PHILOSMITH
Investors and Advisors Since 1962

Market Uncertainty Remains

August 2011- Market Outlook

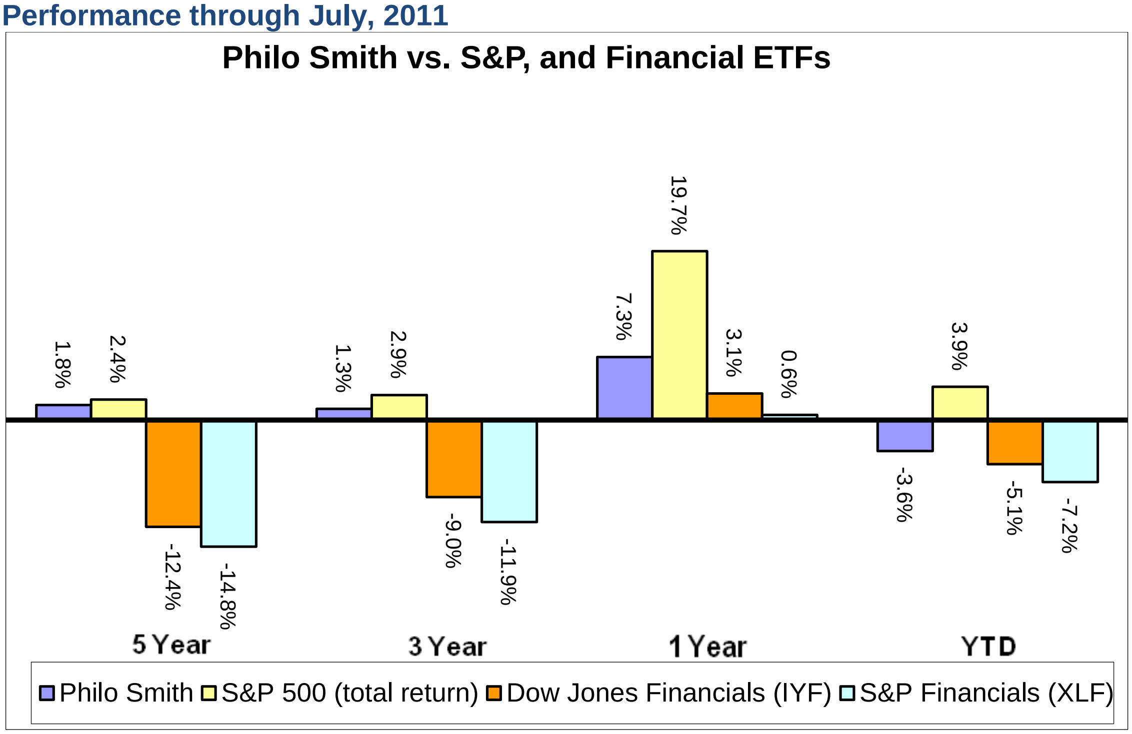
For the month of July our return was down 3.95% vs. a 3.58% drop in the financial index (XLF), and a 2.03% drop in the S&P 500. Our return on the year (through July 31st) is down 3.61% versus the drop in the financial index (XLF) of 7.21%. Fears of a double-dip recession, fueled by economic indicators below expectations, continue to cut the valuations of financials. Financials have also been held back on concerns about job growth, home prices/sales, and consumer spending. With the battle over the debt ceiling accomplished, at least for now, the focus is on S&P's recent downgrade of the U.S. credit rating. Though it has been a topic of discussion since S&P placed the U.S. on "credit watch negative" back in April, the downgrade solidified a lack of confidence in political leadership and the rising debt burden. While the U.S. default was unexpected, the extended debate about the debt ceiling brought into crisper focus the longer term risks associated with deficit spending and the market reacted accordingly. Ironically, this downgrade gave way to the opposite reaction in the bond market which sent many investors into 10–year treasuries, dropping the yield to its lowest level since January 2009. Many insurers, most of which are invested in government or government-related securities, released second quarter earnings and noted that changes to a more conservative posture in the first half of this year left them well positioned.

The advance estimate of the second quarter GDP is showing a slight increase of an annualized 1.3%. A second estimate is due out later this month with leading indicators pointing to a further drop in that estimate. With relatively flat economic growth and the economic indicator's pointing to more towards downside risks, the Federal Reserve committed to keep the Fed Funds rate near zero at least through mid-2013. This extended period of lower rates is intended to keep the monetary policy more accommodating rather than jumping into another quantitative easing which would raise concerns for inflation.

Our portfolios are well diversified among different segments of financial stocks. We are confident that those companies are positioned well for growth and can stay the course through the volatility. However, until the widespread fear eases we expect the market fluctuation to continue. We continue to focus on opportunities to purchase quality companies below book value.

If you have questions regarding the financial services sector, or would like to discuss our investment approach, please contact us at the phone number below, or visit our website. (www.PhiloSmith.com)

Performance through July, 2011



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