

PORTFOLIO UPDATE

The stock market turmoil that reigned last year has continued into this year. The RCM portfolio has been caught in the downdraft, but is holding up better than the broader market. In the first three months of 2009, the RCM portfolio declined 5.5% (net of all fees), compared to a 10.8% drop for the market index.

As for risk, the portfolio is about even with the market. The annual yield of the portfolio is about 6.7%. While this is an attractive yield, this is slightly lower than previously, largely because the underlying security prices have risen.

COMMENTARY

The SP 500 Index hit a low value of 666 on March 6th. Since then, the market has enjoyed a spirited rally, rising approximately 25%. Is it over? Was that *THE* low? Probably not. The economy and the stock market aren't done washing out the excesses.

This is not a run-of-the-mill recession. A normal recession is an economic downturn that occurs when the Federal Reserve raises interest rates to fight inflation. This weakens the economy enough to control inflation. Once inflation simmers down, the Fed then lowers interest rates and eases monetary policy. Lower interest rates encourage individuals and businesses to expand, grow and spend. This awakens a subsequent economic expansion. The recession usually plays out over a few months to a year.

This time things are different. The current downturn is something bigger than a routine recession. This is debt/credit imbalance. It took years to create and will require deep economic restructuring to correct. For many years, consumers and businesses financed increased spending by borrowing, aided and encouraged by banks. In due course, debt levels rose, eventually to unsustainable levels, exceeding the ability of borrowers to make payments on the debt and encumbering their balance sheets with too much leverage. The debtors are now defaulting, dragging the banks and other financial intermediaries down with them. Homeowner bankruptcies and home foreclosures are just the most visible manifestation of this process, but it involves many other participants as well.

Simply lowering interest rates, as in a normal recession, won't repair this situation. Lowering interest rates works to encourage borrowing, spending and expansion. But, those are the very causes of the current crisis! This situation will require writing off the unsustainable debt, a process that will take much longer and create significant economic turmoil. Economic analysts estimate that eventually approximately \$10 trillion will have to be written off. So far, only about \$1-2 trillion has been addressed. It will likely take years to complete the deleveraging.

My outlook is that the brisk market rise that began on March 9th is not a new dawn, but merely a bear market rally. It will play out over few months, then the SP 500 Index will decline again, possibly into the 600's, maybe even lower. That will probably be a good time to start increasing our stock allocation. Looking further out, I suspect the next few years will look a lot like the 1970's, trading up and down within a range. I also expect inflation to increase as the economy deals with the enormous debt that the federal government is taking on as it tries manage the economic crisis.

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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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