Fagan Financial Report

Registered Investment Advisors

VOLUME 15, ISSUE 4 FOURTH QUARTER 2011

INVESTMENTS * FINANCIAL PLANNING * RETIREMENT PLANNING

Locally owned and managed since 1989
No proprietary products
Individually managed portfolios
No outsourcing to institutional money managers
Current assets under management exceed $100 million

www.faganasset.com
767 Hoosick Road, Troy, New York 12180
518-279-1044 1-800-273-6026

TO OUR CLIENTS

Investors welcomed the end of the third quarter as major indices posted their first calendar quarter loss in a year and one-half. However, these steep losses were tempered by a strong bond market, that more conservative investors as well as those that require some income from their portfolios benefited from.

The catalysts for the selloff included continued concern over the ability of European Countries to deal effectively with the problems surrounding debt in five of its member countries, namely Portugal, Italy, Ireland, Greece and Spain (PIIGS); a slowdown in the U.S. Economy, due in no small part to the political wrangling that accompanied the debate over the lifting of the debt ceiling back in July and finally continued weakness in the housing and labor markets.

At its worst, the most closely monitored index, the Standard & Poor's 500 was down twenty percent from its 2011 closing high, thereby pricing in a mild recession. Investors, who have become accustomed to recessions being accompanied by much larger corrections, were worried. However, for the following reasons, at this time we believe that this worry is not well-founded.

At this time we believe that the chance of a recession in the United States over the near-term is a little under fifty percent. However, should a recession occur (defined as two consecutive quarters of negative growth in Gross Domestic Product), we also believe that it would be a shallow one, due in large part to the fact that hiring coming out of the prior recession in 2009 was anemic so job cuts will be few; the housing market remains sluggish at best, but unlikely to fall much further; over the past two years American households have made great strides in repairing their balance sheets; and finally we are entering an election year, one in which the Obama Administration and Congress will do all in their power to improve the economy.

Despite the above, we have also stated numerous times that economic growth for the foreseeable future will be sluggish as America works off the excesses it accumulated over the fifteen year period that ended in 2008. The good news is that individuals and corporations alike, have been making tough choices over the past two-and-one-half years and now we await the government to do the same. Social Security, Medicare, Medicaid, Health Care and the Tax Code require overhaul. However, by making minor reforms early enough, the result will be major savings down the road and set the country on the right path. Sacrifice for all now will benefit all in the form of a more vibrant economy later.

We believe that going into the fourth quarter stocks are undervalued and bonds are fairly if not overvalued. Bull markets do not begin during great economic times. Think back to 1999 when Unemployment was under five percent, the stock market was steamrolling higher, the housing market was on fire and U.S. debt was under control. Unfortunately, all of that good news was already priced into stocks. Now, we believe that the majority of the bad news is priced in and it is for these reasons that we do believe that stocks, including equity mutual funds provide the most potential for gains in your portfolio, especially during this upcoming quarter.

TEN STEP PROGRAM TO NAVIGATE THESE TURBULENT INVESTMENT WATERS

Just as it pays to establish an escape route from your home in case of a fire, it pays to establish a disciplined plan of action pertaining to your investments, all the while keeping in mind that panic is not a strategy. It is with this in mind that we thought it was timely to provide a ten step program that might help you navigate these turbulent investment waters.

Step number one. Assess your current financial situation. Include your income, perceived job security, details of your pension plan, projected Social Security benefits, insurances (life, health, disability, property and casualty), real estate values, mortgage information and other debt.

Step number two. Get an historical perspective on this period in history. Is it really different this time or are we in a phase in our history that will pass? Keep in mind that the stock market generally moves up over a twelve to twenty year period with mini bulls and bears contained within and then moves sideways over the next period with mini bulls and bears in between. We believe that until further notice, we are obviously in a sideways moving period and have been so since early 2000.

Step number three. Given the above, begin to determine your appropriate asset allocation. Some rules of thumb include the older you are, the more fixed income (bonds) you should include in your portfolio. The more guaranteed your pension plan, the closer you are to realizing the benefits of that plan, and to what extent that pension plan along with Social Security will meet your income needs during retirement, the more equities (stocks) one should include in their portfolio. The more prone you are to making emotional investment decisions, the more you should include fixed income investments. Keep in mind that the opposites of the above also hold true and that we are speaking in generalizations only.

