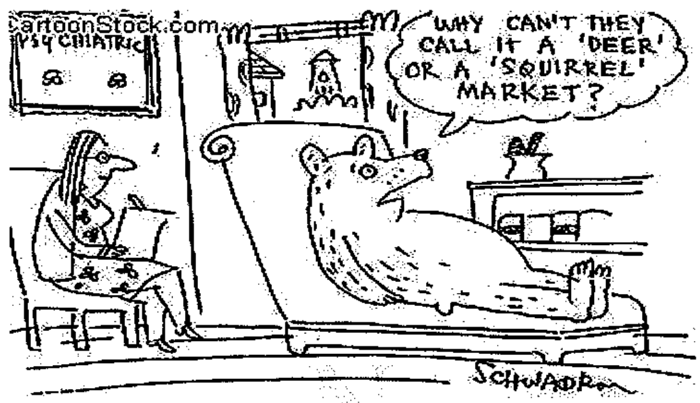
Colley Asset Management, Inc.

REGISTERED INVESTMENT ADVISOR

Defense Is The Best Offense



U.S. financial markets are poised to retest market bottoms as a host of pressures keep the retreat in bearish territory. We are, again, at the low end of the 10,400 to 11,800 band for the **DJIA**. Since the April highs, we have been up and down so much that the **VIX** (Volatility Index) has been like a tornado (VIX @ 46). The worries have been enumerated before so I won't belabor the points or provide academic analysis in this newsletter. Unfortunately, we are all well aware of the many challenges out there. Suffice it to say, here are some of the more relevant realizations and perspectives:

1) The global slowdown is both a real phenomenon and a relatively new "gloom and doom" perspective. Probably "baked in already" to some extent, this domino-like behavior has a self-fulfilling quality attached to it. Experts tell us that it is nowhere near as bad as 2008, but yet the selloff has been very frustrating and wave-like. Some of the worst case scenarios out there have an unknown quality, too.

2) Newly revised numbers put worldwide **GDP** growth at 2.5% for 2011 and 2.8% for 2012, down from the rosier May/June forecast of 3.1% and 3.5% respectively. Technically, not a recession by strict economic definitions. **China's GDP** has been revised to 8.8%-9.0% from 9.8% and India's has been reset to 7.5% (like Brazil's) growth rate (was 8%). Eurozone's growth has been flatlined at +1% to -2% and the U.S.A.'s latest projection is slightly plus at +1.3% to 1.5% for 2011. **Political policy and the solutions to the Federal debt/budget deficit will also be key to how the year-end unfolds**. The ever-lingering (and unresolved) Eurozone headache is another handcuff to rallies. All tolled, this uncertainty surely plays havoc with confidence, planning, and long-term commitment of

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capital. Furthermore, sorry to say, but the Eurozone problems can't be ignored and won't go away. They have been an overhang, now, for almost two years. Experts are divided about the impact a Greek default would have and, right now, the worst case scenario could play out. This ripple effect is obviously cause for concern.

- Emotion and some sense of fear and panic has definitely reentered the marketplace. There is the legitimate fear of revisiting the selloff of the steep 2008-2009 recession. This is fresh on everyone's mind and has a depressing tone. Good news seems dismissed, overshadowed, or written off as a fluke, which are usually signs that "a bottom" is nearing, but also not very reassuring because the "trend momentum is not your friend".


- **Defense mode is "on".** If I haven't talked with you recently, I will be and I invite you to call me at any time. Is it a "ride out" approach with a few smart tweaks or the raising of cash and use of Preferred investments (i.e. AT&T Preferred, yields about 6%) for some return? Is it a balance of both updating and refreshing some stop protections (this can be prudent, too)?

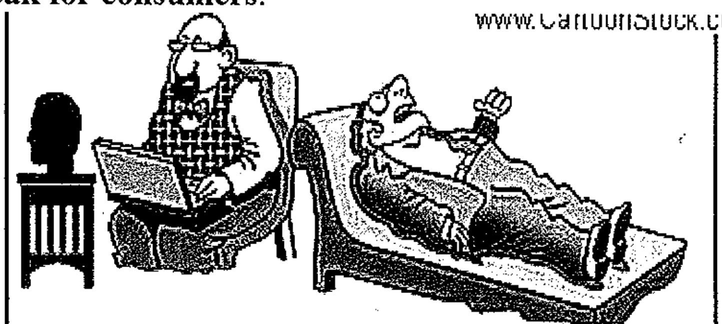
- Our financial markets are not trading off all the fundamentals—just selective ones--and this is especially frustrating because the focus remains aimed at the struggling stories or comparing today's dimmer outlook to Fall 2008. Confidence is challenged, but it is not the time to give up. Future outlook is dimmed by uncertainty and poor job growth, but there are bright spots, too. The slowdown, although documented, has resulted in a "buy the dip" reaction several times, but in each instance, the selloff came back to haunt us. The correlation to wilder volatility is the obvious result. Some of this selling feeds on itself, as you know. Some of it is even forced selling (like margin calls) or option covering.

- **P/E**'s, the purest measure of valuation for stocks, are registering at 50-year lows. The **S&P 500** composite has an average P/E of 9.6x earnings at the moment. The 50-year P/E range has been 9.5 (low) to 29.9 (high) with 18.8 as the moving average. We are sitting at the lows. The question being asked is can we go much lower? Can this be a look forward 6-9 months "down the road" as stocks often anticipate the future? **Or is this a bottom and, hence, a turning point?**

- <u>Low interest rates are not the deterrent to stock market performance, right now</u>. With rates so low, yields on bonds, CD's, and Treasuries are also very low and offer little help or consolation (rates this low have not been seen since the early 1950's).

