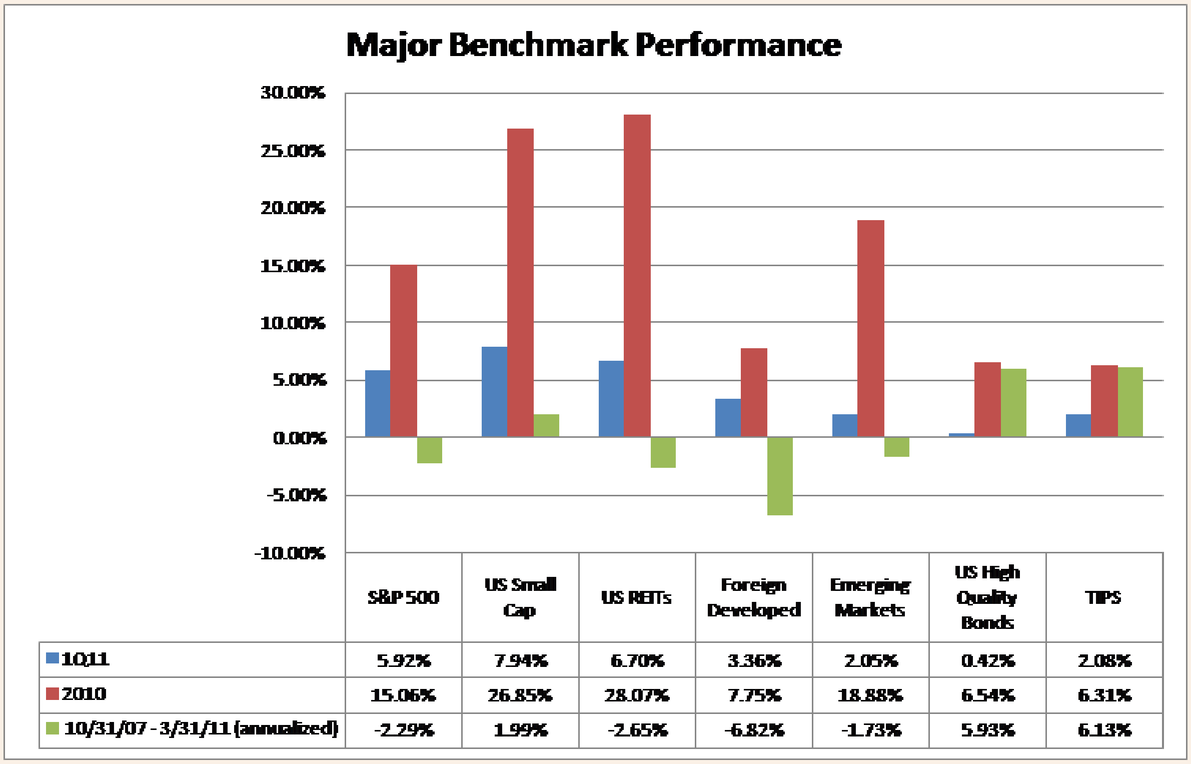
Market Summary and Outlook 1st Quarter 2011

We are delighted to send you this inaugural issue of our newly redesigned quarterly newsletter that features our new logo and brand identity. We hope you enjoy our new look!

Following stock and bond advances in 2010, all of the major markets were also positive for the first quarter of 2011.As of the end of March, the S&P 500 had its best quarter since the late 1990s. The S&P is now only approximately 2% below the market high of October 2007 when, what we now term the "Great Recession," began. Below is the performance of the broad benchmarks we typically track that represent the markets typically found in our clients' diversified portfolios.



	S&P 500	US Small Cap	US REITs	Foreign Developed	Emerging Markets	US High Quality Bonds	TIPS
🟦 1Q11	5.92%	7.94%	6.70%	3.36%	2.05%	0.42%	2.08%
🟥 2010	15.06%	26.85%	28.07%	7.75%	18.88%	6.54%	6.31%
🟩 10/31/07 - 3/31/11 (annualized)	-2.29%	1.99%	-2.65%	-6.82%	-1.73%	5.93%	6.13%

** Benchmarks:S&P 500; Russell 2000 (US Small Cap); Dow Jones US Select REIT Index, MSCI EAFE (Foreign Developed) - US dollar, net dividend; MSCI Emerging Markets - US dollar, net dividend; Barclays Capital US Aggregate Bond Index (US High Quality Bonds); Barclays Capital US Treasury Inflation Protected Securities (TIPS)*

MSCI = Morgan Stanley Capital International

Foreign benchmark performance stated in US dollars

Source: Dimensional Fund Advisors

Positive growth in spite of...