Step number four. Sell the peripheral holdings. Get out of investments you don't understand or investments that contain volatility that exceeds your temperament. These may include but are not limited to emerging market funds, aggressive growth funds, non-investment grade (junk) bonds, and small cap stocks. Sell so that you can sleep at night.

Step number five. Hold some cash. Depending upon your situation, we believe that anywhere from zero to twenty-five percent of your account is appropriate. Too little and you may sell in panic. Too much and you are not moving toward your long-term goals.

Step number six. Buy some dividend paying stocks. Do you realize that the ten-year U.S. Treasury Note yields only 2.10% and that Proctor and Gamble stock yields over 3.40%? Moreover, interest rates are at or near a fifty year low and P&G has not only paid, but increased its dividend every year for the past fifty-three years. With this in mind and assuming that P&G does NOT increase or decrease their dividend over the next ten years, should the stock decline thirty percent over this time frame you will still make a little money. A pool of these stocks sounds like a better alternative for long-term investors than money sitting at zero percent in your bank account.

Step number seven. Recognize that too many investors have their fingers on the sell trigger and too many investors have guns in the form of their computers. Try to determine if perhaps you are one of those individuals that does not have the temperament or time to invest on your own. There is an old adage that says, "just because you can afford the ticket doesn't mean you can fly the plane." Simply put, yes, it is your money, but perhaps your time, talent and temperament are better spent elsewhere.

Step number eight. Be disciplined. Don't chase the stock market on up days thinking that you have missed the boat. There will be many more boats to come around. The volatility will continue. Be patient and let the stock market come to you. What a novel idea, buying on the down days.

Step number nine. Gain some perspective. We're both around fifty. If statistics hold true, that means we have only about thirty more Summers to enjoy. All that you can do is do your best and work toward reaching your goals. It is kind of like dieting and exercising, it is your best shot, but doesn't promise anything.

Step number ten. Become an investor, not a day trader. The media wants you to act, act, act, by always yelling fire in a crowded room. Think of the preceding nine steps to gain perspective. Buy low, sell high. Sounds easy but is rarely accomplished by the retail crowd because they are often scared out of their investments at the wrong time. If history is any guide whatsoever, this is truly what will prevent you from reaching your goals.

CHICKEN WINGS

Initially appeared in "The Record" Newspaper July 31st, 2011.

Let us give you our take on this debt crisis. You can't eat chicken wings every day of your life and then when the doctor tells you that you need to take some medicine to lower your cholesterol, you decline and say that you are just going to stop eating chicken wings.

How does the above relate to the debt crisis? Americans, all of us, have overspent (chicken wings) and built up more than $14 trillion in public debt. In our opinion, the solution is for the government to increase revenue through a combination of increasing taxes, broadening the tax base and practicing fiscal restraint by a reduction in spending. This is the correct approach. We can't just cut spending (stop eating chicken wings) without raising the debt ceiling (medicine). If we do we risk defaulting on our debt, the equivalent of a financial stroke.

The continued political wrangling on our debt will be felt on either Wall Street or Main Street. However, the risk is worth more than the reward. Market pundits and economists have forecasted anything from a muted response from a default to another severe recession. We believe that the already slowing economy will slow even further, quite likely coming to a halt, one that will be temporary and short-lived assuming that the political wrangling over this subject is also short-lived. Politicians have the uncanny ability to do the wrong thing at the wrong time. However, once they realize that their reelections are in jeopardy, they will do the right thing as outlined above.

Despite the fact that the United States has never defaulted on its debt and as such we would be in uncharted territory, we believe that some of the following might occur. Almost certain would be a downgrade of America's AAA credit rating to AA by Standard & Poor's which could very well lead to hiring borrowing costs for both public and private entities. In addition, investors in U.S. Treasuries may become reluctant to continue to invest or require higher interest payments for the additional risk. Continued uncertainty over the debt issue would also cause businesses to remain cautious therefore slowing an already slowing economy. This will also filter down to individuals. Finally, the value of the U.S. dollar, the world's reserve currency, will also be called into question. That will ultimately be inflationary, once again eroding America's standing as the global economic power.

THE BOTTOM LINE – Fiscal responsibility is of utmost importance to the long-term financial health of the United States. However, this is a process and cannot occur overnight. It therefore becomes imperative that Congress approve a raising of the debt ceiling as it begins to reign in spending.

E-MAIL ADDRESS REQUEST

IN ORDER TO BETTER COMMUNICATE WITH ALL OF OUR CLIENTS, ESPECIALLY DURING MARKET TURMOIL, WE ARE IN THE PROCESS OF ESTABLISHING A COMPREHENSIVE E-MAIL PROGRAM.

