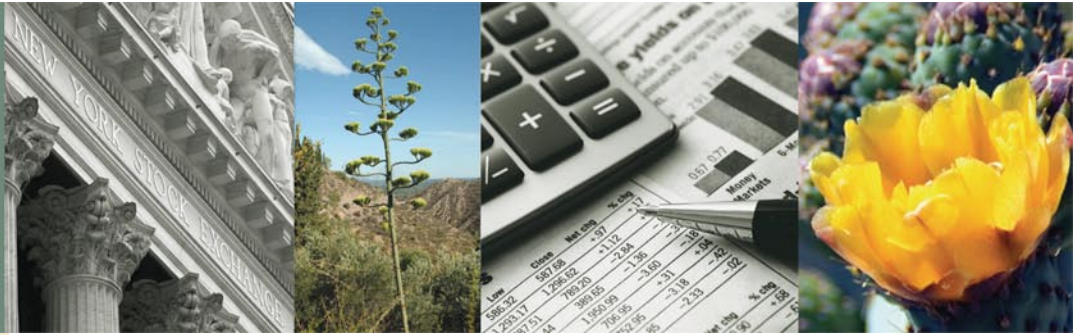




Austin Calvert Flavin
Investment Advisors
Established 1981



Quarterly Review

CULTIVATING WEALTH AND COMFORT FOR OUR CLIENTS THROUGH CUSTOMIZED PORTFOLIO MANAGEMENT

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1Q2010

Business-Led Recovery Evident – Consumer Must Participate

As 2009 drew to a close, the question on many investors' minds was, “Will the U.S. economy continue its rebound, or will there be a ‘double-dip?’” The evidence suggests the rebound will continue. As the first quarter of 2010 nears its end, the U.S. economy continues to grow, with most estimates of Gross Domestic Product (GDP) growth for the quarter in the 3.5 to 4.5 percent range. To be sure, the economy still faces some headwinds – housing continues to be a drag on GDP as residential construction declined in the first quarter. On the whole, however, the positives outweigh the negatives.

The healing of credit markets is evident, corporate profits are rising, inflation remains tame, and industrial production increased 8.3 percent over the last eight months. This pace is despite the massive snowstorms in February, and matches the industrial production jump during the rapid recovery of 1983. In our 2009 Fourth Quarter Review, we discussed capital expenditures as a potential driver of higher employment. The jump in industrial production is clearly driven by increasing capital expenditures as companies invest record levels of cash into property, plant and equipment. Compared with the fourth quarter of 2008, corporate profits are up 36 percent, the most since 1984. While profits in 2009 were mostly derived from expense cutting such as layoffs and delay of capital expenditures, profit growth in 2010 is in-

creasingly coming from revenue growth.

This recovery is clearly neither a housing nor a consumer-led recovery (which is typically the case), but rather one led by business spending and corporate profits.

To sustain a long-term recovery, the consumer must prove a significant player – thus the market's continued focus on employment growth. The March employment report noted 162,000 new jobs in the month, but the unemployment rate held steady at 9.7 percent. While this is the best employment number in three years, it did not match most analysts' forecasts of 200,000 to 250,000 new jobs. The idea of a “jobless recovery” continues, as many economic barometers point to a gradual recovery while employment (a lagging indicator) remains a concern.

In the face of economic growth, inflation remains subdued and is likely to remain so for “some time,” according to the Federal Reserve's March 16th statement. Core inflation (food and energy not included) is 1.4 percent and is predicted to remain around this level for the remainder of the year. Wage growth remains flat. As a direct result, retailers find it difficult to increase their prices or, if prices are boosted, they face decreased demand. The question surrounding the Federal Reserve continues to be the timing of future Fed Funds rate increases. The Federal



Reserve did increase the discount rate in February, but was quick to note this action was more about an improvement in banks, and not a signal of an imminent tightening in monetary policy. Many market analysts foresee the beginning of a rate tightening cycle in the latter half of this year.

