Carl F. Petersen
Capital Management

Quarterly Newsletter

April 1, 2011 to June 30, 2011

ECONOMY

The recovery continues to be feeble, but the **likelihood of another contraction** this year is improbable, although 2012 is not out of the question, as the economy is still highly susceptible to geopolitical and economic risks.

The **economy**, as measured by the Gross Domestic Product (GDP), will grow with 2.6% for 2011, with little or no indication of further improvement. This is primarily due to: geopolitical risks; small businesses inability to secure credit for growth; lower personal credit availability; further home price declines which threaten to diminish consumer spending; reduced, relatively speaking, government spending; growing local government problems; and last, but not least, a lack of consumer confidence.

Inflation for 2011, as measured by the Consumer Price Index (CPI), will be around 3.0%, which is an increase from prior estimates. Food, energy, and commodities in general, are exerting tremendous upward pressure, while housing, which comprises 42% of the CPI, is keeping it flat. Inflation has been accelerating as commodity price increases are in the process of working themselves into the consumer products.

The **job market** for 2011, while seemingly gaining some momentum, will continue to be weak, with a job gain of a modest 1.5 – 2 million; however, due to the loss of over 8 million jobs in 2008 and 2009 combined with new workers, this will only just barely push the current unemployment rate down. The private sector is still hiring while the state and local governments are cutting jobs. Businesses will continue to be sluggish in hiring workers until they feel convinced we are on the road to recovery. Consequently, when State and local governments begins their new fiscal year, we will see an increasing unemployment rate.

We expect the **trade deficit** to increase to an upward revised $560 billion in 2011. The growth of imported goods, with the exception of oil, will continue to normalize; but unfortunately, so will the growth of exported goods, with a slight advantage to imports – mostly due to a strengthening dollar. With the Euro Zone still bordering on the brink, China and India's attempt to temper their growth, the global recovery is slower than expected.

Oil prices will continue their normal seasonal swings, and will average somewhere between $80 to $100, with peaks between $100 and $120 for the summer. Volatility in oil prices will continue due to geopolitical events, especially as they pertain to Europe, China, North Korea, Japan, and of course USD exchange rate fluctuations. In addition, OPEC's refusal to raise output, although temporarily offset by Saudi Arabia's increase, will establish a floor for the price. Gas prices will probably normalize at $3.60 per gallon during the summer, and then slowly decline 20 cents by fall. Prices could spike, if the problems in the Middle East and Africa spreads – in particular to Saudi Arabia – or a major hurricane hits the Gulf of Mexico.

Housing will continue to slide, with some experts guesstimating another 20% slide in prices, but we could see a bottom in Q3, with as little as a 3% to 5% further drop. The continued slow creation of jobs and foreclosures surpassing 2 million for 2011, combined with the increased mortgage requirements, will continue to dampen the housing market.

For 2011, we still expect **retail sales** growth to increase with 3.0%, although a job and income growth slowdown could seriously dampen consumption. Expect the cost conscious consumer to continue looking for discounts and the biggest growth to be among the affluent buyers. In addition, expect the peaks to be around seasonal changes and holidays.

EQUITIES

In our last communiqué, we expected to see continued volatility with continued erratic upward movements.

The market was indeed very volatile last quarter, with a strong April, a weak May and June, with June setting the low for the quarter, as measured by the Dow Jones Industrials.

All the market trends, the Primary-trend, the Long-term, the Intermediate-term, and the Short-term are up for both the Dow Jones Industrial Average (DJIA) and the S&P 500.

From a technical point-of-view, the markets are in an upward trend defined by a breakage to the downside of 11,126 and 1,176, for the DJIA and the S&P 500, respectively. The biggest unknown is the Government and their inability to understand economics – case in point is the debt ceiling.

For the next quarter, we expect to see continued volatility with a sideways bias.

BONDS

In our last communiqué, we expected a neutral to downward and volatile bias on the direction of the interest rates.

