Falcon Financial Management, Inc.

May 5, 2011

Dear Friends,

I became a certified financial planner in November of 1990 and founded Falcon Financial Management, Inc. in January of 1994. During that time frame I have never seen such varied opinions on the outlook for the financial markets.

As one client recently said it's almost like Alice in Wonderland; it just keeps getting “curiouser” and “curiouser”.

There are always those who think everything is rosy and those who are glum. But today’s opinions are unusually diverse. Actually, I think a better word is skewed.

The majority of investment professionals are bullish on the prospects for both the economy and the financial markets, but some are extraordinarily bearish.

The stock market reached its bottom during the last bear market in March of 2009. In the two years since then we have seen one of the greatest bull market rallies of all time. Unfortunately, few investors have enjoyed those kinds of returns. Most investors have remained gun shy and nightly news hasn't helped.

The Federal Reserve Board is doing everything it can to keep the economy afloat after the financial crisis of 2008. And a good economy means good corporate profits. Stocks, of course, like that.

Short-term interest rates, which were as high as 5% in mid-2007, have now been virtually zero for over two years.

Short-term interest rates are not going to go below zero and the Fed is still worried that the economy needs a push. That has brought us into the bond-buying programs of QE1 and QE2 (if you aren't familiar with the acronym QE it stands for quantitative easing or in English the Fed buying bonds.)

QE2 may be the biggest driver of the market’s most recent rally. As in the past, nothing makes investors more bullish than the market going up. This phenomenon is what I would refer to as momentum. There is currently a lot of momentum in the stock market. When you couple that with the ISM index, which continues to suggest that we have an expanding economy, leads me to be cautiously bullish.

That being said, I still think 2011 is going to look much like 2010. I want to remind you that in late spring 2010 we saw the stock market retreat to around 9500. Today as I write this quarterly report letter to you the Dow is above 12,500. A modest 10% drop in the market will bring us to 11,000. A 20% correction will bring the Dow to 10,000. That said, I wouldn’t be surprised to see the Dow end the year over 13,000.

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The other side of the coin suggests that the Fed eventually will have to reverse course, start raising short-term interest rates and sell back the bonds it purchased. Slowing growth.

Additionally, the U.S. and other developed countries are awash in debt and are running such huge budget deficits that the only way out appears to be higher taxes and less Government spending. This will cause slower economic growth and corresponding slower growth in corporate earnings.

The Federal Reserve Board has found itself in a really difficult position. It can't lower short-term interest rates any more and every time it tries to lower longer-term rates, they go up instead of down.

Regardless, there is only one way for short-term rates to go and that is up. Eventually inflationary pressures will get to the point where the Fed has to raise them. And higher short-term interest rates will slow the economy, which is bad for profits, which is bad for stocks.

Furthermore, Standard & Poor's last week actually said it might lower the U.S. Government's debt rating sometime over the next two years, which would cause the interest payments on new Government debt to go up.

Bill Gross, the well-known Chief Investment Officer of PIMCO (one of our favorite managers here at FFM) is very concerned that the market will be not be able to handle the huge dollar amounts of U.S. Government bonds that will be coming to market.

So, what does all this mean?

One thing you may have noticed is that the bulls' case seems to be a short-term one. As long as the Fed keeps rates low and as long as the trend is up, there is less of a reason to fear a bear market.

On the other hand, from a longer-term perspective, things seem more bearish.

Eventually the Fed will have to raise short-term interest rates. The Government debt problem appears that it will keep getting worse over time, keeping the economy and corporate profits mired in a slow or no growth mode.

We still remain firmly planted in the preservation of capital camp. I believe that things will be better five years from now, and even better 10 years from now. That said, I still believe in the adage prepare for the worst and hope for the best.

One of the realities of this last decade, especially for the baby boomers, is that most of us don't have as much money as we expected to have at this point in our lives. That is going to mean that many of us are going to need to retire with less or we are going to have to work longer than we may have expected or some combination. As much as I want to participate in all of the gains in the stock market I believe we must approach our future investing cautiously. Pay off our debts, live within our means and save, save, save.

All in all the portfolios that we have constructed for our clients have performed as we expected.

If there's one thing I hope that we've learned from the last decade, it is that our investments need to be in sync with our goals and our ability to withstand the risk of the market along with the volatility that goes hand-in-hand with that risk.

If your goals have changed we need to reevaluate your portfolio and be sure that your investments are in sync with your goals.

The Scoreboard
(www.investmentadvisor.com)

	1stQ 2009	2ndQ 2009	3rdQ 2009	4thQ 2009	2009	1stQ 2010	2ndQ 2010	3rdQ 2010	4thQ 2010	2010	1stQ 2011
DJIA	-13.3%	11.0%	14.9%	7.4%	18.8%	4.1%	-10.0%	10.4%	7.3%	11.0%	7.1%
S&P 500	-11.7%	15.2%	15.0%	5.5%	23.5%	4.9%	-11.9%	10.8%	10.2%	12.8%	5.9%
NASDAQ	-3.1%	20.0%	15.6%	6.9%	43.9%	5.7%	-12.0%	12.3%	12.0%	16.9%	5.0%
LBAB	0.1%	2.2%	3.7%	0.2%	5.9%	1.8%	3.5%	2.5%	-1.3%	6.5%	0.4%

(Investors cannot invest directly in indexes)

I also want to invite all of you to join Chris and me on Saturday mornings at 8:30, where we will continue to be hosting Dollars and Sense on 97.3 FM. Our show is also available, if you are not in Gainesville via the Internet. So check us out on Saturday mornings. If you have questions or topics that you would like us to be discussing then please give Chris a phone call or drop him a line at Chris@ffmonline.com.

We are here to solve problems. It's what we do. Do not hesitate to let Darla or me know if there is anything you need from us. When we can assist, we will.

I also want to take this opportunity and ask you to remember us when friends and family are struggling with these same questions going forward.

Many folks are in retirement plans that don't offer them the kind of investment and planning advice that we provided for you. We have built this business on referrals, on the idea of working with a lot of people just like you. We appreciate you and would like to help those around you.

Thank you for your continued business

Best wishes,

Jeff Davis, CFP®
President

All economic and performance information is historical and not indicative of future results. All views expressed in this letter are those of Jeff Davis, CFP® and should not be construed as investment advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Additional risks are associated with international investing, such as currency fluctuations, political and economic stability, and differences in accounting standards