Fagan Financial Report

Registered Investment Advisors

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TO OUR CLIENTS

The stock market as represented by both the Dow Jones Industrial Average as well as the Standard & Poor's 500 posted its best first quarter returns since 1998, prompting many to proclaim that this bull market has run its course. To that we say not so fast.

Investors in the U.S. stock market seemed to have a classic case of "bubble-phobia," loosely defined as "fear that this bull market will collapse in a similar fashion to ones in the not so distant past." These symptoms can afflict both the experienced professional as well as individual investors and include a failure to commit an appropriate percentage of assets to stocks based upon a fear that the current bull environment is unsustainable. This "bubble-phobia" can further manifest itself in a lack of action by the investor thereby keeping said investor out of the stock market and reducing one to being reactive rather than pro-active.

Our prescription for the above referenced malady is simple – set up disciplines and follow those disciplines. One way or another, decisions are made. Either you make them, or through procrastination, they are made for you.

To help ease your case of "bubble-phobia," we point to several reasons why the stock market is not in a bubble. First and foremost, investors can feel comfortable that relative stock valuations are reasonable. The thirty stocks that comprise the Dow Jones Industrial Average are expected to earn an aggregate of $986 this calendar year. With the Dow trading at just over 12,450 this places the Dow's Price-to-Earnings (P/E) Ratio, a common tool used for valuation, at 12.6, somewhat below the normal historical range.

Corporate profits benefit from a stable interest rate environment, one which makes for a more healthy current business climate as well as enabling business to better predict future trends. Over the past two years, the ten-year U.S. Treasury Note has traded between 3.00% and 4.00%, very predictable indeed. Furthermore, the Federal Reserve appears to be on hold with regard to raising interest rates. In fact, some believe that the next move from the Fed will be to lower rates.

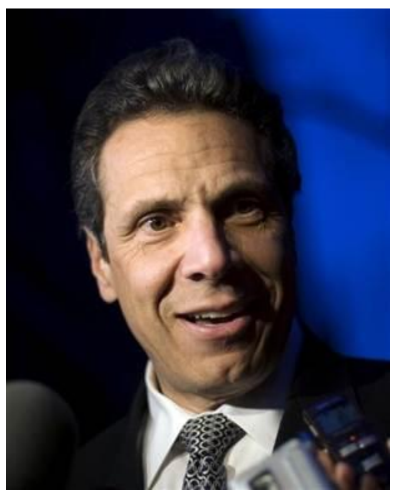
At this time, rampant inflation appears not to be an issue. Due to the slack in the economy, both the Consumer and Producer Prices Indices, key measures of inflation, are subdued and now, with oil trading somewhere around $110 per barrel, the pressure on manufacturers and service providers to raise prices appears to have ebbed.

The leading stocks over the past few months have been quality companies with sound earnings and foreseeable growth in corporate profits. They have not been speculative companies. Historically, a market led by the "blue chip" companies, usually has not reached its peak. It is when it is led by the speculative companies, those that retail investors like, the market has historically topped out.

Finally, retail investors have not fully embraced this rally. As long as "bubble-phobia" continues to persist, there is most likely room left to run. At this point in time, stocks are still climbing that veritable wall of worry. At this time and if history is any guide, after a brief, relatively shallow pullback, we look forward to a strong stock market at least over the three first quarters of 2011.

GOVERNOR CUOMO'S "STATE OF THE STATE" OFFERS ENCOURAGEMENT

If it wasn't just rhetoric, politics aside, much of the recent "State of the State" address by incoming rookie Governor Andrew Cuomo should encourage investors. First and foremost, after noting that "today we are at a crossroads," in our opinion the governor then immediately and accurately states that "we are at a time of crisis that has been created by national economic pressures, out of control State government costs and a dysfunctional political system that has lost the trust of its people." We believe that it is this dysfunction both within New York State and nationally along with the loss of trust that is partially responsible for the lackluster business climate. That said, let us be fair and state that Wall Street also shares blame for the current economic malaise.



Although the devil is in the details and time will tell, in our opinion Governor Cuomo seems to have the right solution to turn the state around. Early in his speech, he attributes part of the reason that 800,000 New Yorkers are unemployed on "the crush of the second highest combined state and local tax burden in the nation." Cuomo observes that "New York's already hostile business climate – ranked 50th in the nation – must change if we are to have prosperity."