The picture continues to be unclear regarding fiscal policy. For example, currently, there are no estate taxes if one dies in 2010. Or are there? Many estate attorneys suggest Congress will retroactively pass legislation to enact an estate tax, effective January 1, 2010. The constitutionality of such action is an open question. Similarly, while President Obama signed the health care legislation into law, the legislation faces potential legislative and legal hurdles. The nearby chart

details medical care per person per year in U.S. dollars for various countries, average doctor office visits per year, and average life expectancy. As the chart points out, the U.S. spends more on health care per person than any country, yet life expectancy is less than most developed countries and some developing ones.

The U.S. economy is healing and the recovery is indeed real. A great deal of quantitative data supports a gradual economic recovery. However, on the qualitative side, investors and economists continue to seek clarity on a range of policy issues – taxes, Federal deficit reduction plan, banking/financial reform, and the ultimate shape

and cost of health care reform. As these and other important issues are better defined in the coming months and quarters, the perception of a broader recovery will take place.

	Health Care Spending Per Person Per Year in US \$	Life Exp. Years	Avg Number of Doctor Visits Per Year
USA	\$ 7,290	78	4 or less
Switzerland	\$ 4,417	82	4 or less
Canada	\$ 3,895	81	4 to 8
France	\$ 3,601	81	4 to 8
UK	\$ 2,992	79	4 to 8
Japan	\$ 2,581	84	12 or more
Portugal	\$ 2,150	79	4 to 8
South Korea	\$ 1,688	79	8 to 12
Poland	\$ 1,035	75	4 to 8
Mexico	\$ 823	75	4 or less
Average	\$ 2,581	80	

Source: OECD Health Care Data 2009

Equity Market Review

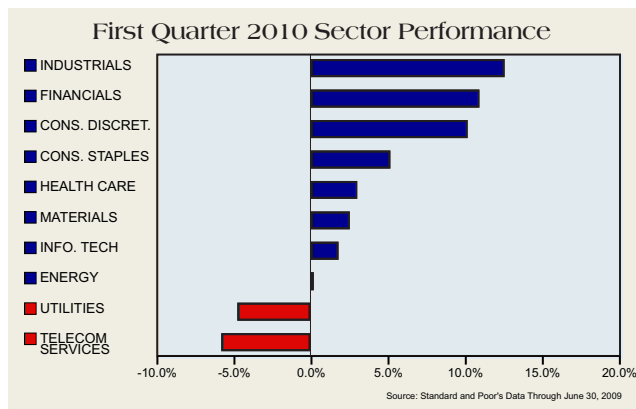
Industrial Stocks Support Business Spending-Led Recovery

The S & P 500 rather quietly posted a 5.5 percent gain for the first quarter. Since early February, the market began a steady 11 percent gain following January's drop. This rise has been aptly described as "baby steps" given there were quite a few "big days" when the market posted triple digit gains. Investors are beginning to focus again on earnings and less on the macroeconomic situation. An earnings recovery appears to be in full swing as almost three-quarters of the companies in the S & P 500 beat estimates for the fourth quarter of 2009. The outlook for first quarter earnings and revenue growth is robust based on continued low interest rates and signs of a sustained recovery.

As the nearby chart indicates, the industrials sector of the market far

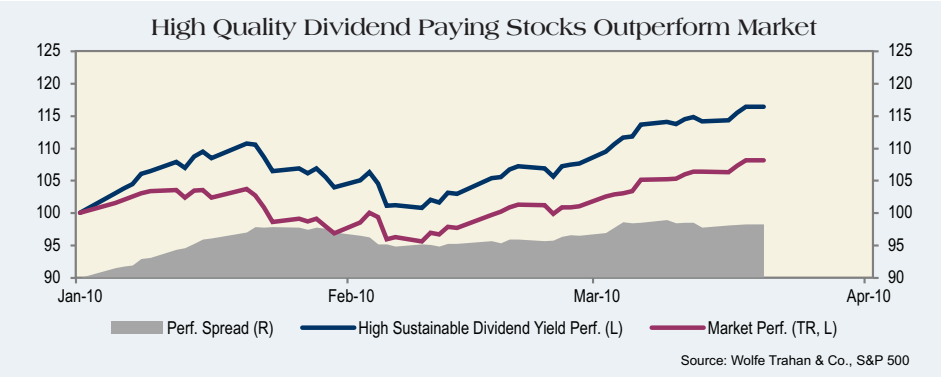
outpaced most other market sectors, posting a 12.5 percent return. The rebuilding of severely depleted domestic inventories and strong emerging international demand for capital goods drove the sector's impressive return. This performance is consistent with the capital spending-led recovery thesis noted earlier. Financial stocks rallied in the face of likely increased regulation and lower future earnings. Emerging consumer strength is evidenced by the discretionary sector posting the third-highest sector return of 10 percent.

