

**PORTFOLIO UPDATE**

The RCM portfolio finally succumbed to the market correction that started last year. We held the market demons at bay last year, rising 14.7% in 2007 compared to the 5.5% gain for the S&P 500 Index. Unfortunately, we have finally felt the weight of the market correction. During the first quarter, the portfolio declined 7.3%. On a positive note, this is still better than the S&P 500 Index, which declined 9.5% during the same period. Since 2003, the annualized performance is +11.0% (net of all deducted fees).

As for risk, the portfolio risk profile has declined dramatically (which is good). Our diversified selection of stocks and exchange-traded funds has a risk index of 60 (relative to the general market which is defined as 100). When I rebalanced the portfolio in November, my goal was to reduce risk and volatility by increasing our investments in some new areas. It looks like it worked.

**COMMENTARY**

I sense a climate change coming. I'm not talking about global warming, but climate change in the stock market. I sense that, during the next few years, the investing climate may be different than what we have been accustomed to in the past. A little market history may help explain.

Back in 1982, the stock market began an historic rise. Over the next 18 years, the S&P 500 Index rose nearly 13-fold with only brief, shallow corrections along the way. This was a 15% annualized return! Events were interrupted in early 2000, when the Internet bubble burst, causing a 2-year correction. However, the market regained its feet and began a new upward climb, averaging 14% per year for the next five years. All in all, between 1982 and 2007, investors enjoyed average annual returns of 14 to 15% most of the time.

This was an agreeable time to be an investor. The investment environment was straightforward and rules simple: buy and hold. If investors could ride out the occasional correction – even buy on the dips – a steady buy-and-hold strategy was amply rewarded. Stock price appreciation and capital gains were the name of the game, while dividends and other income-producing strategies were relegated to the sidelines.

But, it hasn't always been so. Looking farther back in history, before 1982, we see a very different picture (see the graph on the reverse side). After the end of WWII, the market embarked on a steady 20-year rise, eventually hitting a peak in early 1966 ... and then it stopped. For the next 16 years, it wobbled up and down, but didn't break into new ground until 1982. Sixteen years with no net gain! Buy-and-hold did not work during this era.

What is the point? I sense that the next few years may look more like the 1970s than the 80s and 90s. Why is that? The credit crisis is a significant consideration. I believe that we aren't even close to seeing the complete damage. It will take several years yet to work off the excesses of the credit and housing bubble. In the meantime, there will be a drag on the economy. Additionally, the prospect of rising tax rates (regardless of the next presidential administration), the financial and psychological burden of an increasingly unpopular war, the weak dollar, rising inflation, rising energy prices and declining reserves, and global geopolitical instabilities add to uncertainties and risks facing the market.

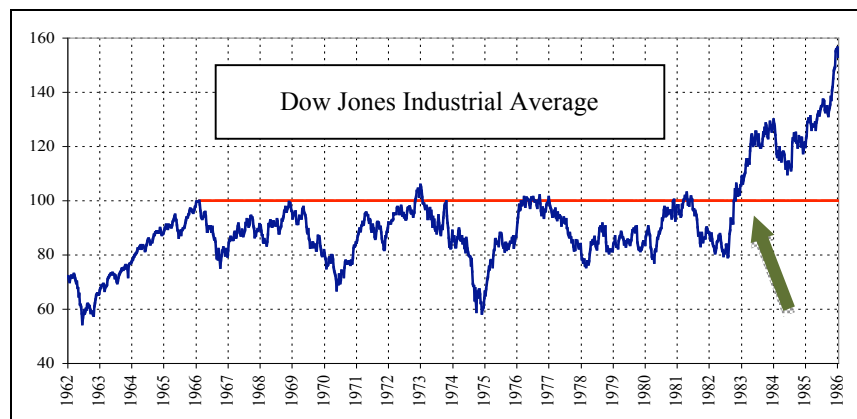
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I might be wrong about all this. The market may shrug off these concerns and continue marching upward, but I don't think so. I don't see any compelling factors driving the market upward.

This isn't meant to be a bleak message. Investing doesn't have to be unrewarding in coming years. This simply means that investing will require a different mindset than was successful for the past 25 years. Successful investing will require more creativity than simply buying and holding an index fund. Capital gains are still welcome, but can't be relied on as a central investing principle. Income-oriented strategies need to take a bigger role. However, with domestic interest rates once again falling to historic lows, bonds aren't very interesting right now. We will need to look to other investment strategies such as foreign securities, commodities, equity options, or enhanced dividends. Also, in a lower return environment, risk management assumes an even more important role. It is important to minimize the damage caused by periodic market declines.

Later this spring, I plan to rebalance our portfolio. Beyond careful stock selection of U.S. stocks, you can expect to see a broader range of exchange-traded and closed-end funds that will expand our investment exposure into some of the areas outlined above.

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### Edward S. Rollins, MD CFP CFA

Dr. Rollins has earned both the Chartered Financial Analyst® designation and Certified Financial Planner™ credential. He was awarded the CFA® designation in 2004. The CFA charter is the only credential for investment analysis and management recognized worldwide. Recipients of the CFA charter have successfully completed a graduate-level educational curriculum, and have passed a series of three sequential annual examinations. Pass rates average about 50 percent at each examination level. In 2005, he also successfully completed financial planning coursework and passed the qualifying examination for the CFP® credential.

### Company Profile

ROLLINS CAPITAL MANAGEMENT is a fee-only financial advisory firm serving individuals. Using a consistent, patient investment strategy, our focus is long-term, high-quality, personalized investments. Clients have their own individualized accounts. ROLLINS CAPITAL MANAGEMENT handles all the daily investment decisions.

### Presentation Disclosures

1. Portfolio composite returns are actual total annual returns, including stock price appreciation, dividends, corporate spin-offs and divestitures, and other occasional cash and non-cash distributions.
2. All returns are actual annual returns for each full year displayed, or are year-to-date results for the most recently displayed year.
3. Portfolio composite returns represent an asset-weighted combination of the equity components of fee-paying client accounts under management in the period specified, reported net of all withheld fees.
4. Annual portfolio composite returns and benchmark annual returns use a time-weighted calculation over the period specified.
5. Annualized portfolio composite returns and benchmark returns are calculated as the geometric mean of annual returns.
6. Portfolio and benchmark risk measures calculated using methodology provided by RiskGrades®.
7. Detailed disclosures available on request.

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