The fact that we are seeing positive market returns is somewhat surprising when we consider the social and political uprisings, natural disasters and ongoing challenges to economies worldwide.

Closer to home, the Republican-controlled Congress and the Democratic Obama administration are waging their own war over the country's budget deficit and rising government indebtedness.The government's inaction is in stark contrast to all other developed countries, which have implemented some version of an austerity plan.

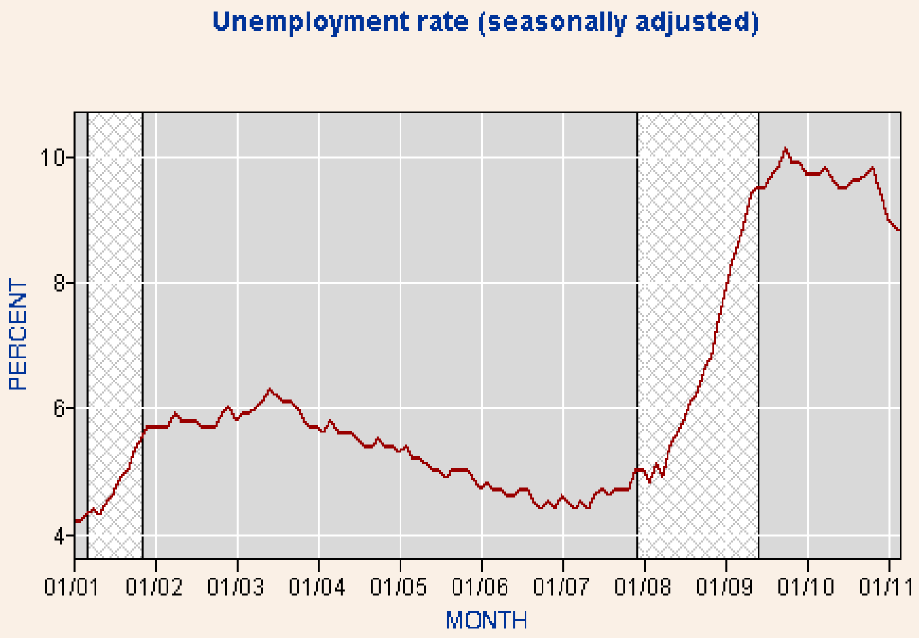
Below are our observations about the domestic and global economies.

Domestic

Prior to the uprisings in the Middle East and the subsequent pressure on oil prices, we were starting to see indicators of a US economic recovery. Economists and government officials are closely watching developments in the Middle East with an eye on whether oil (and other commodities) prices will continue to rise and whether these trends will slow down our economic recovery.

One positive development this quarter was favorable employment reports. Nationwide, the unemployment rate as of quarter-end is now 8.8%, down from 8.9% the month before and close to 10% throughout 2010.

While the downward unemployment trend, as shown in the graph below, is encouraging, over 13 million Americans remain out of work (not to mention those who have given up looking for work and are not counted in that number).We have a long way to go before we reach full employment, which is generally around 5%. As we stated in our year-end commentary, "We do not expect to see a full recovery for several more years and we expect continued volatility."



Note: Cross-hatched area represents recession.

Source: Bureau of Labor Statistics, Current Population Survey

The slow decline of unemployment will continue to have a lingering negative impact on consumer spending, including housing. Although U.S. retail sales gained 0.4% in March 2011, the increase was largely due to higher gas prices.

Despite some reports that housing prices were starting to stabilize in late 2010, they dropped during the quarter, aggravated by continued foreclosures (including more to come) and the reluctance of financial institutions to lend money. The recent decline is consistent with the Case-Shiller data (calculations based on repeat sales of single family homes), which continues to be negative. PIMCO forecasted in February that housing prices will fall another 5-10%.

Politically, we expect gridlock to preclude any meaningful progress in tackling our budget problems and ongoing deficit.As of April 8, the federal government narrowly averted a shutdown over the current budget. There will be little respite until the next showdown, which will focus on whether to increase the debt ceiling and must be addressed by May 16.