Echoing other governors regarding austerity measures that must be taken, Cuomo states that "our government costs are simply unsustainable – at this rate government employee pension and employee healthcare costs will collapse the State's economy. The cost of pensions and health benefits for active and retired employees will grow from $1.3 billion in 1998-99 to $6.2 billion in 2013-14 – almost a 476 percent increase. State spending continues to exceed income and inflation. From 2000 to 2010 State spending grew at an average rate of 5.9%, while personal income only grew 3.8%." We agree totally with Governor Cuomo. This level of spending is unsustainable and will crush our economy.

The solution to the above is to take steps that most families in New York have been forced to take, reduce spending and attempt to increase income. To this Cuomo proposing a reduction in the number of local government entities from the more than 10,500 that currently exist; the creation of Regional Economic Development Councils; commercializing the research done at our states' universities; creating jobs through better utilization of New York's Low Cost Power and capping property tax increases at the lesser of the rate of inflation or two percent.

Governor Cuomo also proposes the establishment of the Spending and Government Efficiency (SAGE) Commission "whose charge will be to undertake a comprehensive review of every agency of state government and recommend structural and operational changes" to the more than 1,000 of them.

On a more immediate basis, Governor Cuomo plans to close the more than $10 billion 2011-2012 budget deficit without new taxes or borrowing by imposing a one-year salary freeze on most public employees whose contracts expire as of April 1, 2011 and imposing a spending cap that will limit growth of government.

These are only some of the points addressed in Governor Cuomo's speech. We suggest you Google "New York At A Crossroads / A Transformation Plan for a *New* New York" to read the speech in its entirety.

THE BOTTOM LINE – In order to create an economy that is conducive to job creation, the private and public sectors must work together. If both try to gain the upper hand or get the most that they can for themselves, both will fall far short of their potential, leaving New York and New Yorkers once again at a disadvantage to other states.

FED CONDUCTS SECOND EVALUATION OF THE U.S. BANKS

During February 2009, the Federal Reserve conducted a stress test of sorts, one in which it evaluated the capital levels of the nineteen largest U.S. bank holding companies, those deemed "too big to fail." As a result of this test and according to a press release from the Federal Reserve, "the Federal Reserve advised bank holding companies that safety and soundness considerations required that dividends be substantially reduced or eliminated. Since that time, the Federal Reserve has indicated that increased capital distributions would generally not be considered prudent in the absence of a well-developed capital plan and a capital position that would remain strong even under adverse conditions."

In laymen's terms, the Federal Reserve was attempting to make certain that the largest U.S. Banks had adequate capital to take them through another financial crisis without being bailed out by the U.S. Treasury.

Speed forward to present day. A week ago Friday, the Federal Reserve announced that it had completed a second stress test, called the Comprehensive Capital Analysis and Review (CCAR) and as a result announced that "some firms are expected to increase or restart dividend payments, buy back shares, or repay government capital."

One of the banks that have since announced dividend increases include **J.P. Morgan** who raised their dividend from $0.05 per share per quarter to $0.25 per share per quarter for a yield of 2.18% based upon the closing price Thursday, March 24. Prior to the whole financial mess that came to a head during early 2009, J.P. Morgan was paying a quarterly dividend of $0.38 per share resulting in a yield of more than 3.00%. We believe that if an investor were to own only one bank, it would be **J.P. Morgan**. We believe that it provides the best opportunity for capital appreciation relative to the risk that you would be assuming. In addition, we believe that further dividend increases are likely and would provide a hedge against inflation.

Another bank that responded to the recently concluded CCAR by raising their dividend was **Wells Fargo** which announced a special $0.07 per share dividend for the first quarter in addition to their normal $0.05 per share dividend for a total dividend of $0.12 per quarter. We believe that this "special" dividend may be incorporated into their normal dividend for the second quarter and beyond. If so, Wells Fargo will now pay an annual dividend of $0.48 per share for a yield of 1.50% based upon their closing price Thursday, March 24. In addition, the Board of Directors of Wells Fargo announced a 200 million share buyback plan totaling $6.4 billion.

