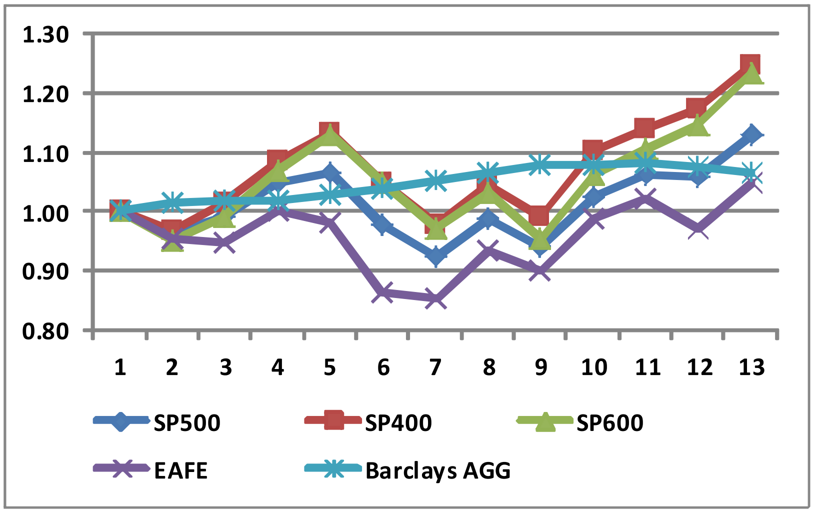
PRAETORIAN℠ GUARD

FIRST QUARTER 2011
NEWSLETTER

2010: YEAR IN REVIEW

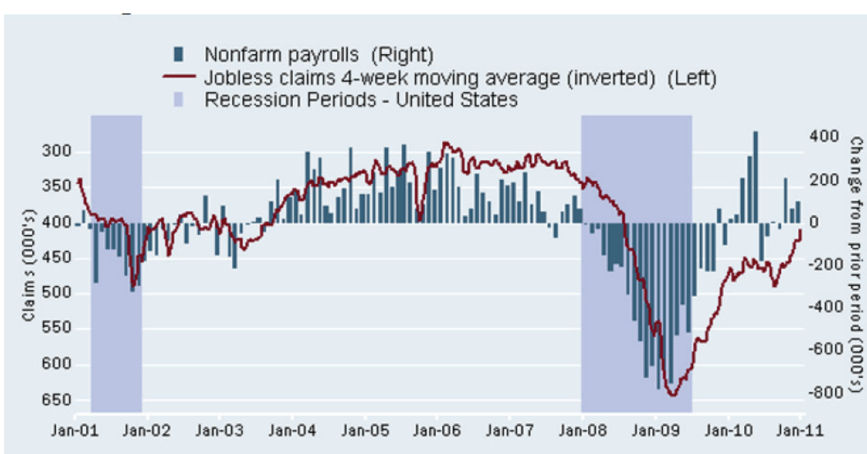
Markets were positive and generally supportive of growth for much of 2010, with a few pockets of "excitement" (for good measure). The graph below shows returns of the major indices for the year, all indexed to 1.00 (for comparison). It is clear that mid-caps (SP400) and small caps (SP600) had a very good year, returning more than 20%, respectively, all in the last few months of the year. Large capitalization stocks, represented by the SP500, returned 11%, while developed international stocks (EAFE) were adversely impacted by the turmoil first in Greece and later in the year, Ireland. Barclay's Aggregate, representing the fixed income sector, shows the benefits of adding bonds to a portfolio by lowering volatility.



Source: Barclays, MSCI & theFinancials.com

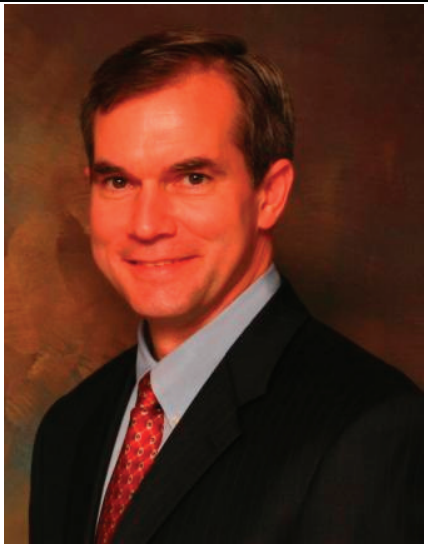
While most all of the equity asset classes above generally move in concert, the magnitude of a reaction to an event (e.g. Greece debt crisis) is different. Mid and small caps generally have limited international exposure and their reaction will be muted while large caps are multinational and move in correlation to a home country's reaction (in this case Europe).

Unemployment continued to be a major drag on the economy and the primary source of political hyperbole in Washington. While we believe the rate has peaked, it will be a slow process to return to "full" employment. We anticipate that by Labor Day, unemployment will be below 9%, but will stagnate thereafter. While this is not a rip-roaring-expansion, it is progress and we see more and more signs of that in our economy.



Source: Schwab

The above graph shows the trough for job losses and unemployment claims and we can clearly see that the labor market is firming slowly as more and more companies are starting to hire once again.



Dick Hewitt

PRESIDENT'S COMMENTARY

The economy continues to expand and jobs are being created. While we are not in a robust expansion, we are no longer concerned about a "double dip" recession in the United States.