Interest rates were indeed volatile, and finished lower for the quarter with short-term, intermediate-term, and long-term interest rates all leveling out after the fall in interest rates following the high in mid-February. Fears of a meltdown in Europe is still weighing on the markets and funds flowing from Europe looking for safer investments are pushing down rates. In the US, fears of QE3 is still looming while fears of a US default from not raising the debt ceiling are increasing.

Our charts indicate a neutral trend – at the low end of a trading range – for the 30-Year and the 10-Year interest rates. However, our charts indicate the 5-Year interest rates have entered a downward trend – indicating the possibility of lower rates.

Therefore, for this quarter, given the current trading range, we will take a neutral to downward and very volatile bias on the direction of the interest rates.

STRATEGIES

For the last 12-Months, the DJIA and the S&P 500 increased with an average of 27.57%.

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For the last 3-Year, 5-Year, and 10-Year periods, all of our strategies outperformed the average of the markets.

Please remember these are for the current strategies and could differ substantially from actual results.

The returns are for the model strategies, which are hypothetical. Past performance, real or hypothetical, is not a guarantee for future performance. In addition, real portfolio returns will vary depending on date and time entered, and deposits received and invested - some portfolios will be higher and some will be lower.

REFLECTIONS

What is the deal with our debt?

Most people are not aware of this, but the US essentially defaulted on its obligations when we went of the Gold Standard in 1971. The reason we went off the Gold Standard was that we could not exchange the printed US$ notes for gold as promised when requested by Bank of England and the Swiss National Bank among others.

The simple reason was that the Government had printed more money than they had gold to cover the money with, as they had continued to run deficits. Therefore, in a very real sense, the US Government has been bankrupt since.

Unfortunately, no attempts were ever truly made to rectify this situation, and the national debt has continued to increase virtually non-stop since – relying on their ability to keep issuing Treasuries.

Forget about all the various spins the media and the officials are trying to sell you. The real problem to what is happening right now – The Debt Crisis – is simply due to the Government continually spending too much money, which in turn requires continuously printing of more and more money. This in turn massively leverages the economy, and now we have too much money chasing too few assets, and, voila, bubbles start forming – each one larger than the previous one.

Now that we are truly in a pickle, both political parties have their own respective “solution” to how to get us out of this situation. Actually, only one party claims they have a solution to get us out of debt, while the other believes that doing what got us in trouble in the first place will somehow get us out of it.

Unfortunately, they will both get it wrong. The reality, at least from a historical perspective, is that we are now so far along that we have virtually no way of recovering and, again historically, the eventual outcome will be a default.

In a very simplistic way of looking at it, the default can be through an outright default, which sticks it to the “wealthy” or the default can be through printing more money and thus causing more inflation, which sticks it to the “poor”. Obviously, there is spillover to both sides. Ironically, this means Republicans are looking out for the “poor” and Democrats are looking out for the “wealthy” – go figure, but maybe this explains why banks historically gives twice as much to Democrats as to Republicans.

However, this is not really about politics. We are too far along. This should be about preserving the people, their standard of living, and their rights.

Instinctively, we all know what has to be done. It is no different from what we ourselves would have to do in order to save any organization, business, or our family from financial disaster.

Everybody knows that continuing to run up the line-of-credit, the credit card, or any other type of debt is a recipe for disaster. Every single family or small business that has successfully weathered a financial storm, every single company that has made it to the Fortune 500 knows the simple secret.

In crisis, tighten the belt, live within your means, and wait for better times.

That is it! It is that simple.

Forget about taxing the “wealthy” to bail out the Government’s excessive spending. Believe it or not, the so-called wealthy simply do not have enough money. For those that simply refuse to believe this, let us try to put it in perspective.

This year’s deficit will be in the neighborhood of $1.4T. According to the IRS 2008 figures, about 4 million returns have an AGI over $200,000, which means they each will owe an average of $350,000 more just to cover the deficit – not possible.

Digging a little deeper we find that the total national income of everybody earning over $200,000 is $2.4T, which would mean that the Government would have to *increase* the average tax rate with 58 percentage-points, in addition to their current taxes, just to cover the deficit.