Finally other financial institutions either announced dividend increases, share repurchases or plans to begin to repay the TARP funds borrowed by banks from the Federal Government.

It appears as if the Federal Reserve believes that the worst is behind us for the economy and as such the banks. However, more so now than ever, there will most likely be a wide moat between the winners and the losers. We believe that J.P. Morgan is a winner. Another bank we are high on that is not cited in this column is **First Niagara**, a bank that combines the potential for capital appreciation along with solid income from dividend payments.

ALL OF MY MONEY IS IN CERTIFICATES OF DEPOSIT AND THEY ARE PAYING CLOSE TO NOTHING

What do I do? I need monthly income. What follows is a list of potential alternatives.

1. You should be invested in a CD for a reason – safety, guarantee, or a timeframe when you are going to NEED this money – is that still the case? That is the primary question that you need to ask yourself about Certificates of Deposit as well as all other types of investments. There is absolutely NOTHING wrong or un-American about accepting a low interest rate for an investment assuming that some of the other investment characteristics meet your investment objectives.

2. Don't leave an investment like a CD because the rates are low. Leave them because you know that you are not going to need the money for a longer timeframe than you originally thought or perhaps you don't renew a CD because these monies should become growth oriented investments. The last thing that you should be doing is zigzagging between risk and safe investments and trying to time these moves. Invariably you will be out of the market as it moves up and in it as it corrects. That seems to frequently be the case of the smaller, emotional investor.

3. Consider moving a portion of your money into an alternative investment- -maybe you roll over 75% of the money to the lower interest rate CD and invest 25% into an income fund such as the Payden GNMA Fund. In that manner, you can dollar cost average should interest rates move higher and the Payden GNMA head somewhat lower. Be sure that the fund that you use meets your investment objectives. We mention the Payden GNMA as it is a "relatively" conservative fund with income production as its primary objective.

4. Don't be fooled by the highest trailing performance as that has been achieved in a falling interest rate environment. It is easy to convince someone to invest in an income fund with a sterling trailing performance record. Sometimes these numbers can be misleading (and ALWAYS past performance is no indicator of future results) but they are especially misleading with long term bond funds that have directly benefited from the dramatic move lower in interest rates. Be sure to look at consistency of performance and how the fund performs in down quarters/years. This performance should give some indication of how the fund might do in a rising interest rate environment.

5. Don't fall victim to the rates "HAVE" to go higher theory (we believe that to be true but it's like the stock market - - there just are no hard and fast rules). Please note that a 10 year U.S. Treasury yields better than 3.5% at this time and that longer term commitment could certainly be part of the solution to produce higher income. Many investors are avoiding longer term Treasuries thinking that rates have to go UP. While most likely rates will be higher you can stagger maturities and get some higher longer rates while keeping money more liquid with a balance between long and shorter maturities.

6. Even conservative investors should consider some stock in their portfolio. Many conservative investors shudder when stock investment is mentioned. They are tainted with the memory of some of the recent market declines we have witnessed. Many companies have dividend yields of better than 3.0% and it is not difficult to construct a diverse portfolio of stocks yielding 2.5%. One note of warning is to realize that even the bluest of blue chips stocks can be volatile and that a smart investor (despite a desire for high income) will not choose all of the high yielders. It is wise to mix energy, financials and health care into the mix to create a diversified stock portfolio not beholden to the movement of any one sector of the economy.

7. The Vanguard Inflation Protected Securities fund and the Exchange Traded Fund (TIP) using treasury inflation protected bonds seem to be gaining some momentum here. We think that we are beginning to see a modestly higher move in inflation and that these funds can play a role in a fixed income portfolio.

8. It is important to be diversified. Investors (many of them older) seem to believe that all of your money in a six-month CD is a "GOOD" conservative play. While that investment has no risk of principal, it has a more subtle type of risk that those investors are now witnessing. That is the risk of reinvestment as well as the loss of purchasing power. We would wager that most of these investors would love to go back and invest a chunk of the maturing dollars into a longer term higher paying (at the time invested higher than the available current rates) investment.

We feel for investors with maturing CDs searching for higher rates with little or no risk. Our advice boils down to know yourself as an investor, assume nothing in terms of interest rate movement and stay diversified.

WHAT COULD DERAIL THIS STOCK MARKET?