WITH THIS IN MIND AND DESPITE THE FACT THAT YOU MAY HAVE ALREADY FORWARDED YOUR E-MAIL TO FAGAN ASSOCIATES OR CHARLES SCHWAB & COMPANY, PLEASE DO SO AGAIN IN THE FOLLOWING MANNER:

SEND YOUR E-MAIL TO info-faganasset@nycap.rr.com

YOU WILL BE HEARING A LOT MORE ABOUT THIS IN OUR NEXT NEWSLETTER

TAKE IT EASY. SLOW IT DOWN

Think of a world in which everybody had loaded guns and were always poised, ready to pull the trigger. What a scary place that would be. However, in this day and age the vast majority of investor's do have guns (their computers) and have their fingers on the triggers (the computer keys). Our advice, relax take your fingers off the keys and move away from the computer.

Just like we shouldn't fix our car or electrically wire our home, perhaps you shouldn't have the constant access and therefore temptation to trade your investment portfolio.

In an era of fast, faster, fastest it just might pay to slow things down when it comes to investing. The financial media encourages investors to watch, to act quickly, to respond instantaneously to the latest breaking news. Theirs is a job to produce ratings and not necessarily to provide solid information upon which most investors can take action. Fast, faster, fastest can often lead to foolish, more foolish, most foolish.

Recently, Pandora came public and the stock shot higher. Investors were forced to decide quickly on the day of the initial public offering – "should I or shouldn't I"? The stock topped out at $26 only to then be cut in half and still remains approximately fifty percent below that high. We received calls seeking counsel on whether or not to buy the shares. Our advice was to wait and figure out how such an investment made sense over the long haul. There is not and still is not enough data to support the stock at these levels.

That said, we recognize that it doesn't always pay to wait. It doesn't always pay to dither. We have found that in decisions of money and in life changing decisions that it does pay to act decisively but with thought. Establish a disciplined plan of action, steps to take to determine what and when to buy and sell and follow those in as most an unemotional manner as possible. Invest with your head and not your stomach.

Too often we are put in the position of deciding NOW about life changing situations. Our advice, "slow it down." Don't shut it down, slow it down and make decisions after the pressure and emotion has subsided.

THE BOTTOM LINE – There are no balls or strikes in investing. Certainly, if you establish a disciplined approach to investing you will miss some opportunities. An investor knows that for every opportunity that passes there is another waiting in the wings. You can wait for that fat pitch to hit without worrying about striking out.

FEDERAL RESERVE ISSUES CAUTIOUS STATEMENT

Stock markets around the globe sold off over the past few days, in part due to the cautious statement issued by the Open Market Committee of the Federal Reserve after their regularly scheduled meeting on Monetary Policy this past Wednesday.

Most notably, the Fed replaced the statement that "downside risks to the economic outlook have increased" released after their August 9th meeting with "there are significant downside risks to the economic outlook." Believe it or not, just with the addition of the word "significant," market observers shuddered. What follows are some additional observations by the Federal Reserve.

"Information received since the Federal Open Market Committee met in August indicates that economic growth remains slow. Recent indicators point to continuing weakness in overall labor market conditions."

"Investment in nonresidential structures is still weak, and the housing sector remains depressed. However, business investment in equipment and software continues to expand."

"The Committee continues to expect some pickup in the pace of recovery over coming quarters but anticipates that the unemployment rate will decline only gradually."

"The Committee also anticipates that inflation will settle, over coming quarters, at levels at or below those consistent with the Committee's dual mandate as the effects of past energy and other commodity price increases dissipate further. (The dual mandate of the Fed is to "foster maximum employment and price stability.")

To all of the above we respond, "tell us something we don't know." Here's what we think.

There's about an even chance that the U.S. economy will enter into a recession within the next three quarters as a recession is defined as two consecutive quarters of negative growth in Gross Domestic Product. However, that recession will be both short and shallow.

The stock market has in great part discounted the possibility that there will a short and shallow recession. Perhaps there is another five to ten percent of downside risk if a recession proves shallow. That said, it has not discounted another deep and long one. This bears watching.

Over the intermediate (one to three years) to long-term, with the ten-year U.S. Treasury Note at 1.70%, dividend paying stocks are very attractive. There are dozens of stocks, including McDonald's, Proctor & Gamble, Intel, Bristol Myers and Abbott Labs that pay dividends far above this Treasury note. Yes, you are assuming more risk. However, there is also risk in locking ten-year money up at 1.70%.

