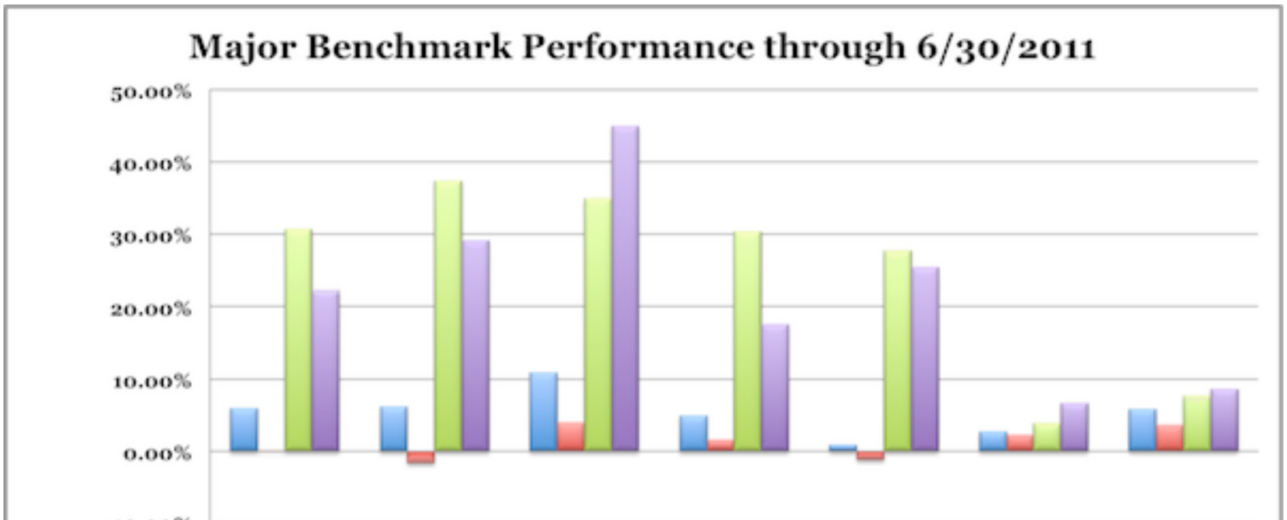
integral financial solutions

Market Summary & Outlook

Second Quarter 2011

Market Summary

Year-to-date the markets are up. However, volatility returned to the equity markets in the second quarter accompanied by negative economic headlines. Despite the negative media reports (some factual, some hyped), it is difficult to believe how much equity markets have increased over the past one and two years given economists' predictions in 2009 of a slow recovery (please refer to the performance chart).



	S&P 500	US Small Cap	US REITs	Foreign Developed	Emerging Markets	US High Quality Bonds	TIPS
YTD	6.02%	6.21%	10.93%	4.98%	0.88%	2.72%	5.81%
2nd Qtr 2011	0.10%	-1.61%	3.97%	1.56%	-1.15%	2.29%	3.66%
12 Month	30.69%	37.41%	34.95%	30.36%	27.80%	3.90%	7.74%
2 Year (ann.)	22.29%	29.20%	44.95%	17.51%	25.45%	6.66%	8.63%

**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

The fact that the S&P 500 (the broad U.S. market index) was only flat and not down during the second quarter may indicate that investors have taken the recent worrisome economic news in stride.

Following are some key observations:

- GDP (gross domestic product) is growing at a rate lower than the 3% forecasted by the Federal Reserve in April.

- The U.S. trade deficit has increased at a rate greater than anticipated, which economists expect to have an additional negative impact on GDP as well as employment.

- Unemployment remains at a stubborn 9.2%, up from 8.8% at the end of the first quarter. The increase is a disappointing indicator and reinforces the prediction that it will be several years before unemployment is reduced to the historical average of 5%.

- Housing continues to be weak. The problem continues to be unemployment, increased restrictions on loans, and the excess bank inventory, which is predicted to take 4-5 years to absorb, putting more downward pressure on housing prices.