As of a recent close the stock market as represented by the S&P 500 (the largest 500 publicly traded companies domiciled in the United States) had doubled from its ominous-sounding intraday low of 666.79 set on March 6, 2009. With this in mind, rather than focus on how much higher this index might be able to go from here, a prudent investor is asking his/herself what could derail this upward momentum. As prudent investors, our response detailed below.

First and foremost, the catalyst for the recovery that we have witnessed initially in the stock market and subsequently in the U.S. economy can be directly attributed to trillions of dollars of stimulus from the Treasury Department as well as the Federal Reserve in the form of a reduction in interest rates, taxes and two rounds of quantitative easing. The hope is that this "kindling" will be enough to light a lasting fire under the economy, one that won't go out after this "kindling" either is removed or runs out. To date, this stimulus has been relatively effective, but, in our opinion, temporary in nature and temporary in its impact.

With Unemployment hovering around nine percent and down from a multi-decade high of over ten percent, a substantial change in the direction of the recently improving labor market could derail this stock market by dimming the optimism currently shared by businesses and consumers and result in a reduction in spending on both fronts. For businesses, this would mean a curtailment in the addition of employees and reduction in capital investment. For individuals, this would imply a reduction in discretionary spending as well as a reduction in spending on big ticket items like homes, cars and appliances. Keep an eye on the job market.

A second potential catalyst for some serious downside to stocks could be a second leg downward in the housing market. As is well documented, from mid-2003 through mid-2008 home ownership in the United States climbed from an historically normal low-sixty percent range to the mid to upper sixty percent range as banks and other financial institutions such as government agencies Fannie Mae and Freddie Max eased lending standards and then packaged those loans to unsuspecting investors. The result was a near cataclysmic drop of more than 30% in housing prices nationwide which ran concurrently with a severe economic slowdown which, as a nation, we are still emerging from. At the present time housing demand remains tepid despite the historically low mortgage rates, rates which are slowly helping new homeowners soak up the excess inventory from overbuilding. Should this demand weaken substantially, the entire U.S. Economy would also weaken placing this recovery in jeopardy. Watch the housing market.

Rising commodity prices that may eventually cause inflation or worse stagflation is a cause for concern. Food costs have risen 0.5% over the past month at the retail level while geo-political tensions in the Middle East as well as strong demand from the BRIC (Brazil, Russia, India, China) Countries have fueled higher energy costs. The result is that consumers have less discretionary dollars in their pockets and businesses have become a bit cautious. Watch food costs. Watch what you pay at the pump.

Keep an eye on the politicians. While researching the historical returns of the stock market over the past century or so we found that stocks during the third year of a Presidential Election Cycle (calendar year 2011) outperform the other three years by about a two-to-one ratio. Furthermore, during the first six months of this third year stock investors reap almost their entire gains for the year. After that, stocks historically move sideways until the Presidential Election, November 2012. The reason is clear. As the election season draws near, the political rhetoric and divisiveness grows thereby dimming the optimism of most Americans. Listen to the news. Listen to the rhetoric. See if the Democrats and Republicans continue to play nicely together or begin swinging at each other.

We've had a nice rally off the lows. Time will tell whether this was a short-term, cyclical rally or the beginning of a longer-term, secular move. By paying attention to the job market, the housing market, commodity prices and our elected officials you may find a chair should the music stop.

S&P CUTS LONG-TERM OUTLOOK ON U.S. DEBT

This past week, Standard & Poor's (S&P), perhaps the country's premier rating services agency, reduced its outlook on direct debt of the United States Government. In a lengthy release S&P stated that "it affirmed its 'AAA' long-term and 'A-1+' short-term sovereign credit ratings on the U.S. Standard & Poor's also said that it revised its outlook on the long-term rating of the U.S. sovereign to negative from stable."

S&P elaborated on the reason behind the change to negative from stable, the first such change ever for the United States. "Our ratings of the U.S. rest on its high-income, highly diversified, and flexible economy. It is backed by a strong track record of prudent and credible monetary policy, evidenced to us by its ability to support growth while containing inflationary pressures. The ratings also reflect our view of the unique advantages stemming from the dollar's preeminent place among world currencies."