This is not an easy environment to invest in if you don't know what you're doing. We often say "just because you can afford to buy the plane doesn't mean you can pilot it." Some can invest money on their own. Others need help. It's an expensive lesson if you think you're the former and it turns out you were the latter.

This political wrangling in Washington between the Republicans and Democrats is a mess and it is hurting consumer confidence. Like it or not, what hurts Main Street hurts Wall Street and what hurts Wall Street hurts Main Street. Both are hurting right now and the longer this finger pointing, campaigning and stalemate continues, the more there will be repercussions on both streets. It will be very detrimental if this drags out until the 2012 Presidential Election. We fear it may. We hope it doesn't.

ALTERNATIVES TO U.S. TREASURIES AND CERTIFICATES OF DEPOSITS

First and foremost, let us state that investors are scared to death that "it's different this time." Perhaps it is. However, in believing that the United States has truly entered an eternal period of no or slow growth and a flat stock market, you are also taking risk that it is NOT different. For example, by leaving long-term investment money at zero to two percent you are assuming opportunity risk, the risk that you will not have accumulated enough assets to meet your objectives.

Second, let us state that opportunity comes with risk. Think back to 1999 when the economy and stock market were humming along just beautifully. Unemployment was near 4%, Americans were building and buying houses like crazy and the stock market was at all-time highs. Ask yourself this question, would you have been more or less apt to invest money in stocks at that point? The answer is simple, more, much more. The reason is clear. Studies have shown that individuals and investors believe that the period of time that they are in will last forever, be they good or bad times. In part, this is why after eleven years of zero returns on stock market indices, investors are shying away from what we believe will help them achieve their goals over the next eleven years – dividend paying stocks.

For this column we have put together a list of potential investment alternatives to your low-paying Certificate of Deposit, Annuity or U.S. Treasury Note. However, keep in mind, this is for long-term investors only who wish to assume some risk. Also, keep in mind that the ten-year U.S. Treasury note is yielding approximately 2.00% per year.

One logical alternative to a U.S. Treasury note yielding 2.00% is a basket of dividend paying stocks. For example, Procter & Gamble (3.40%), Johnson & Johnson (3.60%), Altria Group (6.20%), Abbott Labs (3.80%), Pepsi (3.30%) and McDonald's (2.80%) all yield much more than the ten year Treasury. In addition, they have all INCREASED their dividends at least on an annual basis for more than twenty-five consecutive years. Therefore, as an investor in any of these companies you are starting off receiving much income than a U.S. Treasury AND you have a good opportunity for increasing income every year.

Another logical alternative for mid- to long-term investors is a basket of dividend paying stocks that have increased their dividends every year for at least twenty-five years. This can be found in the SPDR S&P Dividend ETF (symbol SDY) whose objective is to invest at least "80% of its assets in the fifty highest dividend yielding constituents of the stocks of the S&P Composite 1500 index that have increased dividends every year for at least 25 consecutive years."

THE BOTTOM LINE – It is not during periods of economic prosperity that bull markets begin. It is usually during periods of uncertainty. A good way to mitigate this uncertainty and the risk that comes with it is as described above, by buying securities that provide income at or above the level of other, more guaranteed alternatives. Certainly this adds risk to your metrics. However, given the fact that interest rates are at multi-decade lows and provide little bang for the buck, it might be worth a look.

FOOD FOR THOUGHT – According to a lead anchor on business channel, CNBC "why would we ever lead with the house is not burning." Thus implying that bad news gets the viewers and viewers get the ratings. Are we too into this reality TV, perhaps to our own detriment? Perhaps we are getting too much information without the knowledge necessary to use the information to our benefit.

21 Years Serving the Investors of the Capital Region

THIRD QUARTER BUSINESS HEADLINES

The sad news regarding the passing of Apple CEO Steve Jobs, the announcement that Berkshire Hathaway CEO and legendary investor Warren Buffet was investing $5 billion in Bank of America, and talk about a "double-dip" recession were all newsmakers during the quarter that just ended.