Consumer spending during the quarter derived from higher personal net worth fueled by strong equity returns over the last 12 months, and to some degree by government payments. While the information technology sector's first quarter return was lackluster after generating a 60 percent increase in 2009, expect to see strong tech returns in 2010 as firms continue participating in a long overdue tech upgrade cycle. Defensive sectors – utilities and telecoms – generated the weakest sector returns, as investors' appetite for growth remained strong.



Dividend Paying Stocks - "Sweet Spot" in Coming Year

Looking ahead, high quality dividend paying stocks appear poised to continue their superior performance relative to the market year-to-date. According to equity market strategist Francois Trahan of Wolfe Trahan, 2010 will prove a "sweet spot" for dividend investing. Trahan's rationale is as follows:

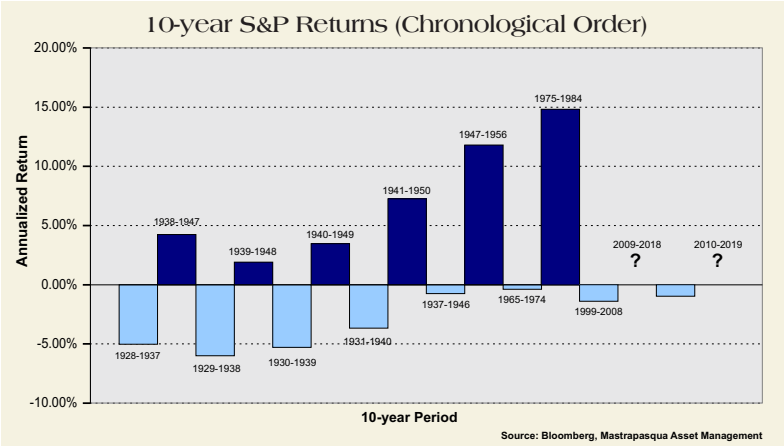


- **Total Return:** Dividends are likely to be increasingly important to total returns as leading economic indicators peak and growth potentially slows. In the last 80 years, dividends contributed about 40 percent to the S & P 500's annualized total return.
- **Yield Spread:** Many stocks are yielding higher than U. S. Treasury bonds – 78 stocks in the S & P 500 offer a larger dividend yield than the 10-year Treasury bond (as of March 22, 2010).
- **High Cash Levels:** Firms maintained high cash reserves to weather the recession – cash could be used to reward shareholders in the form of increased dividends.

Dividends comprise a significant part of Austin, Calvert & Flavin's current equity strategy as all holdings must pay a dividend and have a history of increasing dividends.

Will History Repeat?

As the chart below indicates, a 10-year period with negative annualized returns for the S&P 500 has historically been followed by a positive 10-year annualized return. The market is coming off such a period over the last ten years ending 2009. While history is no indicator of future markets, this chart represents an interesting data point as we move forward.



the specter of inflation is low. These and other factors should continue to drive earnings into the second quarter.

Outlook

The Federal Reserve may begin adjusting the language of its policy statement as early as April by deleting a commitment to keep rates low for an "extended period." Such a shift in the policy statement, combined with actual rate increases predicted in the latter half of 2010, could roil equity markets. The Federal Reserve's removal of credit market supports is another potential risk to the market. The healing of credit markets drove equity markets over the last year.

Most U. S. companies are lean – they have cut staff and other expenses such that a greater percentage of each incremental dollar of revenue goes to its bottom line. In addition, multinational firms are experiencing increased foreign demand as overseas markets recover, the U. S. consumer is reawakening, interest rates remain low, and

International Outlook

Asia Booming, Europe Weak

Economic growth in Asian countries continues its impressive pace. The bulk of this growth is export-driven. Exports in both Hong Kong and Singapore are up 30 percent over last year. The unfortunate side effect of such growth is the potential for a wage/price spiral. High growth fuels wage increases, which in turn, can drive

price levels higher creating inflation. China and India, for example, recently increased their minimum wage by 20 percent and 8 percent, respectively. In addition, commodities and real estate prices will drive Chinese inflation. Central banks in these and other developing countries are moving to more restrictive monetary policies and raising interest rates. Asian central banks could already be behind the

curve and need to increase the pace of tightening. Expect to see more rate hikes across Asia and a revaluation of the Yuan in China.