Raising taxes on the wealthy to +80% is clearly not a viable solution.

In addition, anybody who has studied economics knows that each $1 increase in taxes will have a $3 negative impact on the economy, according to Christina Romer, Obama’s first Chairperson of the Council of Economic Advisors. That is why an austerity/tax increase program like the one in UK is having such problems.

Further, from a historic perspective, raising taxes simply does not work and seems to serve only one purpose: to save the Government at the cost of the people.

Regardless of ideology or empirical data, we are too far along, from an economic point-of-view, to do this gracefully and it will be either a very long drawn out process, think Japan, or it will be a very short process like Germany – there is no in-between.

Either way will hurt. So what does one prefer? To get the bandage ripped off quickly or slowly? I know I would like to get it over with as quickly as possible, so we can move forward.

So what can we do? I will repeat what I said in the last quarterly report. I believe the biggest mistake we can make is to believe that the government or, if you are so inclined, private enterprise will look out for us – those days seem to be disappearing fast. The best, and only thing, we can do is look out for our families and ourselves. The simple reality is it is up to each one of us. I suggest saving and investing for a rainy day, and let us not forget the future.

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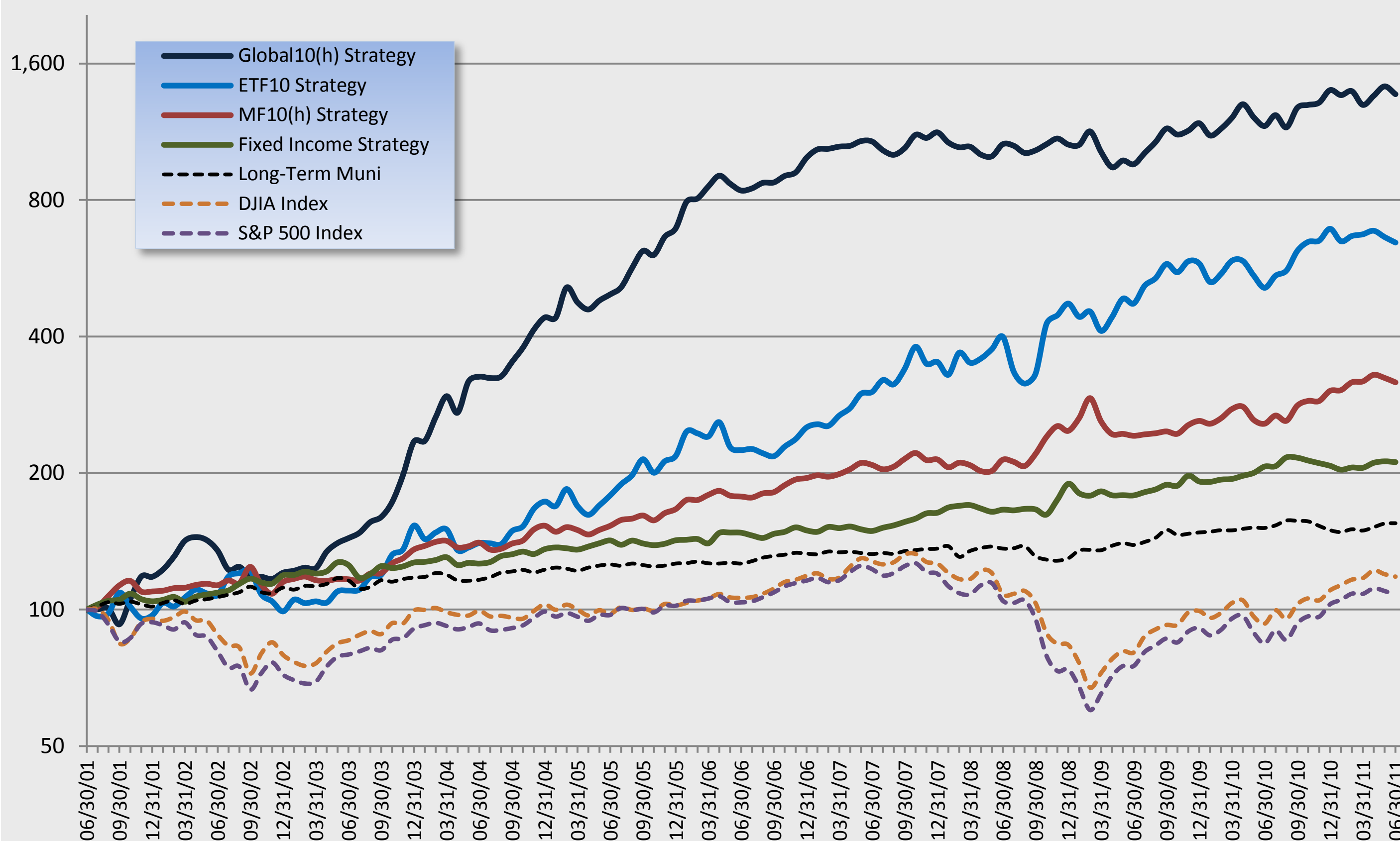

