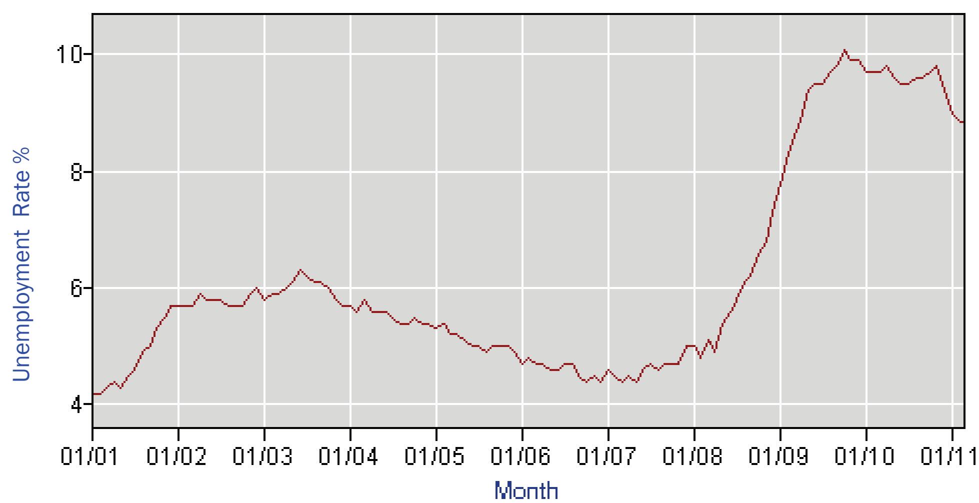
PRAETORIAN GUARD

SECOND QUARTER 2011 NEWSLETTER

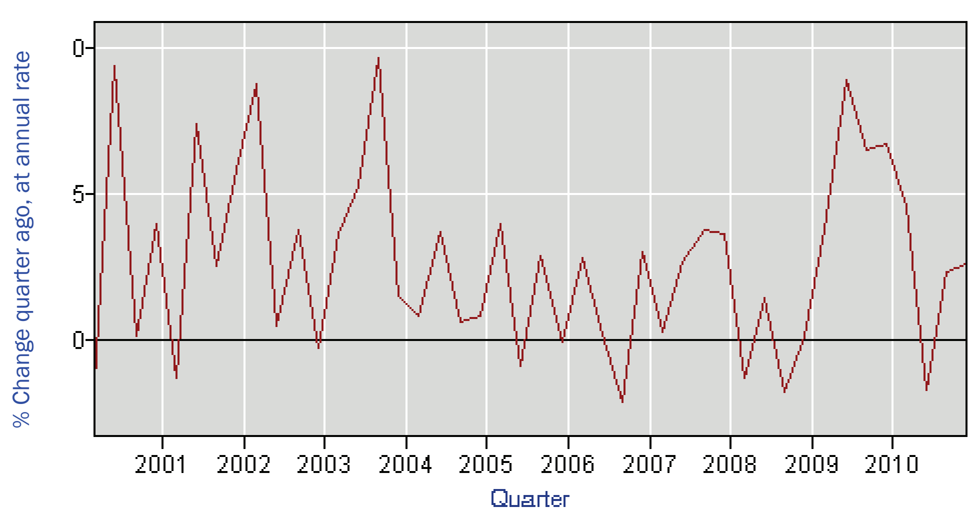
Q1 DISCUSSION

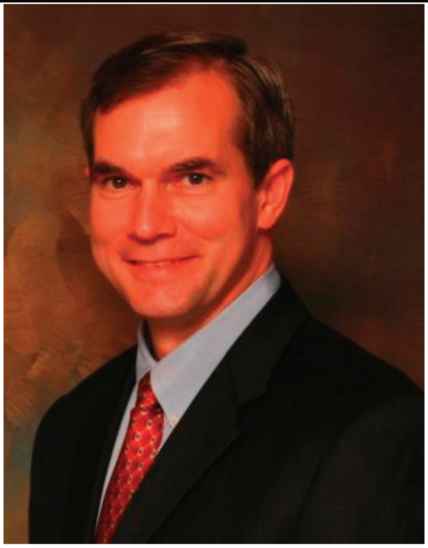
Equity markets returned positive results in the first quarter as signs of increasing economic activity began to ripple through the economy. The most significant result is the continuous improvement and firming up of the job market. Unemployment has begun to decrease marginally, and the last two months' data shows large improvement in the key area of job creation. We have seen creation of over 200,000 jobs in the private sector in each of the last two months—a key indicator signaling that more jobs are being created than workers entering (or re-entering) the labor force.

The predictable result is a decline in the unemployment rate, which now stands at 8.8%, down from 9.8% in November 2010. While still exceedingly high, the unemployment wave has crested, and we expect to see it continue a slow but steady decrease towards 8% over the next 6-9 months. The chart below shows the civilian unemployment rate and clearly indicates an improving labor market.



Related to unemployment is the productivity data shown below. In previous quarterly newsletters we have mentioned productivity as the area where firms will attempt to squeeze as much output as possible before adding workers. After significant gains during the Great Recession (see graph below, 2009 timeframe), gains have dropped as firms are now at the point of hiring additional workers to increase output gains in the future.





Dick Hewitt

PRESIDENT'S COMMENTARY

"May we live in interesting times." We do. The most significant events of the 1st quarter are the continued demonstrations and protests in the Middle East. While their historical significance in the long-term is yet to be determined, their short-term economic impact has been keenly felt. Oil prices are continuing to rise on both output and security concerns in that volatile region, as well as the Federal Reserve's continued easy money policy.

We are witnessing events that are *potentially* as significant as the fall of the Berlin Wall in 1989. It is still too soon to say if the demonstrations will remake the region for the better in the next 10 years, but we believe that long-term, freedom will prevail and we'll be able to look back to 2011 as the start of a new era in Arab countries.

