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Second Quarter 2010

ARS Insights

Anderson, Riley, & Spoor, P.A.

Registered Investment Advisor

Index Returns First Quarter 2010

S&P 500	5.4%
Dow Jones Industrial	4.1%
Russell 2000	8.6%
EAFE (Int'l Index)	0.2%
Barclays Cap Agg. Bond	1.8%
DJ-UBS Commodity Index	-5.0%
DJ-Wilshire REIT Index	9.8%

- Tony Anderson, President

As the economy continues its slow recovery and the Federal Reserve contemplates when to begin raising interest rates, many have begun to debate the relative attractiveness of investing in bonds. Bond prices and interest rates have an inverse relationship, thus as interest rates go down the prices of bonds go up and as interest rates go up the prices of bonds go down. Since the majority of our clients have some portion of their portfolios allocated to bonds, I thought it would be beneficial this quarter to review the rationale behind maintaining exposure to bonds.

During 2008, in the face of a deteriorating economic situation, the Federal Reserve reduced interest rates dramatically in a quest to try and spur economic growth. The Fed pushed rates down to a range of 0.0% to 0.25%, where rates have remained since December 16, 2008. Now, as the economy starts showing signs of life, the Fed is wrestling with the decisions of when and by how much to raise rates.

I don't envy the position Fed President, Ben Bernanke, is in. If the Fed keeps rates low for too long, they run the risk of inflation getting out of control, on the other hand, if they raise rates too much / too fast, they run the risk of choking off the still weak economic recovery. With the Fed Funds rate at its current level of 0.0% to 0.25%, we can state with a high degree of confidence that the direction of the next move for interest rates will be up. This leads to a question: if the next move for interest rates is up <u>and</u> if the prices of bonds go down when interest rates go up, then **why should I continue to hold bonds?** A few of the reasons why you want to continue to hold bonds in your portfolio are:

1. To reduce risk and diversify the portfolio.
2. To add exposure to non-dollar assets (thru Global Bonds) and protect against a weakening U.S. Dollar.
3. To increase the overall income generated by your portfolio.

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The US equity market continued to climb the wall of worry . . . - Kurt Ulrich, CFA, Chief Investment Officer

. . . despite conflicting economic data. Most other international equity markets, however, either declined or trended sideways during the quarter. In the first quarter the big news revolved around Greece's bailout and the passage of the healthcare plan in the U. S.. Greece has been a financial disaster waiting to happen having completely mismanaged their debt while at the same time not being forthright with the European community. Germany appears to be disgusted and unwilling to help. They are the strongest member of the European Union…by far. While Greece's problems seem relatively small on the surface ($20 -25 Billion give or take) they have the potential to trigger a much larger problem due to the overall financial weakness of the rest of Europe. For now it appears that European officials are going to give Greece a short-term bailout at below market rates. This problem may go away for a couple of years but it will be back.

Fortunately the US benefits from Europe's woes as sovereign nations continue to see our Treasury debt as the only liquid and relatively safe place for their reserves (at least for the time being). This also serves to strengthen the US dollar. It is perplexing to consider that our debt continues to enjoy strong pricing despite the weak state of our economy and our deteriorating balance sheet. Foreign governments have few markets to turn to with enough size and liquidity to handle their billions in reserves. Hmmm. This is something that bears close scrutiny as it could change quickly if these same sovereigns decide to bail out of US Treasuries.

On the healthcare front the bill became law in a most unusual way inciting an uproar in Washington and around the nation. November's elections will be interesting to watch. This new healthcare legislation will change the landscape of our healthcare system. From a purely financial perspective I seriously doubt our country's ability to pay for it without a significant increase in taxes OR a significant cut in entitlements - or both.

While economic numbers remain weak and unemployment high the market's health appears sound. During the quarter we added to our equity exposure based on the market's continued strength. In view of all that is going on in the US and Europe

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If you would like additional information about the services offered by Anderson, Riley & Spoor, P.A., please contact us at (727) 322-7681.

We're on the Web! www.arsinvestments.com

Time to Reflect & Prepare *(cont'd. from pg. 1)*

While stocks may appear more attractive, relative to bonds, it's still important to maintain a diversified portfolio. In the majority of cases it would not be prudent for our clients to allocate <u>all</u> of their funds to stocks, as such; we choose to maintain some allocation to bonds.

In light of the expected increase in interest rates, we conducted an analysis to see how our bond funds performed during the last rising interest rate environment (2004-2006). We were happy with what our analysis showed. While the <u>prices</u> of some of the bond funds went down (as would be expected "rates go up/prices go down"), the <u>total returns</u> for the funds were still positive – thanks to the income the funds paid. The analysis helped set our expectation for what the funds should do during the next increasing interest rate cycle.

We are very grateful for the trust you have placed in our firm and will work hard to never take that trust for granted. If you would like to schedule either a meeting or conference call, to review how the accounts are positioned and how they are performing, please don't hesitate to contact our office.

Kind Regards,

Tony Anderson

What to expect in 2010? *(cont'd. from pg. 1)*

we continue to look for opportunities in countries with stronger balance sheets, prudent fiscal policies and stronger economies. Canada meets these criteria. We've been purchasing Canadian stocks the past few months through the iShares MSCI Canada ETF (Symbol: EWC). Canada has some of the highest rated banks in the entire world; a small debt to GDP ratio; and a strong, resourced based economy. Australia and Brazil also have an abundance of natural resources and we have initiated positions in these countries as well.
Demand for many natural resources appears to be on solid ground as witnessed by prices for industrial metals such as copper which recently hit a 20 month high. Most of this demand is coming from the emerging economies around the world. Nations and companies rich in natural resources will be prime beneficiaries of this trend providing investors with above average returns.
In closing I want to share some thoughts about our country. The US government is spending at an unprecedented rate - and it is spending money it doesn't have. Our leaders need to make tough decisions which may not be politically popular in the short-term but will be vital to our country's long-term economic health. These leaders MUST reign in spending and reduce debt without stifling innovation and the free exercise of capitalism. Burdensome legislation and overbearing taxation will kill any chance of overcoming this challenge. The USA is still the greatest nation on earth but our biggest test to remain so lies just ahead. I think we're up to the task if we exercise our freedom and select those leaders who understand this challenge and are willing to tackle it head on serving the best interests of our nation. Respectfully, G. Kurtis Ulrich, CFA

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