



Mailing Address: PO Box 31550
Bellingham, WA 98228

Physical Address: 1255 Barkley Blvd. #102
Bellingham, WA 98226

Phone: 360-647-0649 Fax: 360-647-0068 Toll Free: 1-888-311-(2237)

Email: bcfs@baycityfinancial.com

www.baycityfinancial.com

2011 Major Stock Market Index Performance

	YTD	2 nd Qtr
S&P 500	6.02%	.10%
DJIA (Dow Jones Industrial Avg.)	8.59%	1.42%
Nasdaq Composite	4.55%	-.27%
MSCI EAFE (International)	4.98%	1.56%

Source: Morningstar. These indices are unmanaged and gross of all fees. Your individual performance is not represented by these indices.

Second Quarter 2011 Newsletter

Market Commentary

May and June broke the streak of 8 months in a row of positive performance in the S&P 500 (an unmanaged index of widely held stocks). The market was up close to 32% in that time frame, but dropped 3% in the last two months. **While the news has been full of doom and gloom, the S&P 500 has quietly risen 6% the first half of the year and is on track for another good year of performance.** The financial news has been full of commentary on our nation's debt, the job market, the economy, debt problems in Greece, slowing growth in emerging markets and the end to "quantitative easing". Here is a brief summary of each problem:

Debt: Our national debt is close to \$14.5 trillion dollars and increasing by over a trillion each year for the foreseeable future. This annual deficit is up against the "debt ceiling" and if they fail to raise it, there will be dire consequences for all. Government leaders know we need to raise the debt ceiling, but are also trying to formulate a plan to reduce our overall debt. The details of this plan are the source of the disagreement. They all agree that we need to cut costs, but Republicans do not want to raise taxes due to worries that it will hurt economic and job growth. Democrats want to raise taxes so the cuts don't have to be as large. Despite the disagreement, I think the risk of failing to raise the debt ceiling is low because of the obvious disaster it would create. They must agree on a plan (even a partial plan) and when they do, it should boost the stock market.

Jobs and the Economy: Jobs are being added back to the economy, but at a very slow rate. If we have persistent slow job growth, it will weigh on the stock market as there is less employed people spending money on goods. Some of the recent weakness could be due to the earthquake and tsunami in Japan which had a large impact on our critical automotive sector. As manufacturing comes back on line, jobs should come back and job growth should increase, but this is only part of the solution. We need less uncertainty in government so corporations will be comfortable expanding their workforces which will renew our economic growth.

European Debt Crisis: This crisis caused our market pullback a year ago, and it continues to be a problem today. Banks all around Europe lent money to insolvent countries like Greece, Portugal and Ireland and now these countries need more money, but can't afford the payments. In an interconnected world, this will have an impact on U.S. companies and our own economy. This is

higher on my list of risks, but it should be manageable if Germany, the E.U., European banks and the ratings agencies can all agree on some kind of debt restructuring or E.U. bond issuance to increase investor confidence.

Emerging Markets: These are markets that are emerging from "third world" status and include countries in Asia and Latin America. As these markets have expanded, opportunities for U.S. companies have expanded, but growth in countries like China is at risk because of their reliance on unsustainable spending in infrastructure and real estate investment. China is transitioning to a more "high-tech" consumer oriented economy, but the transition is far from smooth. If growth drops more than expected, it will hurt our corporate profits. This is also high on my list of risks.

Quantitative Easing: This is a phrase describing the massive quantity of bonds that the Federal Reserve has bought in order to "ease" interest rates lower. Low Rates = Cheap Money = Stock Market Gains. The Federal Reserve has stopped their scheduled purchases of bonds and will now only purchase enough to maintain their current level. This should be more of a psychological impact than a financial impact and interest rates have stayed at historically low levels, thereby continuing the flow of cheap money into our economy. If the economy continues to sputter, the Federal Reserve is poised to continue their quantitative easing.

The news headlines may be gloomy, but these risks are manageable and in some cases temporary and the stock market should continue its recovery during the second half of the year. Investing involves risk and reward.

Sometimes the risks outweigh the potential rewards, but the game is rigged in the favor of long term investors because the probability of having good performance increases dramatically as your time frame increases.

Investment Portfolios

The Bay City Financial Services Multiple Manager Portfolios (MMPs) have money allocated in several asset classes and include exposure to one of the weaker performing areas this year, Emerging Markets. As I mentioned above, these have been poor performers as growth has slowed and inflation fears have increased. We are monitoring our position here and may make a change if conditions warrant. The mid-sized company funds and the large aggressive growth company fund that we added to in March have all been great performers and the MMPs have performed well despite volatility in emerging markets and commodities. The MMPs have performed well for the first half of the year, but we expect our emphasis on growth to prove more fruitful in the fall and winter months.

The **BCFS Wealth Management Program** takes **comprehensive** research, **independent** advice and **professional** management to formulate an investment strategy that builds wealth in accordance to **Your Financial Plan.**