- Inflation is still low, but it began to creep up during THE second quarter.

- Concerns over Greece's debt crisis and the possible impact on greater Europe's debt caused widespread market volatility during the quarter. There does not appear to be an easy fix in sight, which raises concern about the ultimate impact the debt crisis will have on all of Europe and beyond.

- One bit of good news is that although the Federal Reserve quantitative easing program (QEII, $600 billion bond-buying program) ended June 30th, the Fed has indicated that the program will be unwound in stages over several months, reducing the immediate impact. Additionally, the Federal Reserve has indicated that it may be willing to continue quantitative easing, especially since Q2 initial economic indicators do not appear as strong as anticipated.

Outlook

Below are the major issues we and the markets will be watching closely over the next few months. These include the U.S. debt ceiling, the European debt crisis and the leading economic indicators.

U.S. DEBT CEILING

The immediate, greatest challenge that faces the economy (world-wide) is the U.S. national debt crisis. The Treasury actually reached the debt limit on May 16 but Treasury officials engaged in financial juggling to postpone the deadline, now set for August 2.

The U.S. Treasury market currently enjoys AAA status. In the past few months, the ratings agencies have released warnings due to concern over Congress' inability to resolve its differences over fixing the large and increasing deficit. Considering the size of our existing debt service (and how low existing rates are), everyone in this country would suffer if we missed this deadline and the market punished us by imposing higher rates.

Based on all of the material we have reviewed, we feel a default is unlikely. However, we fully believe there will be a lot of political posturing up through the August 2 deadline. If a final deal is not reached by August 2, we believe there will still be a resolution by August 5 when Congress goes on recess.

We believe *only* reducing the deficit will not solve our national debt challenge, nor will *only* increasing taxes. It appears that the ultimate solution will require a combination of both. Any compromise that does not adequately address spending and taxes increases the likelihood that it will be a temporary fix.

While it is predictable that a failure of the U.S. economy would have a negative world-wide impact, as part of the global economy, we also need to be concerned with debt in other countries.

EUROPEAN DEBT CRISIS

Despite austerity measures that prompted sometimes violent protests, it became clear during the quarter that Greece would not be able to service its debt obligations and that the country would require another round of bailout funds. After much disagreement and negotiation, the IMF and the major European countries (Germany and France) agreed to fund another bailout in return for further austerity measures and other concessions. While this solves Greece's problem in the short term, the long term problem of solvency remains and could spread to other European periphery countries such as Spain and Portugal.

What the Greek crisis has shown is that even a hint of insolvency will be punished in the debt markets with significantly higher yields. The current spread for the 10 year Greek bond (over the 10-year U.S. Treasury bond) is almost 14%, up significantly since the financial crisis began.

LOOKING FORWARD

The current dual threat of the U.S. debt crisis and European debt crisis will continue to be a drag on our economy. However, even if the debt crisis is solved in the near term, we will continue to experience a slow economic recovery. Thus, as we have previously predicted, investors will continue to experience market volatility.

As part of our work, we spend a fair amount of time analyzing the markets and looking at trends. Longer term, we observe stocks outperform bonds (as they should since stock investors are taking more risk). However, that is not always the case over the shorter term (as is evident over the past 10 years). Both stocks and bonds play a critical role in a diversified portfolio. We encourage you to maintain a long-term outlook for your portfolios and do not encourage changes based on ongoing threats to the economy, or "buying opportunities" when the markets do decline.

Portfolios should be adjusted from time to time as part of the rebalancing process. Typically the only time that major changes to the portfolio may be appropriate is when life situations change (i.e., birth, death, divorce), which may be cause to revisit and possibly modify your financial plan.

As always, please contact us with any questions or concerns. We thank you for your confidence in us.

Sincerely,

Janet Hoffmann, CFA, CFP(R)
Barry Taylor, CFP(R)
INTEGRAL FINANCIAL SOLUTIONS, LLC
415-291-9999