Regarding Jobs and Apple, short- and mid-term this should mean nothing to a company that has its product cycles well mapped out for approximately the next three years. However, over the long term it remains to be seen if the innovative Apple bench is deep enough to offset the loss of the visionary, Jobs. Despite not having Steve Jobs at the helm, at eleven times 2012 earnings, more than $73 per share in cash and no debt, along with an excellent management team, now with a chip on their shoulders and something to prove, we believe that a pullback in Apple should not be sold. We believe that the loss of Jobs is akin to the loss of Walt Disney. Both have created an environment that nurtures product creation and to a great extent institutionalized these qualities. This will be tested over the next several years.

Regarding Buffett and Bank of America. Warren Buffett will invest $5 billion in perpetual preferred stock of the beleaguered banking giant which will also provide a warrant to buy 700 million shares of common stock at $7.14 each. Has the Greenspan Put been replaced by the Buffett Put? This caused Bank of America to initially surge more than twenty percent early Thursday before settling nearly ten percent higher by the close. The entire banking sector also rallied on the belief that "the bottom must be in" if Buffett was investing. We say, not so fast. Sentiment is still very negative regarding the financial sector and it will take more time before the housing market sorts itself out. This should keep any bull markets that begin in the financial sector in check. We have not taken a stake in Bank of America and at this time, we continue to prefer JP Morgan Chase, First Niagara and FNB Corp.

Last, but not least, there has been much talk lately regarding the likelihood that the economy over the next year will be similar to 2008, when credit markets shut down and the economy sank. Although we do firmly believe that the economy is slowing and perhaps at a stall speed, we do not believe that we are setting ourselves up for another economic freefall like the one we went through during2008. We have always been of the belief that this economic recovery will be modest, at best, filled with fits and starts. We have not changed this outlook. At this point in time we are looking for this recent economic slowdown is temporary and that the economy will reaccelerate over the next two to three quarters to approximately 2.5% GDP growth, not great, but not another recession either.

THE BOTTOM LINE – We do not believe that we are in for a robust economy or for a robust stock market. However, valuations are reasonable for stocks, but most likely overvalued for bonds. With this in mind, there will most likely be a slow migration out of fixed income and into highly liquid, dividend paying U.S. stocks over the next year or two. We think that this would be a smart move if you have a three to five year time horizon and can stomach some risk.

Largest Holdings Regardless of Asset Class *Ranked by Market Value as of September 30th, 2011.*					
Percent of Total Assets Managed	***Company Name***	***Symbol***	***As of Sept 30th, 2011***	***As of Aug 31st, 2011***	***As of July 31st, 2011***
17.50%	Cash & Equivalents		1	1	1
5.97%	Payden GNMA Fund	PYGNX	2	2	2
2.84%	Apple Computer	AAPL	3	4	4
2.65%	Loomis Sayles Bond Fund	LSBRX	4	3	3
2.18%	SPDR Dividend ETF	SDY	5	5	5
1.71%	PIMCO Total Return	PTTDX	6	7	8
1.70%	iShares Barclays TIP Bond	TIP	7	6	7
1.66%	MetWest Tot Ret Bond Fund	MWTRX	8	10	12
1.65%	Conoco Phillips	COP	9	8	10
1.63%	Nike, Inc.	NKE	10	11	11
1.59%	McDonald's Corp.	MCD	11	9	13
1.47%	MasterCard, Inc.	MA	12	12	14
1.19%	General Electric	GE	13	13	9
1.12%	Altria Group, Inc.	MO	14	16	47
1.07%	Intel Corporation	INTC	15	18	17
1.04%	Exxon Mobil	XOM	16	15	16
1.01%	Ridgeworth High Income	STHTX	17	17	6
0.99%	Gilead Sciences, Inc.	GILD	18	19	19
0.97%	Celgene Corporation	CELG	19	23	24
0.92%	Schwab 1000 Fund	SNXFX	20	20	18
0.90%	Permanent Portfolio	PRPFX	21	21	21
0.90%	Visa, Inc.	V	22	24	22
0.87%	JP Morgan Chase	JPM	23	14	15
0.85%	Baron Asset Fund	BARAX	24	22	20
0.82%	DoubleLineTotal Return	DLTNX	25	25	25
0.70%	Direct TV	DTV	27	31	23

Portfolio Concentration: Top 25 holdings represent 55.19% of the Assets Managed at Fagan Associates as of September 30th, 2011.

Largest Mutual Fund Holdings as of August 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	iShares Lehman Bros TIPS
Dow Jones Broad Market Index	Harbor International Fund	PIMCO Total Return
Oakmark Fund	Vanguard International Growth	MetWest Total Return Bond