POLITICAL AND ECONOMIC DEVELOPMENTS TO WATCH

The first clear signs of the end of easy money are taking shape. Since the beginning of the year, 18 developing economies' central banks have raised interest rates and during the first full week of April, the European Central Bank raised rates by 1/4 of a percentage point. This is positive for several reasons. First, beginning to return to a more neutral monetary policy stance would signal that the Federal Reserve believes the risk of a double dip recession and deflation have passed. Secondly, it would help to put a floor under the value of the US dollar in currency markets and would have benefits in the price of commodities, especially oil. Finally, it would signal the end of the Federal Reserve's extraordinary measures to "reflate" the US economy and marks a return to more economically driven policy decisions (as opposed to emergency).

The recently passed budget deal will fund the US Government for the remainder of fiscal year 2011 and marked some real cuts in spending after several years of unparalleled growth. This is no small feat and one that has the opportunity to change the political and economic policy debate heading into the 2012 election cycle—yes, we are already there!

The next fight in Washington playing out in the news cycles will be a bruising battle to raise the Federal Debt limit. Sometime between May 16th and July 8th, the United States will reach its statutory limit of $14.294 trillion dollars of debt. We will see a great deal of political posturing around this issue, but in the end we believe politicians of both parties will agree to raise the debt limit sufficiently to keep us away from the brink of default. We don't see this as an issue upon which either party will truly make their last stand—this is not the big fight they need to have and as a result, they won't.

The big fight is the 2012 budget and whether or not the 2010 elections truly changed the prism through which Washington views the deficit spending crisis. We are somewhat optimistic the time has arrived for tackling this issue by politicians who realize the country has little time remaining for posturing and must confront the issues head on. Congressman Paul Ryan of Wisconsin has clearly placed a marker down with his budget blueprint issued in late March.

