sovereign debt crisis in Europe remains in the forefront. Government deficits, as the U.S. and Europe are proving, are not issues that can be resolved easily or quickly. We expect that these issues will continue to be in the news which will elevate market volatility and investor nervousness and dampen near-term returns. However, it is critical for us to be masters of our emotions and willing to add to equities (risky assets) when others are taking risk off – this approach over time has added significantly to returns. As Warren Buffet said:

“We simply attempt to be fearful when others are greedy and to be greedy only when others are fearful.”

While it is understandable that the global uncertainty is creating considerable anxiety for all of us, we would like to stress that the current situation is not comparable to the 2008 global financial crisis. Also, sudden changes in markets rarely reflect equally the true changes of the world. We highlighted the following points in our recent communication on the debt ceiling crisis that you should always consider especially in turbulent times:

1. Is my portfolio’s investment strategy appropriate for my goals and risk appetite?
2. Do I have a sufficient emergency fund?
3. Can I emotionally handle the volatility of my investments?
4. Understand that investors have survived worse situations!

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“This is a period when emphasizing portfolio diversification, earnings growth and income generation especially from equity dividends becomes increasingly important.”

“To further diversify portfolios, we have expanded the use of alternative investments such as commodities, emerging market bonds, preferred stocks, floating rate loan funds and a long/short fund.”

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CONCLUSION

Shorepoint’s approach has been to try to “hit singles and doubles” and focus on producing strong risk adjusted returns for our clients – attempt to protect on the downside. This is a period when emphasizing portfolio diversification, earnings growth and income generation especially from equity dividends becomes increasingly important. To further diversify portfolios, we have expanded the use of alternative investments such as commodities, emerging market bonds, preferred stocks, floating rate loan funds and a long/short fund. We are also encountering many attractively valued stocks and in most cases with solid dividend yields. We expect these stocks will be able to thrive in a slow growth environment and provide some defensiveness in a period of volatility.

We recommend staying committed to your long-term strategy and if appropriate gradually increasing your equity allocation. If the market pulls back further from these levels, we would accelerate the process in a disciplined manner.

Here’s why:

Equity valuations look especially attractive with the S&P 500 Index only trading at 13x 2011 earnings and only 11x 2012 estimates. In addition, we are finding many large cap stocks with attractive valuation, solid dividend yields that are generating strong cash flow. Also, investor **sentiment is bearish** for equities and investors are redeeming significant amounts from equity funds. Historically both actions have been a contrarian indicator and very positive for future equity returns. As Winston Churchill said:

***“A pessimist sees the difficulty in every opportunity;
an optimist sees the opportunity in every difficulty”***

Another major positive for equities is the **large cash balances** on corporate balance sheets. Merger and acquisition activity has accelerated as has stock buybacks and dividend increases. The data shows **improved household balance sheets** by individuals. The **significant cash balances on the side line** and in Treasuries earning little to no yield will eventually find its way to the equity market. After all, companies and individuals will want to get a return for their capital as fear subsides!

We encourage you to turn off the news if you can, relax, get ready to be flexible as we shape and are shaped by the latest incarnation of America. The U.S. is still by far the world's biggest economy, blessed with large and deep markets and a currency, battered as it is, that has no real rival as a medium of exchange. As Winston Churchill said:

***“You can always count on Americans to do the right thing-
after they’ve tried everything else”***