

Dear Ladies & Gentlemen,

A New Format is Introduced...let us know what you think of it!! Thanks for your patience!

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January certainly helped us get the year off to a good start, with market volatility settling well into the normal range. We sure hope the first month of the year started off just as well for you! We know Jan sure flew by....where *did* that month go?

First, after a long hiatus, with this, the first Investment Update of the New Year, a new format is introduced. A summary of changes:

1. **Narrative Summary.** The narrative summary of the week past and week ahead will be right here starting on page 1, column 1.
2. **Topic of the Week.** Starting on page 1 in the right column (page 1, column 2) each week an educational article will be featured.

continued on page 2

Topic of the Week

*This section will feature an educational article on timely subjects! You can request a specific subject be covered; in fact we **prefer** to hear from you regarding the topics covered herein.*

*Expect to see educational articles on, **among others:***

1. *specific vitally important economic indicators;*
2. *leading, lagging, & coincident indicators;*
3. *investing in specific regions of the world;*
4. *geopolitics as it applies to investment risk or opportunity;*
5. *domestic politics & political risk (legislation/regulation) as it applies to investments;*
6. *debt/bond markets both aggregate and by sector;*
7. *precious metals;*
8. *real estate both aggregate and by sector;*
9. *equity sectors and sector weighting;*
10. **and this week, tactical vs. strategic asset allocation**

continued on page 3

INDEX & ASSET SUMMARY (WEEK OF 1/30 -1/3)

Index	Weekly Change	Week	YTD	Note
S&P 500	+28.5 @ 1,344.9	+2.17%	+6.9%	Decent economic data & calming Eurozone debt crisis
DJIA	+201.7 @ 12,862.2	+1.59%	+5.3%	Ditto
WTI Oil	-\$1.76 @ \$97.80/Bbl	-1.7%	-1.0%	Robust supply & gasoline demand down 7% Y/Y
Gold	-\$6.80 @ \$1,728.6/oz	-0.4%	+10.3%	Bounce off fall correction + Global liquidity = inflation?
10yr Treasury Yld	+3bps @ 1.92%	+1.6%	+2.0%	Still strong due to Fed intervention, but jumped 10bps Friday
US Dollar (DXY)	+0.10 @ 78.94	NM	-1.5%	US\$ strength due to better economic data than Euro/Japan
VIX (Volatility)	-1.43 @ 17.10	-7.7%	-26.9%	US markets a "safe haven" + Eurozone debt crisis calmer
Italian 10yr Bonds	-20bps @ 5.672%	-3.4%	-17.8%	Perception growing that debt crisis may be resolved

continued from page 1

3. **Index & Asset Weekly Summary.** An executive summary is introduced at the bottom of page 1, covering the major asset classes with a single line summary or note. In short, if you have better things to do with your time than read this 3-4 page Investment Update, but feel compelled to keep abreast, the goal is to provide a snapshot of investment asset weekly performance that can be read in less than a minute.
4. **Data Tables.** The domestic economic data tables are moved to the back on a single page so that readers can scan the economic data at a glance. This, we hope, will help the flow of information in the narrative sections.
5. **Asset Allocations.** Here is where things get a little sticky, so we'll see how this goes. Anytime an advisor puts a **strategic** or **tactical** (I cover the difference in the Topic of the Week section) asset allocation in print, anyone can take it as a recommendation when in fact **they are nothing of the sort. Why aren't they recommendations?** Easy, since each of you have so many different factors that combine to yield different solutions to the asset allocation question. Life goals, financial goals, assets available, income, tax sensitivity, debt, age, experience, and risk tolerance are some of the major ones. **So why print asset allocations? Three reasons:**
 - a. **To give readers a look at baseline (aka "strategic") asset allocations versus tactical allocations for three different risk tolerance/volatility levels.**
 - b. **To give readers a sense of *changes* to asset allocations in response to tactical and strategic opportunities/threats.** Most weeks there will be no change to the tables, but when the situation warrants a shift to more or less risk, or a shift from one asset to another, those will be highlighted.
 - c. **Outside Assets.** Upon changes to the asset allocation tables, especially changes that are significant ($\geq 20\%$), **outside assets like 401k accounts may be considered for reallocation as well. In short, a change to our allocation table may help remind you that an account elsewhere warrants attention. Of course, we're honored to assist you with those decisions even though the accounts are elsewhere.**
6. **Calendar of Events.** Getting our monthly investor information meetings going this month is a high priority for us, so we'll dedicate a small section to page four so you know what's scheduled and when.
7. **That's it for the changes!** Jumping right into a quick

summary of the markets and economy:

Hot Last Week

The past five weeks have exhibited a trend of improving economic data capped off by Friday's **Jobs Report** that blew away the estimates. In fact, Friday provided a one-two punch to the bears.