- **The balance sheets of corporate America are much better than in the recent recession and many are hoarding cash reserves, retiring debt, and gearing up for the eventual recovery.**
  The C- Report Card has become a B-/A- for the S&P 500 companies with the two main exceptions being financials and airlines.

- **Lower oil prices and lower commodity prices are like a tax break for consumers.**



"I'm being denied access to the Warren Buffett within me."

<u>The Times Are Tough</u>

After turning in the worst quarter since the 2008-2009 crisis, U.S. stocks (as measured by index correction) are approaching a technical "BEAR MARKET" (by being down 20% from the modest April highs).

Cooler heads will prevail. **<u>It is not a time to panic or overreact</u>**. It may seem like the "sky is falling", <u>but it isn't</u>. Despite the cloudy/turbulent weather, **<u>the restrained recovery will eventually get better but some defense is the best offense at the moment.</u>**

A few final reflections about tactical defense as a strategy in these volatile times. The volatility is likely to stick around for a while and intra-day swings could remain a fairly typical occurrence, too. At CAM, we remain very vigilant and do daily tracking of prices and daily monitoring of news on many levels. Our intelligence includes analyst reports, economic releases, "wire" news, "shorting and longing" ratios, insider buying and selling, company reports, and broader sector overviews, too (including P/E and PEG analysis).

Over the years, I have relied more and more on my past experiences to guide me through times like this. I have found that staying defensive can sometimes be equated to being in "low beta" stocks and those that pay attractive/reliable dividends. Dividend paying stocks are one of the more popular recipes for coping with uncertainty. First, we find that these companies tend to have strong balance sheets and cash flow and, secondly, we find it comforting to receive a steady income that is better than MM, CD, and Treasury rates.

Also, the rapid sentiment shifts and potential bursts (to the up or downside) create a bothersome volatility and history has clearly pointed out that high dividend stocks are more stable and less volatile. This is also true for the lower beta stocks and ETF's (healthcare, consumer staples, food and beverage, utilities, etc.). Being tactical about allocation is another consideration. If the recovery theme is "off", stocks in certain sectors (i.e. cyclical, industrial, commodity) are usually weaker and more vulnerable. Contrastly, these sectors tend to rebound the most (as oversold picks) when risk is back on and the recovery theme is revered, again. So, the lower beta stocks tend to provide "smoother" returns and are labeled the "defensive" picks. These are generalities, of course, and much more research and analysis is done to determine the "best of the best" or to identify the best bargain or most "oversold choice". In short, this is what asset management is all about because you match up the portfolio with the client's objectives and the economic climate.

Here is a "short" list of some of our favorite low-beta and/or high yield stocks:

Stock Name:	Ticker:	Beta:	Dividend Yield:
AT&T	T	0.6	6.1%
Altria	MO	0.4	6.1%
Annaly Capital Mgmt.	NLY	0.3	15.4%
BP Prudhoe Bay Royalty Trust	BPT	0.6	10%
CenturyLink Inc.	CTL	0.8	9%
Coca Cola	KO	0.6	2.8%
Colgate-Palmolive	CL	0.5	2.6%
Consolidated Edison Inc.	ED	0.2	4.3%
CVS	CVS	0.8	1.5%
Disney	DIS	1.0	1.3%
Enbridge Energy	EEP	0.6	8%
Enterprise Products Partners	EPD	0.6	6%
Health Care REIT	HCN	0.9	6.3%
Johnson & Johnson	JNJ	0.6	3.7%
Kraft Foods	KFT	0.6	3.5%
Kinder Morgan Energy Partners	KMP	0.3	6.8%
Linn Energy	LINE	0.7	8%
National Grid PLC	NGG	0.6	6%
Pepsi	PEP	0.5	3.4%
Permian Basin Trust	PBT	0.6	3%
Pfizer	PFE	0.7	4.5%
Proctor & Gamble	PG	0.5	3.3%
Smuckers	SJM	0.6	2.7%
Southern Copper	SCCO	1.1	9.7%
StoneMor Partners	STON	0.8	9%
Terra Nitrogen	TNH	0.6	10.6%
Triangle Capital	TCAP	0.5	11.6%
Verizon Communications	VZ	0.6	5.6%

In closing, I do not want to underestimate the potential fallout that could arise from further breakdown in the Eurozone or the U.S. selloff potential if we don't get our country's financial house in order. So, let's watch these developments carefully. I am here for you and stand ready to act prudently on your behalf. ***If you are not currently receiving my email updates, please feel free to call or email me at jjjm@capital.net and we will add your email address to our list of recipients. This will allow you to receive relevant updates pertaining to you and your investments as I often send out a couple each week.***

JC

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October 2011

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We collect personal and non-personal information about you from the following sources: Information we receive from you on application forms and transfer forms: information about your transactions (buys, sells, tender, wires, transfers, etc.) which will show up on statements, summaries, and confirmations (i.e. Raymond James, Merrill Lynch, or others) and historical tax information which we compile or have given to us. We also have knowledge relative to market values and investment positions.

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We are providing you with this information as required by Regulations S-P adopted by the Securities and Exchange Commission. Should you have any questions please contact us.

Sincerely,

John E Colley

John E. Colley
Registered Investment Advisor

P.S. CAM invites any client to inquire about advisory fee changes if they have questions, as the client also assumes responsibility for verifying the accuracy of the fee calculation. If you wish, please request a copy of CAM'S ADV-PART II.