"Although we believe these strengths currently outweigh what we consider to be the U.S.'s meaningful economic and fiscal risks and large external debtor position, we now believe that they might not fully offset the credit risks over the next two years at the 'AAA' level."

"More than two years after the beginning of the recent crisis, U.S. policy makers have still not agreed on how to reverse recent fiscal deterioration or address longer-term fiscal pressures," this according to S&P credit analyst Nikola G. Swann.

What could this shot across the bow mean? Well, most likely nothing for now. However, should our elected officials not get the country's fiscal house in order, Americans might expect a continuation of the decline in the dollar and inflation in the form of higher interest rates.

Like it or not, however we believe for the good, the financial markets will most likely determine how quickly our politicians respond to this pending crisis. For example, just this past week the Euro rose to a fifteen month high relative to the dollar. Despite the fact that a weakening dollar is good for exports, too much so makes imports (see oil) more expensive and is thus inflationary. Furthermore, also this past week, the ultimate safe haven, gold, crossed over the $1,500 per ounce mark as debt concerns surrounding the United States as well as the countries of Western Europe has sparked interest in not only this precious metals, but semi-precious metals, industrial metals and commodities, as well. In fact, in addition to tensions in the Middle East and global demand, many analysts believe that oil would be some $30/bbl lower if it not for the falling greenback

All the while our Congressmen fiddle as Washington burns. S&P's Swann also stated that "our negative outlook on our rating on the U.S. sovereign signals that we believe there is at least a one-in-three likelihood that we could lower our long-term rating on the U.S. within two years. The outlook reflects our view of the increased risk that the political negotiations over when and how to address both the medium- and long-term fiscal challenges will persist until at least after national elections in 2012."

In response to S&P, U.S. Treasury Secretary Timothy Geithner said this past Tuesday that there was "no risk" that the United States would lose its 'AAA' credit rating noting that "the President recognizes and the leadership in the Congress recognize that we have to start to bring these deficits down." In our opinion that is easier said than done as America must guard against forfeiting its reputation as the "land of opportunity" for one as the "land of entitlements."

Standard & Poor's has effectively managed to heighten the increasingly contentious debate between Republicans and Democrats, one which came to the attention of most Americans with the publishing of the recommendations on how to deal with our budget deficit by White House Fiscal Commission co-chairs Alan Simpson and Erskine Bowles and may only end with what may be one of the most important elections of our collective lifetimes, the 2012 Presidential Election.

THE BOTTOM LINE – America and Americans, including our elected officials, respond best in a time of crisis. Make no mistake about it. If we do not get the U.S. budget deficit under control, a crisis will occur. Perhaps Standard & Poor's, which by the way many believe is itself not without fault for the way it did or more accurately did not dispense accurate ratings information during the recent financial mess, has, by way of its ratings outlook revision from stable to negative, in a roundabout way issued a challenge to our President and Congress. "Fix it. Get us on the right track." Unfortunately, we believe that "fixing it" will include spending cuts by all municipalities, Federal, State and Local; tax hikes and changes to entitlement programs, including Social Security and Medicare. If this is what it takes to right the ship, we're all for all of the above and we believe so are the financial markets.

Largest Holdings Regardless of Asset Class Ranked by Market Value as of March 31st, 2011.					
Percent of Total Assets Managed	***Company Name***	***Symbol***	***As of Mar 31st, 2011***	***As of Feb 28th, 2011***	***As of Jan 31st, 2011***
15.77%	Cash & Equivalents		1	1	1
4.82%	Payden GNMA Fund	PYGNX	2	2	2
3.22%	Apple Computer	AAPL	3	3	3
2.30%	Loomis Sayles Bond Fund	LSBRX	4	4	4
2.08%	SPDR Dividend ETF	SDY	5	5	5
1.74%	General Electric	GE	6	6	6
1.72%	Conoco Phillips	COP	7	7	10
1.63%	Ridgeworth High Income	STHTX	8	9	11
1.54%	JP Morgan Chase	JPM	9	8	9
1.47%	PIMCO Total Return	PTTDX	10	11	8
1.47%	iShares Barclays TIP Bond	TIP	11	14	14
1.39%	Hewlett Packard	HPQ	12	10	7
1.30%	McDonald's Corp.	MCD	13	13	12
1.26%	MasterCard, Inc.	MA	14	14	13
1.13%	MetWest Tot Ret Bond Fund	MWTRX	15	18	19
1.12%	Exxon Mobil	XOM	16	16	17
1.10%	Nike, Inc.	NKE	17	15	15
1.08%	Schwab 1000 Fund	SNXFX	18	17	16
0.99%	Baron Asset Fund	BARAX	19	20	20
0.96%	Intel Corporation	INTC	20	19	18
0.82%	Ford Motor Co	F	21	22	21
0.77%	Emerson Electric	EMR	22	23	22
0.77%	Mosaic Companies	MOS	23	21	23
0.72%	S&P 500 DR's	SPY	24	24	26
0.72%	SPDR Intl Dividend ETF	DWX	25		
0.70%	Pepsico, Inc.	PEP	26	25	27
0.48%	Johnson & Johnson	JNJ	48	28	24
0.02%	Cisco Systems, Inc.	CSCO	283	249	25