Description	Hypothetical Performance[1]					Risk/Reward		Worst[4]		
	1-Year	*2-Years*	*3-Years*	*5-Years*	*10-Years*	*Volatility*[2]	*Sharpe*[3]	*1-Month*	*3-Months*	*12-Months*
Conservative										
Fixed Income Strategy	2.3%	8.8%	8.4%	7.4%	7.8%	2.2%	1.73	-6.3%	-5.8%	-0.3%
MF10(h) Strategy	23.3%	14.5%	14.0%	12.3%	12.2%	3.4%	2.43	-11.1%	-16.6%	-9.7%
Dynamic										
ETF10 Strategy	25.8%	16.7%	17.3%	23.5%	20.5%	6.3%	2.61	-16.3%	-18.6%	-6.5%
Global10(h) Strategy	17.5%	19.5%	8.8%	10.3%	29.9%	5.7%	4.53	-9.8%	-15.3%	-13.0%
Indecies										
DJIA Index	27.0%	21.2%	3.0%	2.2%	1.7%	4.4%	-0.52	-14.1%	-23.5%	-42.4%
S&P 500 Index	28.1%	19.9%	1.0%	0.8%	0.8%	4.5%	-0.71	-16.9%	-30.1%	-44.8%
Long-Term Muni[5]	2.4%	5.7%	4.4%	4.2%	4.5%	1.6%	0.31	-5.3%	-7.1%	-5.8%

Performance: The performance illustrated for the strategy depicted is for our model and is hypothetical. Although every effort has been made to reflect a true performance, hypothetical performance results have many inherent limitations, some of which are described below. No representation is being made that any account will or is likely to achieve profits or losses similar to those shown. In fact, there can be significant differences between hypothetical performance results and the actual results subsequently achieved by any particular trading program. One of the limitations of hypothetical performance results is that they are generally prepared with the benefit of hindsight. In addition, hypothetical trading does not involve financial risk, and no hypothetical trading record can completely account for the impact of financial risk in actual trading. For example, the ability to withstand losses or to adhere to a particular trading program in spite of trading losses are material points which can also adversely affect actual trading results. There are numerous other factors related to the markets in general or to the implementation of any specific trading program which cannot be fully accounted for in the preparation of hypothetical performance results and all of which can adversely affect actual trading results.

Inception: *Fixed Income Strategy:* February 2009; *MF10(h) Strategy:* Started development in 1998, and the hedge was introduced in September 2008; *CFP Global10(h) Strategy:* January 2008. The hedge was introduced in September 2008; and the *ETF10 Strategy:* September 2009.

Footnotes: [1] Returns for 1-Year or shorter are straight percentage changes, while periods longer than 1-Year are annualized. [2] Volatility is the Standard Deviation compiled from monthly 12-Month data for the last 10-Years. [3] Sharpe Ratio assumes/uses a 4% risk free return. [4] Worst is compiled from end-of-month data for the last 10-Years. [5] VILPX is used as a substitute for the Long-Term Muni Index.

Further Information: Please contact us, or visit our website, for more information.

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