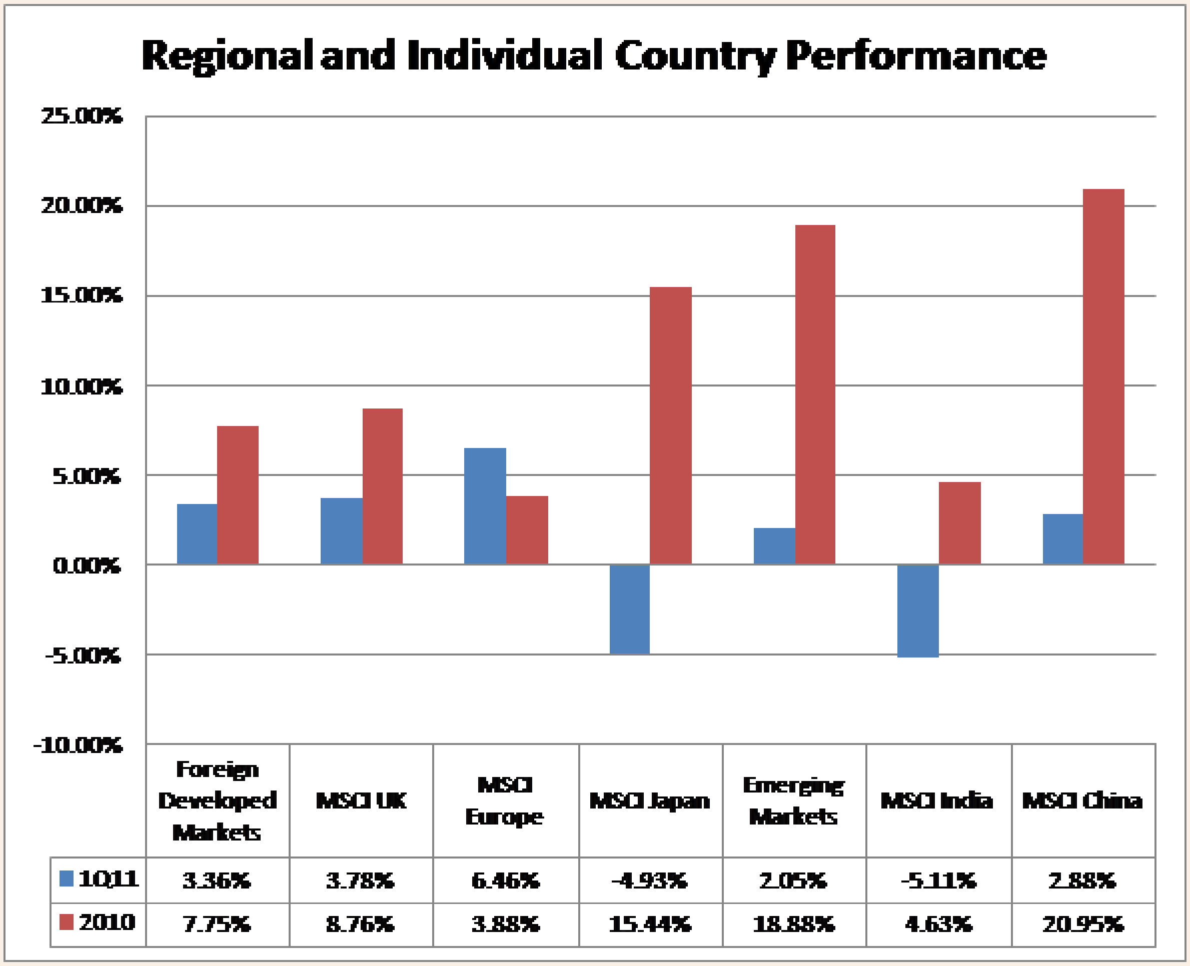
On April 18, Standard and Poor's maintained its AAA rating on US debt but changed its long-term outlook to negative out of concern that the government will not be able to reach agreement on how to tackle the deficit. S&P says that if no plan is in place by 2013 and no meaningful implementation begins by then, it will adversely affect the US's fiscal profile, i.e. how it compares to other AAA-rated countries. The US stock market reacted very negatively to the news, which is surprising since foreign news sources have pointed out for months that the US is the only developed country not implementing an austerity plan (in fact, our stimulus programs continue).

Because we have little confidence in our polarized government's ability to reach a compromise, we do look to the Federal Reserve (the Fed) and believe it will play a key role in ensuring a continuing recovery. The Fed's dual mandates are to minimize unemployment and inflation.

Much of our economic recovery has been fueled by the Fed's QEII (quantitative easing stimulus program), designed to jump-start the economy and increase employment. The policy continues, although economic signals were strong enough by the end of March that the St. Louis Federal Reserve hinted that the Fed may decrease their Treasury purchases. (To recap, the Fed began this round of stimulus in November 2010 by making periodic purchases of US Treasury bonds in an effort to keep interest rates low.) Many economists worry about who will buy US Treasuries after the Fed ends this stimulus program.