Europe, on the other hand, is a different story. Unlike their counterparts in Asia, central bankers at the European Central Bank (ECB) need to consider easing monetary policy, as the chance of a "double dip" is indeed real.



Overall GDP growth in the euro-zone is flat. While the Greek crisis received a great deal of attention, the issues are significantly beyond Greece - it is a euro-zone crisis. Greece's debt problems can trigger defaults in other European nations with debt issues such as Portugal or Spain. In addition,

the Greek situation represents the first crisis for the euro since it was adopted 10 years ago. The euro has already declined 11 percent against the U.S. dollar over the last three months. While Greece is facing its problems and adopting financial and austerity measures, its current unemployment

rate of 10 percent is expected to rise based on these actions. The European Union faces a choice to either fulfill long overdue pledges to cut benefits, or, as many analysts suggest, face years of economic stagnation.

Fixed Income Review

Despite rates hovering near a 10-year low, economic activity improving, and government deficit concerns, the yield on the 10-year Treasury note has hardly changed over the last three months. That is not to say that there were not sharp moves within the quarter as corporate bond issuance surged and investors responded by pushing prices higher. This came only after the credit problems with Greece, their effect on other European nations, and concerns over U.S. government borrowings and bank regulations muted any rally earlier in the quarter.

The Treasury market issued \$601 billion in the last 3 months—compared to \$454 billion in the first quarter of 2009, according to Barclays. Most of these funds were easily absorbed until the last week of the quarter, when demand eased. The quarter ended with the 10-year Treasury yielding 3.837 percent – unchanged from 3.8 percent at the end of 2009. (As of this writing,

2010 YTD Total Returns of Selected Barclays Capital Indices	
US High Yield Bond	4.62%
US Corporate Bond	2.30%
US Aggregate Bond	1.78%
US Government Credit	1.55%
US MBS	1.54%
US Intermediate Government Credit	1.54%
US Government Agencies	1.44%
US Municipal Bond	1.25%
US Treasury Bond	1.12%

and since the quarter ended, the yield on the 10-year Treasury has traded to its highest level since October 2008 when it was at 4.00 percent.) The Federal Reserve's purchase of housing debt has now come to a close. Of the \$2.32 trillion in debt it owns, \$1.43 trillion is housing-related.

Investors continue to pour money into bonds rather than stocks, even though stocks have outperformed bonds significantly over the last 12 months. Perhaps they are looking at the longer-

term annualized 10-year performance of the S&P 500 Index being -0.65 percent while the Barclays Capital Government/Corporate Index returned 6.22 percent for the same period. There is plenty to hypothecate about what this means.

Where do we go from here? At some point, interest rates will rise, but no one knows for sure when. What we do know is that even in today's low yield environment, the outlook on bonds is quite challenging. While investors own bonds primarily for an income stream and to mute the volatility in the overall investment portfolio, any rise in interest rates will raise bond yields, thus resulting in a decline in prices and a lower return. Yet high quality bonds from good issuers can always have an important place in an investor's portfolio.

1st Quarter Scoreboard

Index	3/31/10	12/31/09	3 Month Change	12 Month Change
S&P 500	1,169.43	1,115.10	5.4%	49.8%
S&P/Citigroup Value	559.06	525.07	7.1%	54.7%
S&P/Citigroup Growth	601.57	582.37	3.7%	45.5%
Russell 2000	678.64	625.39	8.9%	62.8%
10-Year T-Bond (Interest Rates)	3.83%	3.84%	1.0%	-6.4%
Crude Oil - W.T.I. (Nearby future)	\$ 83.76	\$ 79.36	5.5%	68.7%
Gold (Troy oz.)	\$ 1,113.30	\$ 1,096.20	1.6%	20.7%
CRB (Commodity Research Bureau) Index	273.34	283.38	-3.5%	24.0%

Note: Total returns are shown.