The Jobs Report was first up, with 243,000 new jobs reported compared to the 135,000 estimate. Across the board, the report looked pretty solid with the Unemployment Rate dropping to 8.3%, and hourly earnings and the average workweek up as well.

The ISM Non-Manufacturing (Service Sector) Index jumped from 53.0 to 56.8 in January, while the estimate was for only a small increase to 53.3. As the service sector accounts for ~65% of our economy, the jump provided the second punch.

The Factory Orders Report Friday may be lagged data covering December, but its 1.1% gain on top of the November 2.2% gain was icing on the cake. The Durable Goods component was +3.0%, while Non-Durables were -0.4% due to lower (in Dec) gasoline prices.

Earlier last week, higher Personal Income (+0.5%) in December and a **jump in Auto Sales** to 14.2 million units in January both surprised analysts. **With worries about the strength of consumer spending, it was also surprising to see Chain Store Sales at +4.2% vs. the estimated +2.0%.**

Lest you think me glossing over the ugly data, last Tuesday's Case-Shiller Home Prices Report (November data) was just that – ugly, at -3.7% Y/Y with 19 out of 20 metro areas negative. I've covered numerous times how badly lagged this data is...November data is the average of September through November escrows, which means most of the contracts were signed July – Sep....a tough period for the economy. We'll see...

Hot This Week

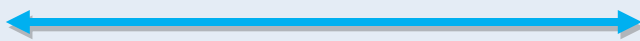
There isn't a single significant economic report until this Friday's **Consumer Sentiment** report. **Unless something happens in Europe** or the Middle East this week, **Corporate Earnings** reports will carry the week.

-End of Weekly Summary-

STRATEGIC-BASELINE

ASSET ALLOCATIONS

	II	IV	VI
CASH	10%	5%	0%
EQUITY	30%	45%	70%
DEBT	55%	40%	20%
PRECIOUS METALS	0%	5%	5%
REAL ESTATE	5%	5%	5%
ALTERNATIVE INVESTMENTS	0%	0%	0%



TACTICAL

ASSET ALLOCATIONS

	II	IV	VI
CASH	15%	5%	0%
EQUITY	35%	50%	75%
DEBT	42%	35%	10%
PRECIOUS METALS	0%	0%	5%
REAL ESTATE	8%	10%	10%
ALTERNATIVE INVESTMENTS	0%	0%	0%

CHANGES ARE HIGHLIGHTED:

RED = ↓ IN % & GREEN = ↑ IN %

CALENDAR OF EVENTS

INVESTMENT SEMINAR

PLACE: LCA OFFICE @ 29995 TECHNOLOGY DR, SUITE 100
MURRIETA, CALIFORNIA 92563

DATE & TIME: THURSDAY, 23 FEBRUARY @ 2:00PM OR
THURSDAY, 23 FEBRUARY @ 6:30PM

Topic(s): Global Economic Update & 2012 Outlook

Please RSVP to Maria @ 951-290-5020 if you plan to attend!

Topic of the Week: Asset Allocation

So what in world are you to make of those tables to the left? Here is a brief summary with more to follow in future "Topics" columns:

The left column covers the five main assets, leaving only the "international" component that some allocators divide out.

1. **Cash.** Cash seem pretty straightforward, but don't forget that the category includes any debt that matures in less than one year (even if that bond is one you've had for 20 years, in the last year before maturity it's considered "cash.")
2. **Equity.** Generally, **where it says "equity"** think "stocks" since that's what they are...equity "ownership" in a very, very small piece of a publicly listed company.
3. **Debt.** **Where it says "debt"** think bonds & preferred stocks, since those pieces of paper (the "bond") are really IOU's for the "loan" investors make to the company in return for (currently paltry) interest payments.
4. **Precious Metals** are divided out from the Materials Sector of the equity market since the dynamics affecting their value are so different from copper, aluminum, steel, etc., in the Materials Sector.
5. **Real Estate** as a part of *liquid* investment portfolio is separated, rather than grouping it in the Financial Sector of the equity market like so many firms do. Why divide out Real Estate Investment Trusts? Just look at REITs as a group last year (exceptional year) compared to the Financial Sector (terrible year). Again, the dynamics are significantly different and therefore warrant consideration as a separate asset.
6. **Alternative Investments.** It is popular these days is to list "Alternative Investments" or "AI" as a separate asset class. Often grouped into AI are Hedge Funds, Private Equity Funds, Precious Metals, Managed Futures, and other derivative-based strategies. ***I offer just a few bullets on AI with more to follow in future weeks:***