Global

As shown in our first graph and below, the MSCI EAFE (Europe, Australasia, Far East), the broad benchmark for developed foreign markets, was up approximately 3.36% for the first quarter. As you will note from the chart below, most global markets appreciated, with the unsurprising exception of Japan. Again, these positive returns are despite the recent social and political upheaval.



	Foreign Developed Markets	MSCI UK	MSCI Europe	MSCI Japan	Emerging Markets	MSCI India	MSCI China
🟦 1Q11	3.36%	3.78%	6.46%	-4.93%	2.05%	-5.11%	2.88%
🟥 2010	7.75%	8.76%	3.88%	15.44%	18.88%	4.63%	20.95%

MSCI = Morgan Stanley Capital International

Foreign benchmark performance stated in US dollars

Developed Foreign Markets

Europe

In northern Europe, the more developed economies of France and Germany are recovering, driven by strong exports and a rise in consumption and investment. Elsewhere in Europe, however, especially in the southern and western regions, sovereignty issues (countries' ability to borrow at reasonable rates) will most likely continue to be a drag on Europe overall, which means that economic weakness and recession will persist well into 2011 and beyond. For example, although media headlines have been overpowered by the more pressing Japan and Middle East developments, the most recent headlines detail the EU's bailout of Portugal.

In the United Kingdom, the large but necessary fiscal tightening announced by the coalition government and weak real income growth will create headwinds for that country's economic growth in 2011.

For the U.S. and our government representatives, the UK will be an interesting country to watch given how aggressively they are tackling their deficit with both spending cuts and tax increases. The headlines in Europe were dire last year and the region still managed to generate a positive return. As we mentioned in last quarter's newsletter, these headlines are not necessarily correlated with that country's equity market performance.

Japan

As California inhabitants along the Pacific Ring of Fire, we had a collective shudder when we learned of the

Japan earthquake. Japan has spent 20 years struggling to regain its economic footing after the collapse of its real estate and stock market bubbles in the early 1990s. Even before this crisis began, the Japanese government was carrying an enormous debt burden. As a result of these tragic events, the risk of recession in Japan has definitely increased. For the longer term, Japan has two major problems that will act as a drag on their economy: the shrinkage of the labor force and the aging population.

While we do not recommend decreasing or eliminating exposure to Japan in our clients' portfolios, this tragedy underscores the difficulty of predicting all of the events that affect markets - and illustrates how quickly markets can change. Accordingly, we continue to advocate remaining diversified and not trying to predict which markets will outperform. That is a losing proposition for everyone except for traders and advisors who work on commission.

Emerging Markets

By definition, emerging markets are nations in the process of rapid growth and industrialization. As of 2010, there were approximately 25 of them across the globe (using the criteria of Morgan Stanley MSCI). Many investors predict that these markets will provide greater potential for profits. Indeed, the MSCI Emerging Markets benchmark returned 9.78% per year from 12/31/1999 to 12/31/2009 (compared with -0.95% per year for the S&P 500). There is no guarantee, however, that a less developed country will evolve into a more developed country, and therefore the potential for greater profit comes with greater risk in the form of opaque capital markets, less developed accounting and disclosure rules, repatriation of capital risk, concentration of a few large companies and government instability.

Inflation has been a concern in many emerging markets for at least a year now. In some countries, for example China, the government has already raised rates to keep growth under control. Contrast this to the US where rates remain close to zero, with no near term plans to raise them.

The risk of inflation is a threat everywhere, driven by strategies to stimulate the economy and the increase in commodity prices. Even before the events in the Middle East, commodity prices in general have been rising strongly.

Portfolio Design

We continue to observe that including both developed and emerging foreign markets in our client portfolios can increase returns and reduce risk.Our strategy and recommendations continue to be consistent with each client's own financial goals and plan. Despite recent headlines, we continue to advocate portfolios that are sufficiently diversified with both equity (stocks) and fixed income (bonds) mutual funds, representing the US and international markets and that provide for long-term growth ahead of inflation but can also withstand market shocks.

We hope that this analysis is helpful to you in these volatile times. Our pledge is to continue to monitor the markets around the world and how they may impact your portfolio. We encourage you to contact us with any questions at any time.

Sincerely,

Barry Taylor, CFP® and Janet Hoffmann, CFP®, CFA
Integral Financial Solutions, LLC