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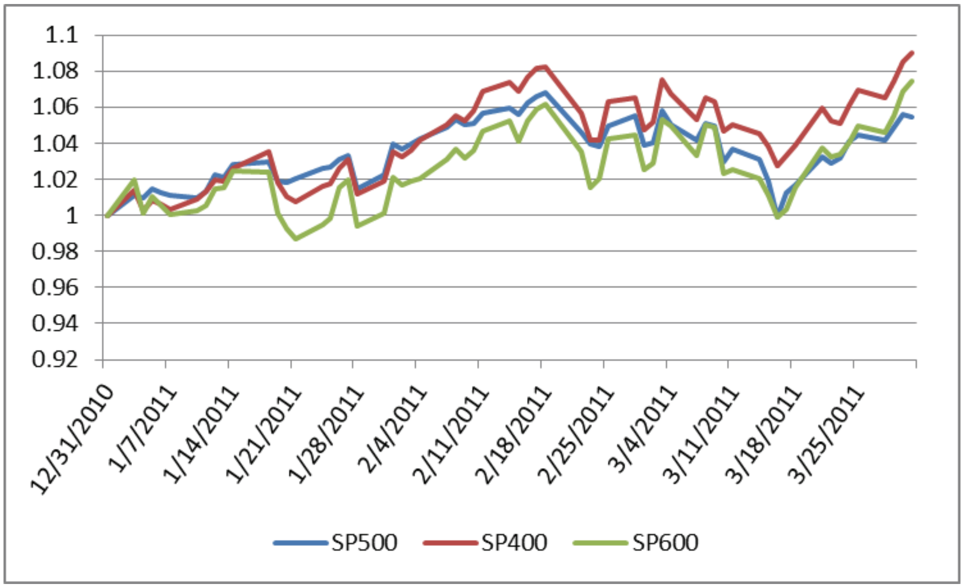
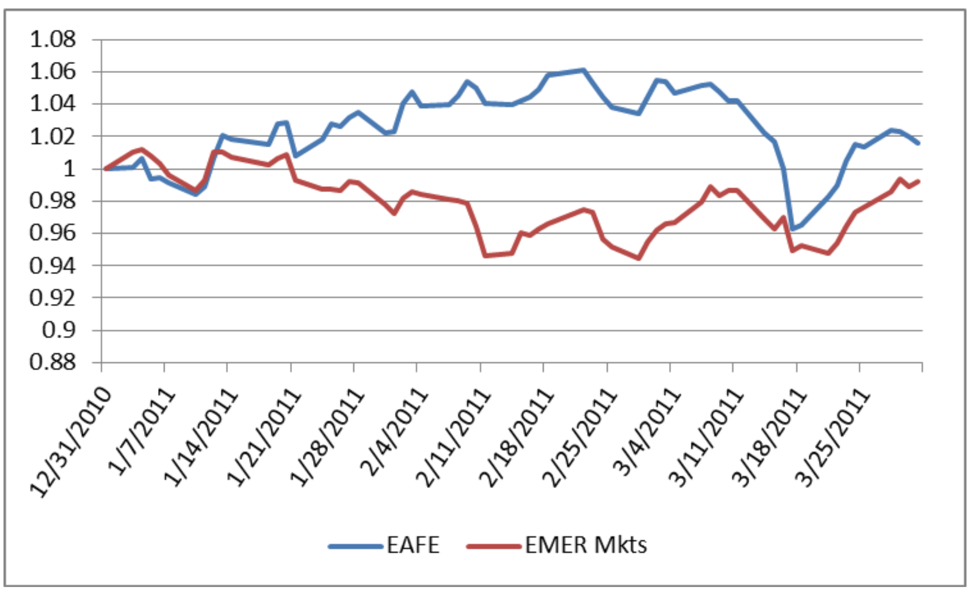
MARKET UPDATE

In the first quarter the domestic equity markets absorbed the rising oil prices, unrest in the Middle East and the earthquake/tsunami in Japan. The quarter was the best first quarter in US markets in over a decade. Historically, that bodes well for the rest of the year. Below we can see the impact of the natural disaster in Japan in early March and the recovery in the markets as the rescue and recovery efforts began.





CLOSING THOUGHT

Do not anticipate trouble or worry about what may never happen.
Keep in the sunlight.
—Benjamin Franklin