Stark Financial Advisers, Inc.

A Registered Investment Adviser

2nd Quarter 2010 Commentary

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Special points of interest:

- We End the Quarter with Above Average Cash Positions
- Emerging Markets Account for Over Half of PPP Adjusted Global GDP
- Yield Favored for Short-term Returns
- Why Invest in Exchange Traded Funds?
- The Impact of the Greek Financial Crisis

Inside this issue:

REITs Post Best Performance During Quarter

It was a roller-coaster quarter for most asset classes. U.S. stocks traded lower and than moved higher to fresh 52-week highs. The S&P 500 added about 4%. Real Estate Investment Trusts were the standouts. The iShares Cohen & Steers Realty Index gained over 9%. The quarter's strong performance took prices to levels not seen since 2008 but, still well below 2007 highs. Emerging market securities basically stalled in part due to the Greek financial crisis, a strengthening U.S. dollar, and less favorable relative valuations. The sector was about unchanged (MSCI Emerging Markets Index Fund, -0.7%). Developing market securities also peaked in 2007 and remain off their previous highs, yet remain the best performing sector overall. As a group, commodities peaked during January and were relative underperformers. A number of reasons contributed to the dulling of the group's shine, including; a stronger U.S. dollar and bearish agricultural prices. Crude oil posted the best relative performance, but ended below its 2008 high. Natural gas has yet to find a bottom posting a new 5-year low. During the quarter a number of securities hit our short-term price targets and were sold resulting in higher than average cash levels. Our short-term view is that a number of sectors are overbought and likely to experience a short-term correction. We expect to reduce cash during periods of short-term weakness. We expect yield to play a larger part in performance and plan to add securities currently paying, and likely to increase, their dividends.

Pros/Cons of Emerging Markets

2010 has been lackluster for emerging markets. The iShares MSCI Emerging Markets Index, has gained a modest 1%. There are a number of reasons for the pause. First, there is evidence that recovery momentum has stalled. Second, the US dollar has strengthened providing a headwind to emerging market equities. Third, as in the US, a number of the European, Middle-east and Asian banking sectors will continue to deleverage through 2010. One could also argue that global excess liquidity is contracting and EM funds appear to be fully deployed. This is being seen in the slowing of momentum of new funds into emerging market mutual funds. Finally, the elephant in the room has been a concern that China's growth may slow. As a result of these factors, EM earnings revisions momentum has turned negative and some analysts no longer find EM valuations compelling. Beyond the short-term factors. Emerging markets now account for over half of purchasing power parity adjusted global Gross Domestic Product and can now take over as the driver of growth as they are far less indebted. Generally, EM corporate, household and sovereign balance sheets are in much better shape than developed countries. Despite the recent slowdown, a rising pattern or consumption continues particularly in the Non-Japan Asia and Arabian markets. In addition expect a continued push toward equalization in healthcare, drug spending and living standards within the EM. As consumption expands there (Cont'd Pg 2)