continued from page 3

- a. I'm generally a skeptic on AI where it applies to these opaque strategies promising uncorrelated returns.
- b. **What we do know:** At the extreme, almost *everything is highly correlated*. In 2008 when the financial world as we knew it was ending, there were very, very few strategies that survived the onslaught. It became fanciful to boast of ever-increasing allocations to AI during the early-mid part of the last decade. University endowment funds, typically bastions of conservative allocations, loaded up on them along with many Wall Street firms recommending them to their more well-healed clients. AI failed to "save" the university endowment portfolios during '08 – '09; rather, in many instances, it exacerbated the declines.
- c. **Liquidity.** Liquidity is, simply, the ability to buy/sell an asset/investment quickly at a fair price. Anyone who has tried to sell a home or condo quickly the past few years is painfully aware of real estate's lack of liquidity. On the other hand, regardless whether it is 100 or 100,000 shares of General Electric stock, during market hours it can be sold in minutes with little movement in its price. In many Alternative Investments, the liquidity of investor funds is very, very restricted.
- d. **So why even list AI as an "asset class?"** There may be occasions when it is both appropriate and prudent to hedge your portfolios or a specific asset class via some type of AI; therefore, we'll show the allocation at zero percent until such occasions arise.

Volatility and Investor Goals. Across the top row of the tables on Page 3 you find the Roman Numerals II, IV, and VI. They correspond to three very different levels of risk/volatility (II = Conservative, IV = Moderate, and VI = Aggressive) and/or different financial goals (I = Income, IV = Growth & Income, VI = Growth).

Other Models. While the tables only cover three different allocation models, there are others. A Roman Numeral I indicates "Capital Preservation" (just don't lose my money...but try to keep up with inflation), while numeral VII is associated with "Aggressive Growth" and 100% equity portfolios.

Strategic vs. Tactical Asset Allocation. Two tables are published on page 3.

1. **Strategic.** The Strategic allocations are what you'll find in most static, aka "passive" portfolio solutions. Generally, they are *not intended to account for short to intermediate term risks to specific asset classes*.
 - a. To be fair, they *have been proven to be appropriate over very long periods of time (20+ years)*.
 - b. Once an investor matches financial status and goals with risk tolerance and decides, along with his/her consultant, on a strategic model, then passive investors & managers may merely rebalance the portfolio back to those percentages once a year.
2. **Tactical.** Tactical Allocations are adjustments when situations arise that will clearly favor one asset over another for a limited period of time, typically 1-3 years.
 - a. For example, with bonds very expensive and their yields very low right now, it may be prudent to "underweight" or lower the allocation to bonds from the Strategic allocation and "overweight" or raise the allocation to either cash or conservative, dividend-paying equity.
 - b. Historically, cash has been a reasonable safe haven to "park" funds given long-term historical yields on cash ~4%; however, it's getting harder to remember the last time we could find a 4%, one-year CD! Given non-existent yields on cash and high headline inflation (food/fuel/healthcare/education costs), it can be a costly proposition to be overweight cash for too long.
 - c. On the other hand, given dramatic equity market volatility over the past three years, to many investors being overweight cash seems like *the most prudent* course of action.

In summary, Tactical Asset Allocations imply some ability to time the cycles in various assets rather than passively rebalancing portfolios back to a static Strategic allocation on a routine basis.

We hope you find the tables useful! Please do forward your questions and recommendations!

TECH GEEK CORNER



SUMMARY OF TECHNICAL ANALYSIS

Trend: **Bullish.** Recent rally caused 50dma (red) to cross up through the 200dma on January 31st. This chart pattern is affectionately known as a “Golden Cross”
<http://www.forbes.com/sites/greatspeculations/2012/01/31/the-spy-and-the-golden-cross>

Resistance: 1,350 – 1,370 (29 Apr – 2 May 2011 high)

Support: 1,300 provides minimal psychological support, then 1,270 – 1,285 (50dma at 1,272)

Volume: **Bearish.** 50 day trailing average volume down 9% since 3 January!

Summary: Penetrating the upside resistance level @ 1,370 will most likely bring both institutional and retail investors more enthusiastically back to the markets. With declining volume, concerns mount regarding the market’s ability to push through. So the market is caught between a rock and a hard place right now. Volume may be too low to make the push through 1,370, but volume will not pick up until it does. Nonetheless, the market’s resilience since the beginning of the year, well-founded based on improving economic fundamentals and relatively inexpensive equity valuations, has shown no weakness other than the volume variable.

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