

PORTFOLIO UPDATE

After the turbulent summer, world markets recovered somewhat during the final months of 2011. Unfortunately, the recovery wasn't complete and the RCM portfolio ended the year with a net loss of 3.3% (including all fees). The portfolio now yields about 6% following the allocation adjustments in November.

COMMENTARY

The small net loss for 2011 is a disappointment, especially given that the U.S. stock market eked out a 2% gain for the year (including dividends). However, we have only a minor share of our assets in U.S. stocks, the remainder is allocated to an assortment of yield-paying investments and to foreign securities, particularly emerging markets. The emerging market investments account for our shortfall.

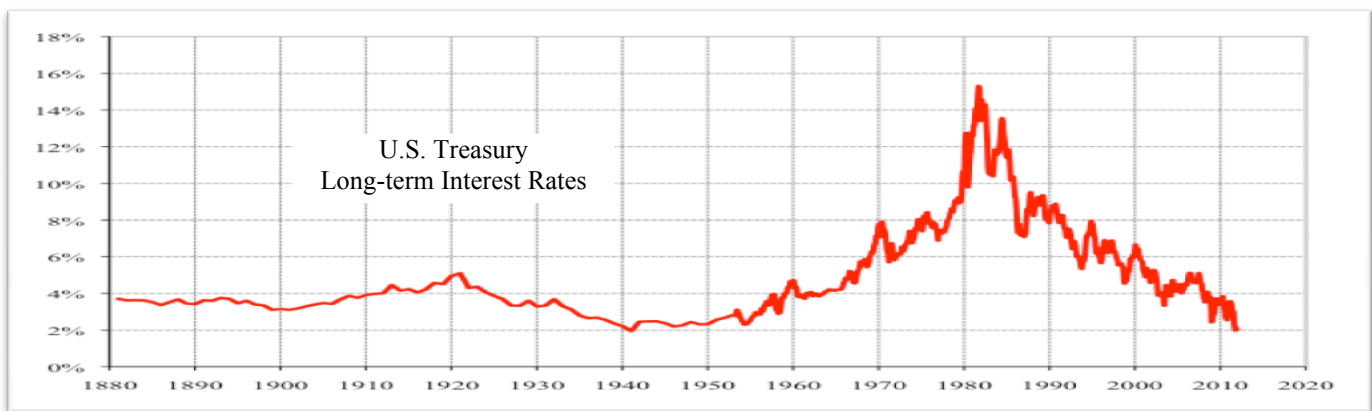
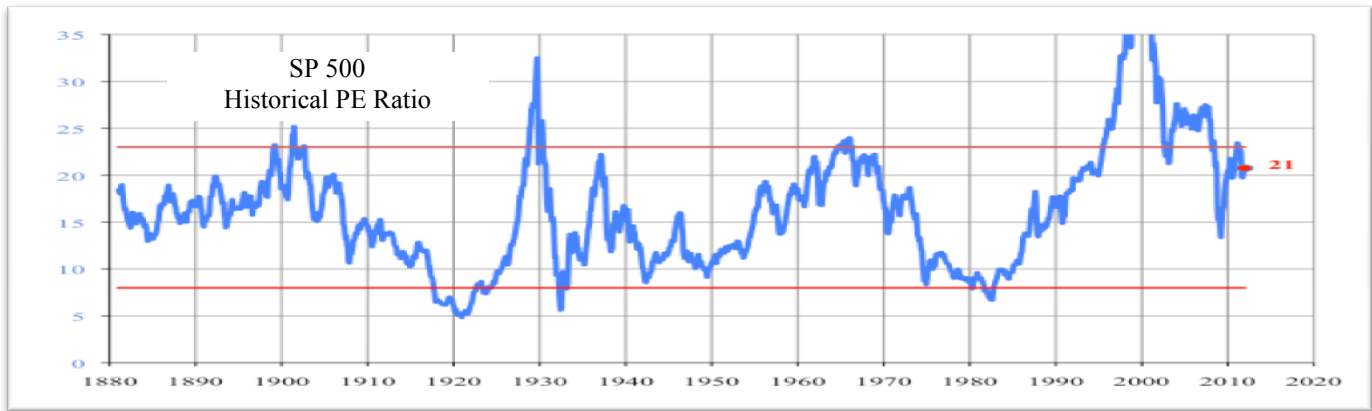
So, what happened to the emerging markets? Europe happened. As the European debt crisis unfolded, global investors began a flight to safety, moving assets into "safe" investments, particularly the U.S. stock and bond markets. Hence, emerging market funds declined, while U.S. stocks rose and Treasury bond yields fell. This is a temporary situation. Emerging markets remain the brightest star on the investment horizon. They have the strongest balance sheets and the best long-term growth prospects. We remain committed to them as the most promising long-term investment currently available.

Every year or so, it is worthwhile taking a birds-eye view of the investment landscape. Included in this report are two graphs. The upper graph shows the historic PE ratio for the S&P 500 Index. The PE ratio is a simple and reliable way to judge the overall valuation of the stock market. Historically, this ratio has bounced up and down within a channel bounded by approximately 23 on the upside and 8 on the downside. Except for 1929 and 2000, when extreme market bubbles caused the ratio to temporarily break through the upper boundary, the ratio has generally been quite well-behaved, hitting one boundary then working its way back to the other boundary, before beginning the cycle again. For the past decade, after hitting an extreme value of 45 in 2000, the ratio has been working its way downward. However, the current value is 21, well above the average, and still almost at the upper boundary. The PE ratio needs to fall back to the lower boundary of about 8 before we can expect a true renewal of the bull market. A decline to 8 may not entail a devastating decline in the stock market. Rather, the market may simply go sideways (or decline more modestly) for several years, while earnings (the "E" in the PE ratio) slowly rise, thereby bringing the ratio down. For now, the stock market is not a promising place to invest.

The second graph displays historical long-term interest rates. After hitting an all time high in 1981, interest rates have been tracing a steady decline to generational lows today. At this point, rates have nowhere to go but back up. However, the Fed has stated explicitly that they intend to keep interest rates as low as possible for the foreseeable future. When rates finally do rise, bond values will be decimated. Traditional bonds are not a promising place to invest right now or in the coming years when rates finally begin to rise.

The RCM portfolio will continue its present course, emphasizing investments in foreign markets (especially emerging markets), yield sources other than traditional bonds, commodities, precious metals, and (recently) a real estate fund.

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Dr. Rollins has earned both the Chartered Financial Analyst® designation. 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.

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. Individual results may vary from the composite due to variations in portfolio size, and timing of deposits/ and/or withdrawals.
2. Portfolio composite returns represent an asset-weighted combination of fee-paying client accounts under management during the period specified, reported net of all withheld fees.
3. Annual portfolio composite returns and benchmark annual returns use a time-weighted calculation over the period specified.
4. Annualized portfolio composite returns and benchmark returns are calculated as the geometric mean of annual returns.
5. Portfolio and benchmark risk measures calculated using methodology provided by RiskGrades®.
6. Detailed disclosures available on request.

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