Exchange-Traded Funds

We rely heavily on the use of Exchange-traded funds, "ETFs" in many of our accounts. Why is this? First, an ETF is an investment company that typically has an investment objective of striving to achieve a similar return as a particular market index. The ETF will either invest in all or a representative sample of the securities included in the index it is seeking to imitate. Typically, ETFs track stock indexes including the Standard Poor's, Dow Jones, Vanguard, Merrill Lynch, and Barclays. The oldest and biggest ETF tracks the S&P 500. It's called SPDRs, short for Standard & Poor's Depository Receipts. Innovative offerings in equities, fixed income, and emerging markets have made ETFs one the fastest-growing investment vehicles in the financial industry. Since 1995 (the birth of ETFs) through the end of 2009, the assets of ETFs have grown to over $800 billion. ETF funds also include fixed-income securities, commodities, and currencies and cover both domestic and international indices. In addition, they may be based on certain characteristics such as market capitalization or investment styles like growth, value and blend. ETFs can also be used to diversify across different sectors such as health care, technology, real estate, utilities, etc. ETFs are traded throughout the day on an exchange, like stocks. ETFs are subject to price fluctuations and can trade at a premium or discount to its net asset value (NAV). Typically, they are passively managed meaning, changes to the portfolio are the result of alterations in the underlying index. Investors incur brokerage commissions when buying or selling ETFs. In addition to trading costs, investors many sometimes pay managements fees. However, ETFs normally have lower expense ratios when compared to traditional mutual funds. Mutual fund strategies can be classified as either actively-managed (active), and passively-managed (passive). An active fund is a fund whose manager takes action by evaluating investments, buying securities that are expected to perform well in the future and selling the ones in the portfolio that are expected to perform poorly. A passive fund manager only attempts to replicate the underlying holdings of a benchmark (index) and does not add or remove from these holdings. Passive strategies are usually associated with ETFs. There are many studies that have tried to establish the advantages of one approach over the other. In most cases, active managers' attempts at beating the market end up falling short. Some extraordinarily-gifted managers can repeatedly produce above-market returns but, most do not. Investing in ETFs involves risk. The type of risks depends on the kinds of ETF investments chosen. While the benefits of diversification from ETFs may lower the downside risk of a single security it is important to understand that the value of an ETF may decline due to factors affecting the underlying index. Stocks tracked by an ETF are subject to the same risks as traditional equities. The market prices for ETFs fluctuate in the same manner as stocks on a daily basis. These fluctuations may be a result of economic conditions, investor sentiment, or security specific factors. Fixed-income ETFs are subject to fluctuations in the interest-rate environment. The prices of bond securities tend to rise with the decline of interest rates and vice versa. International ETFs are subject to risk of capital loss due to currency fluctuations and a country's economic factors. Currency exchange can affect the returns of a foreign security because foreign exchange rates constantly fluctuate with changes in the supply and demand of each country's currency. Thus, returns achieved by local investors are often quite different from the returns that U.S. investors achieve—even though both may be investing in the same security. Credit risk arises from the uncertainty in a counterparty's ability to meet its obligations. For example, the value and ability of ETF funds to pay dividends may be compromised if the issuer is unable to make payments of principal and interest. We incorporate ETFs into our investment strategy because of the many pros associated with them. By buying a single unit of an ETF, we can obtain exposure to all the securities that make up the index. This is known as passive diversification. ETFs also reflect the performance of different sectors in the market, which can enhance the diversification benefits. Since ETFs trade like stocks, their prices can change every minute and new prices are available during trading hours. In contrast, mutual funds are priced once a day. ETFs are also tax efficient. Unlike traditional mutual funds, ETFs are not obligated to distribute realized capital gains on an annual basis. ETFs also reduce "cash drag". Cash drag is the return lost when an open-end fund manager has to keep cash on hand or sell assets to redeem shares. ETFs do not need to hold cash in anticipation of redemptions. ETFs also save on brokerage costs since it is not necessary to invest in numerous securities to obtain the diversification offered by one ETF security. In the end, investment success still depends on how assets within an account are allocated and the proper selection of ETFs (or other securities) within a market sector.

"ETFs are a fast-growing investment vehicle with assets exceeding $800 billion"

The Pros/Cons of Emerging Markets (Cont'd. from Pg .

remains room for productivity increases. Also, improved political stability with trends moving towards democratization and the adoption of the rule of law will likely reduce the risk premiums generally applied to EM securities. There remains significant potential for the broadening out in EM equity and debit markets as foreign partners offer strategic stakes and local investment restrictions are gradually removed. Finally, opposite of many developed countries, whose currencies are at risk of devaluation, there is significant scope for upward revaluation of EM currencies. For moderate growth investors we remain about 18% allocated to this sector.

