FBB capital partners

April 6, 2012

Dear Clients and Friends,

"Trouble ahead, trouble behind
And you know that notion just crossed my mind"
~ The Grateful Dead, *Casey Jones*

My wife and I went shopping for tile recently, as our bathroom shower is falling apart and we need to have some repair work done. Though our house is a mere twenty years old, the grout is chipping in random places and the tiles are popping – quite literally – off the shower wall. The shopping experience was less than pleasurable, as each store we visited was jammed with other shoppers (did we all have the same builder?) and finding an available salesperson was as challenging as getting a good parking spot on Bethesda Row at lunchtime.

But here's what we've learned in our porcelain pursuits: business is good right now for the tile shops and the installers. Indeed, business is apparently booming, as one contractor confided to us that he just had his best quarter ever in his three decades in the business. And, as we see in the shares of the DIY home improvement retailers and paint companies, business is vigorous there too.

Indeed, **earnings reports have been robust** in most consumer-related areas, especially among higher-end companies. With consumer spending accounting for around 70% of US GDP, overall corporate earnings for S&P 500 companies have hit an all-time high, helping propel the stock market off the lows set last Fall when the Greek debt crisis was boiling on the front burner. That became "trouble behind" when the Europeans opened the monetary spigot via their Long-Term Refinancing Operations (LTRO, analogous to our own TARP, TALF, PPIP and various other programs that showered banks with capital during the US credit crisis.) Further supporting stocks over the past six months were the friendly Fed, which maintained its promise to keep rates low for a long long time, and surprising strength in US payroll figures (never mind the fuzzy math used to calculate the official unemployment rate.)

Stocks finished last quarter at the upper end of our "fair value" zone, which we base on price/earnings multiples of 12.5 to 14 times projected operating estimates. This is below the historical post-recession P/E range, as we continue to believe **overall growth will be slower** than it has been historically. Note that in the fourth quarter of 2011 we saw the first sequential *decline* in US corporate profits since the end of 2008, and while we expect earnings to tick higher as the first quarter 2012 results are unveiled in the coming weeks, the pace of earnings growth will likely be the slowest it has been in recent years. So, while the absolute level of earnings is remarkably high, the relatively low growth rate does not warrant a higher P/E, in our opinion.

"Switchman's sleeping, train hundred and two is
On the wrong track and headed for you."

Even if earnings remain strong, a number of **economic yellow flags** are being waved. As we saw last week, the employment situation may have gone off track in March, as payroll growth was well below expectations. We'll have to wait for the April report to see if this was a one-time bump or the start of a trend. Meantime, our latest, greatest monetary stimulus program, popularly known in the economics community as "Operation Twist," comes

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to an end *this coming June*, and the friendly Fed will likely be a little more aloof after that - unless the economy really takes a turn for the worse. Couple that with political posturing tied to the upcoming Presidential election and the debate surrounding the Bush-era tax cuts that expire this year, and there is plenty to be concerned about for the rest of the 2012. These are among the reasons **we do not expect US interest rates to move materially higher** any time soon.

There are global worries, too. The Shanghai stock market has been especially weak this year as China's debt-fueled real estate bubble gets pricked. The Iranian / North Korean / Syrian situations could escalate at any moment. And perhaps most important, **the European credit crunch is back in the headlines, with Spain replacing Greece as the trouble spot *du jour*.** Note the substantial rise in Spanish bond yields since last month – from 4.8% to almost 6% on their 10-year government bond – coincident with the global stock market sell-off so far in early April. As Spain is one of the larger Euro-zone countries, a credit default there would likely have much greater impact than Greece's did. What we think is most likely to happen is an LTRO-II, and maybe an LTRO-III, or whatever it takes for Europe to bail out the Europeans. But there will be much wringing of hands and gnashing of teeth along the way.

With these and several other factors in mind, and especially following the stock market rally that started early last October and continued through March, **we would expect at least a moderate "correction" or pullback in stocks in the near term,** possibly toward the middle of our fair value range. The key factor is how the macro-economic news affects *future* corporate earnings, and we will be monitoring each situation closely to see if further deterioration becomes likely. For now we expect volatility to stay elevated as the markets chug along over bumpier tracks.

As always, we thank you for your continued trust in our investment team. We greatly appreciate having you as clients, and we would be honored to work with your friends, relatives or associates who may benefit from our services.

Sincerely yours,

Mitch Schlesinger
FBB Capital Partners

P.S. A quick note from our Compliance Department:

FBB Capital Partners is required to provide you with any material changes to our Form ADV2, which is filed annually with the Securities and Exchange Commission. FBB Capital Partners had no material changes to its ADV2 filed March 27, 2012. You were provided with a full copy of our filing in 2011. You may request a copy of the 2012 ADV2 by emailing info@fbbcap.com or calling 301-657-8870.