Portfolio Concentration: Top 25 holdings represent 51.87% of the Assets Managed at Fagan Associates as of March 31st, 2011.

Largest Mutual Fund Holdings as of March 31st, 2011.		
Domestic Equity Funds	***International Equity Funds***	***Hybrid/Fixed Income/ Muni Fund/ETF***
Schwab 1000 Fund	SPDR International Dividend ETF	Payden GNMA Fund
Baron Asset Fund	William Blair International Growth	Loomis Sayles Bond Fund
Parnassus Equity Income Fund	Tweedy Browne Global Value	Ridgeworth High Income
Oakmark Fund	Harbor International Fund	PIMCO Total Return
Fidelity Growth Fund	Janus Overseas	iShares Lehman Bros TIPS

WARREN BUFFETT IS OPTIMISTIC ON AMERICA. SHOULDN'T YOU BE?

As he does every year, famed investor, Warren Buffett, the "Oracle of Omaha" and Chief Executive Officer of publicly traded Berkshire Hathaway, writes a letter that precedes the Annual Report. Needless to say, due to the historical stellar investment returns that Mr. Buffett has achieved at this conglomerate, what he has to say and what Berkshire has done is closely monitored. We thought it might be of some benefit to investors to relate some of what Buffett has to say.

One of the more popular tenets Warren Buffett adheres to is one in which "we simply attempt to be fearful when others are greedy and greedy only when others are fearful. This can be illustrated in the fact that during 2010, "in the face of widespread pessimism about our economy – we demonstrated our enthusiasm for capital investment at Berkshire by spending $6 billion on property and equipment. Of this amount, $5.4 billion – or 90% of the total – was spent in the United States. Certainly our businesses will expand abroad in the future, but an overwhelming part of their future investments will be at home. In 2011, we will set a new record for capital spending -- $8 billion – and spend *all* of the $2 billion increase in the United States."

Should there be any doubt as to what this investment means, Mr. Buffett follows up this paragraph with "money will always flow toward opportunity, and there is an abundance of that in America. Commentators today often talk of 'great uncertainty.' But think back, for example, to December 6, 1941, October 18, 1987 and September 10, 2001. No matter how serene today may be, tomorrow is *always* uncertain."

Why do we focus on the day-to-day deafening negative noise filling our airwaves, newspaper columns and internet when someone with the business acumen of Buffett observes that "throughout my lifetime, politicians, and pundits have constantly moaned about terrifying problems facing America. Yet our citizens now live an astonishing six times better than when I was born. The prophets of doom have overlooked the all-important factor that *is* certain: Human potential is far from exhausted, and the American system for unleashing that potential – a system that has worked wonders for over two centuries despite frequent interruptions for recessions and even a Civil War – remains alive and effective." Wow!

Unlike Buffett, why don't most Americans believe in America? Is it that we listen to, read and then draw conclusions from those that have a vested interest to disseminate such negative information? As we often say, the Weather Channel has to sell advertising and can only do so by providing exciting, riveting weather-related information, sometimes regardless of the fact that perhaps it is 75 degrees and sunny outside with a forecast of more of the same. We can say the same thing of the Business Channel. All this said, we do believe that America is faced with many challenges. However, over the long haul, we're with Buffett. We'd rather be on the side of America then bet against it.