Economic Reality and Stock Strategy

With the health-care drama fading, Congress can turn its attention to employment. During late March, the Senate past the first in what is likely to be a series of jobs bills. A key provision of the bill are temporary tax breaks for employers who hire the long-term unemployed. Despite Congress' efforts, unemployment is likely to remain elevated. With this being the case, monetary policy is likely to remain accommodative for an extended period. This expectation has been reinforced by the Federal Open Market Committee (the policy-setting panel) following its March meeting. The committee, "continues to anticipate that economic conditions, including low rates of resource utilization, subdued inflation trends, and stable inflation expectations are likely to warrant exceptionally low levels of the federal funds rate for an extended period." The implication is that the "extended period" would mean keeping the fed-funds rate near-zero (0-0.25%) for another six-to-nine months. By most standards even if the central bank raised the rate to 0.5%, or even 1% it would still qualify as "exceptionally low." Due to the severity of this economic downturn which has resulted in a 6.1% drop in payrolls, more than twice the decline of any recession in the past 60 years and the large amount of slack in the economy the ultra-low level of rates could extend well beyond the conventional wisdom. Since the potential remains for a further decline in core inflation to 1% these downside inflation surprises could serve to keep the FOMC on hold. Despite the slack in the economy. stocks have been bid up rapidly, which could be viewed an apparent contradiction. Since rising stock prices depend upon rising earnings, will economic progress be strong enough to support the current rise in stock prices and be able to fuel further advances? How does a stock investor handle this dilemma? We know 2009 produced a strong recovery for the majority of US corporations. Many corporations entered 2010 on a solid financial footing with strong balance sheets. However, the growth prospects in 2010 are not stellar. In this environment we expect that US corporations will increasingly allocate cash flow to dividends and share repurchases. It is also likely that Merger and Acquisition activity will increase. We believe that an increasing percentage of stock returns in the near-term will come from yield rather than price appreciation. If we are right this is the time to focus on companies with a payout ratio that is low enough to suggest an increase and with a long-term growth rate above the consensus.

"Short-term stock returns more likely to come from yield not price appreciation"

The Impact of the Greek Fiscal Crisis

During February the Greek debt and fiscal crisis dominated the markets and triggered a steep drop in domestic stock prices. Since then the crisis has moved off the front page and U.S. stock prices have rebounded. The trigger for the event was an announcement by the Greek government that the country was having trouble meeting its sovereign debt obligations. Most Southern European developed markets traded off on the news and remain lower. There has been less of an impact on Northern European markets. Greece however, was down 19% in local terms at the end of February. Other markets in Southern Europe suffered a similar performance. The most impacted were Spain and Portugal countries that are perceived to have similar debt issues. Despite the Greek situation, the outlook for developed international markets remains fairly strong in the long-run. What has happened is that uncertainty around the shorter-term economic outlook has increased. Since February, there has been a growing optimism that the rest of the European Union is going to step in and alleviate some of the pain related to Greece. This is far from certain since there is a strong, "fix it yourself" bias among many Europeans. As for Greece, taxes are likely to rise and more and more austerity measures are likely to be introduced causing a slowing of economic growth. The weakening in Greek equity markets is a reflection of these expectations. If you believe the rest of the European Union will step in and assist Greece, there could be significant upside in sovereign debt and equities. For the moment we are an interested observer. Within Europe some of the Euro-zone countries are looking more attractive, particularly the Scandinavian countries. In local currencies, these countries are positive year-to-date. Generally their economic outlook is a lot stronger than some of those in Southern Europe so they have not being tarred with the same negativism. The more conservative approach is to focus on Northern Europe where there is more certainty about the outlook.

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"Helping Clients Balance Risk and Return"

WE ARE ON THE WEB

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We also understand the relationship between risk and return and seek to reduce risk through targeted asset allocation among numerous asset classes. Each asset class has separate and distinct characteristics, including returns and risk that can be measured over time. While all classes are cyclical, they often trend in different directions. Two portfolios, each having similar return prospects, may have substantially different short-term risk characteristics. Clearly, the lower risk portfolio would be the choice of most investors.

Of course, all investments contain risk and there is no guaranty of positive returns; losses can occur. For additional information and a complete performance history, please visit www.starkadvisers.com.

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