The extension of the Bush era tax legislation was a necessary step in protecting the economic gains made to date and pushing this issue to its proper place: as a presidential campaign issue and not a Congressional "football."

The third year of presidential cycles are historically positive for markets and we do not project 2011 to buck the trend.

Happy New Year!

2011 OUTLOOK: PEERING INTO A CRYSTAL BALL

The upcoming year will be positive for stocks. The economic recovery will continue to gain momentum. We expect the Federal Reserve won't raise rates until unemployment drops below 9% (and stays there for a few months) and tax policy indecision has been taken off the table.

The first area we believe will be critical to watch is the statutory raising of the Federal debt ceiling, which will happen sometime in March. While we don't currently expect a full government shut-down as in 1995, we do think it is possible for a short period. Look for President Obama to try to paint the Republicans as Tea Party lap-dogs. We don't believe this will work out to his advantage. The country is in a different mindset than in 1995 with respect to spending, deficits and the national debt.

The second area for observation will be the Federal Reserve's decision to continue its full additional round of quantitative easing. In our opinion, they will complete the $600 billion in purchases. However, it won't have much effect on long-term interest rates, which are driven more by trillions of dollars of market forces than any announced Fed intervention.

A third point is broad tax policy. This was part of the President's deficit reduction committee recommendation and we expect Republicans to pick up this mantle to attempt to reduce the deficit, expand the tax base and simplify the tax code to promote greater economic growth. We think there is a 25% chance of the beginnings of a major tax overhaul brewing and will keep you posted as events unfold.

Our analysis leads us to believe equity returns for 2011 will be driven by the following factors: corporate earnings, overall economic growth and accommodative monetary policy (throughout the majority of the year). We see earnings percentage growth in the low double digits again and corporations finally beginning to loosen their purse strings in the second half of the year. Additionally, overall economic growth will be in the 3% to 3.25% range for the year (now that some previously unknown policy decisions are law). Lastly, the Federal Reserve appears to be steadfast in its commitment to the second round of quantitative easing, but we have scaled back the probability of a third round of easing to a mere 5% chance.

PRAETORIAN GUARD
A division of Praetorian Wealth Management Inc.

3775 Via Nona Marie
Suite 220
Carmel, California 93923

Phone: 831-622-9600
Fax: 831-622-9002
www.praetorianguard.biz

INVESTMENT PROFESSIONALS

Richard A. Hewitt, CFP ®
President
rhewitt@praetorianguard.biz

Jerry M. Ledzinski II
Managing Director,
Business Operations
jmledzinski@praetorianguard.biz

Edward G. Leszynski, CPA-PFS
Director, Mid-West Region
eleszynski@praetorianguard.biz

Joe P. Clark, CFP ®
Director, Mid-Atlantic Region
jclark@praetorianguard.biz

TAX UPDATE

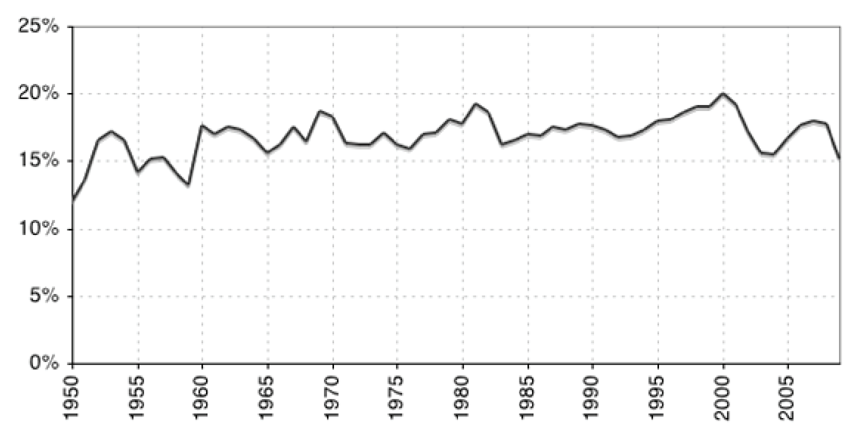
The Federal estate tax is now decided and had a better outcome than we had predicted. The individual exemption amount is $5 million and is "portable". This means that a husband and wife have a total of $10 million they can shelter before paying Federal estate taxes at a marginal rate of 35%. We believe this is a good compromise, as indicated by the fact that no one got one hundred percent of what they wanted politically.

These changes make 2011 a good year to have an estate plan update performed as the last six years have seen major changes in amounts, tax brackets and formulas for standard trust setups. Expect that we will be in touch to suggest why this may be in your interest as the year progresses.

Finally, the compromise between incoming Republicans and President Obama extended the 2001 and 2003 tax laws. This is important to us not only from a macroeconomic policy perspective (a tax hike would have significantly slowed the economic growth needed for recovery), but also as long-term investors. Capital gains tax rates remained at 15% for long-term gains and the two top tier Federal rates remained at 33% and 35% respectively.

As the economy continues to recover, tax receipts will increase as a function of economic growth, helping to reduce the deficit regardless of Washington's political decisions. If they return to the 30-year average of 18.2%, deficit reduction gets much easier and politically palatable.

TAX REVENUE AS A % OF US GDP



CLOSING THOUGHT

"The policy of being too cautious is the greatest risk of all"

Jawajarlal Nehru