FBB capital partners

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Dear Clients and Friends,

"All we want are the facts, ma'am."
~ Jack Webb's 'Sgt. Joe Friday' on *Dragnet*

Stocks around the globe tumbled in the 3rd quarter of 2011, with the S&P 500 index off 14%, its worst showing since the subprime credit crisis in 2008. China's Shanghai exchange was down a similar percentage, while equities in Germany, France, and most other nations fared worse, some off 25% in the same period. Among developed markets, only Japan outperformed the US, as Japanese industry benefitted from post-tsunami rebuilding efforts.

The utilities and consumer staples segments held up best, thanks in large part to their higher than average dividend yields, as well as their relatively stable earnings power. Energy stocks were poor performers as commodities sold off worldwide, but again the yield-heavy pipeline segment held its own.

The main cause of the stock market's consternation has been Europe's inability to come up with something even remotely resembling a plan for resolving its credit, liquidity, currency and political crises. The in-fighting in the so-called 'union' has been remarkable. The EU wants the ECB to backstop the stability fund, while the ECB says no ECB funds will be used. The Fins want more collateral from the Greeks. The Germans want bank bailouts as a last resort, while the French want them *tout de suite*. And with the 17 member nations each holding veto power over any major deal, it is no wonder so little has been accomplished thus far. But, we remain hopeful that a new agreement – announced by Germany's Merkel and France's Sarkozy on the day of this writing – will lead to a credible European plan by the end of this month.

A slew of inconsistent economic data added to the stock markets' troubles, as did the taming of GDP forecasts by much of Wall Street. Recall earlier in the year we suggested the Street was being far too optimistic in its expectations, and that a 'slow-and-low' recovery was the more likely outcome. The Street's forecasts now reflect the slower-than-typical recovery scenario. But surprisingly, recent readings of the leading economic indicators, rail car loads, jobless claims, purchasing managers' reports, corporate earnings and car sales are all consistent with expansion, not recession at this time. Europe is a wildcard that could tip us over should a global banking crisis erupt, but for now the data remain solid.

Fixed Income investments performed quite well in the third quarter. You may recall there was a bit of a ruckus during the quarter when US politicians threatened to default on US debt obligations (they didn't) and the credit rating firm Standard & Poor's threatened to downgrade the US from its long-standing AAA rating (they did.) What happened after that was one of the biggest rallies in the history of US Treasury bonds, with longer bond yields hitting all-time lows. Corporate bonds showed modest gains, and even "junk" bonds – those with credit ratings below 'investment grade' - outperformed stocks.

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Europe's problems were again the driver for bonds, as global investors sought out the safest investment vehicle in the world – US debt. So much for the rating downgrade! Adding to the upside for bonds (downside for yields) was our own Federal Reserve, which first made the unprecedented announcement that it may not raise short-term rates for another two years, and which followed up the end of QE2 with a new program, dubbed "Operation Twist," designed to bring long-term rates even lower than they had been. The desired effect seems to have been achieved, even as the program has only recently begun.

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It wasn't too long ago that investing was like detective work – snooping around companies, analyzing cash flows under our magnifying glass, questioning management's motives for their latest deals. Nowadays it seems we as an industry are spending far too much time evaluating political situations, and guesstimating the economic impact of sometimes bizarre political decisions. Experience shows it rarely pays to bet on catastrophe, yet politicians seem almost to thrive on it!

But the takeaway for the quarter is that **asset allocation and diversification still work,** even with all the political noise impacting the markets. Much had been written about the demise of diversification in 2008, when the financial crisis spread havoc across the entire investment landscape. We believe that was a rare occurrence, as the recent quarter suggests. We further believe our clients will continue to be well served by a diversified investment program, coupled with routine rebalancing of portfolios when asset classes move in and out of favor. Such an opportunity may be approaching, as a viable European restructuring plan – if indeed one emerges – should mitigate many of the risk factors now facing the investment markets.

"Just one more thing."
~ Peter Falk as *Columbo*

If you haven't been able to listen to our "live" quarterly conference calls, be sure to listen to the latest recording on our web site, fbbcapitalpartners.com. We try to have them up within three business days of the call, so the latest should be up by the time you receive this letter.

As always, we thank you for your continued trust in our investment team.

Sincerely yours,

Mitch Schlesinger
FBB Capital Partners