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KARAGOSIAN FINANCIAL SERVICES, INC.

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MARKET AND ECONOMIC OUTLOOK

STOCK MARKET

Most major U.S. stock market indices declined in the second quarter. The exception was the Dow Jones Industrial Average which managed to gain 0.8% last quarter but was still down 3% from its three year closing high on April 29th. Driven higher by stock fund inflows during the first four months of the year ($18 billion), U.S. equities climbed in the beginning of the second quarter. However, the market began to unravel in early May, and investors withdrew $26 billion from stock funds the following eight weeks. The market gains in April helped to keep quarterly performance returns bearable, with the S & P 500 Index posting a second quarter decline of 0.4% and the Nasdaq Composite declining only 0.3%.

With the end of the Federal Reserve's quantitative easing (QE2) program on June 30th, the market will now be turning towards corporate earnings to lead the way. This year's second quarter is the tenth quarter of the current corporate U.S. profit expansion. The average duration of profit expansions post WWII is 14 quarters. This average belies great disparity among the lengths of previous expansions which ranged from 4 to 32 quarters. Hope for continuing corporate earnings growth and its market implications lies with U.S. economic growth.

Industry groups considered more "defensive" did well last quarter relative to the overall market. In general these companies have higher dividend yields and healthy balance sheets. Health care, consumer staple and utility stocks were the choice of investors looking for relative safety. Due to the fact that these stocks correlate less with the stock market, they are considered "low beta" stocks and typically do not perform as well when the stock market is rising. Conversely, stocks of companies considered more economically sensitive were some of the worst performing sectors in the second quarter. Included in this group are energy, financial and commodity based companies.

In contrast to the mediocre performance by the U.S. stock market in the second quarter, some European markets prospered. Both Germany and economically troubled Ireland returned mid single digit percentage gains in U.S. dollar terms, partially due to strength in the Euro but they also had decent returns when measured in the local currency. However, investors in China are worried about slowing growth deliberately induced by the Chinese government in order to ward off high inflation. The Chinese government has raised loan and deposit rates as well as raised the reserve-requirement ratio for local banks in an effort to cool down their economy. This in turn put a damper on equity investors' enthusiasm as the Chinese stock market declined over 5% in the last quarter. Another poor stock market performance was recorded again not surprisingly by Greece. Commodity sensitive Brazil and Canada also saw their stock markets decline by over 5% last quarter.

BOND MARKET

The bond market posted positive returns in the second quarter as investors preferred the relative safety and stability of bonds over stocks resulting in large inflows of cash into bond funds. What was cause for concern for the equity markets proved to be a positive for the bond markets as the Barclays Capital Aggregate Bond Index had a total return of 2.3% for the quarter amidst worries of a slowing economy and the European debt crisis. U.S. Treasuries, typically considered the ultimate safe haven, experienced price increases in the last quarter (therefore yields declined). Three Month Treasury bills now basically have no yield, 0.01%, and Six Month Treasuries yields have also continued to decline from starting the year at a miserly 0.19%, are now at 0.06%. Longer term Treasury prices also fared well in the second quarter as a Ten Year Treasury yield which was at 3.47% at the end of the first quarter ended the second quarter at 3.16%. However, with the conclusion of the Federal Reserve's huge $600 billion Treasury buyback program on June 30th, it may be difficult for rates to stay so low.

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MARKET AND ECONOMIC OUTLOOK *(CONTINUED)*

In addition to the rally in Treasuries, investment grade corporate and municipal bonds also gained in the second quarter. Municipal bonds surprised many with having their best quarter in two years, with an aggregate total return of 4.45%, partially attributed to a lack of new supply which has been noted to be at an eleven year low. Also, second quarter municipal bond defaults were a lot less than this time last year, with a value of only $403 million versus second quarter 2010 level of $1.7 billion.

With interest rates so low, corporate bond issuance remains high, as even companies who do not need to raise cash believe now is a good time to do so. Google had its first bond issuance ever last quarter, borrowing $3 billion adding to its massive cash position. Texas Instruments' bond issuance was its first one in over ten years. Even with the new supply, corporate bonds in general had total returns of over 2.2% for the second quarter. Forty two percent of corporate and sovereign issuers had ratings of BBB- or lower in the second quarter. Investors are still willing to trade risk for higher returns and issuers are taking advantage of the low interest rate environment.

MARKET OUTLOOK

The lull in the stock market during the second quarter was not a surprise to us. Old fears re-emerged, such as the financial condition of Greece and continued weakness in the housing market, and was spurred on by negativity from Fed chairman Ben Bernanke. The consensus from economists is for GDP growth of about 2.6% for 2011, but we are still a bit more optimistic and think GDP growth of 3% is possible. There are still many signs that indicate that the economy is pointed in the right direction. The ISM manufacturing and non-manufacturing indices for June continued to show expansion and May's Industrial Production and Capacity Utilization numbers held steady.

We think that there will be further improvement in 3Q for the following reasons. 1) The first half of the year experienced unprecedented natural disasters throughout the world which disrupted many businesses and the negative repercussions should abate. 2) U.S. companies remain flush with cash with the top 1,500 companies in the country holding over $1 trillion in cash which should lead to increased mergers and acquisitions (M&A) and reinvestment. This should further boost market returns. 3) Oil has dropped well below $100 a barrel, along with other commodities which should give consumers more spending capacity while lowering input costs for manufacturers.

We observe a dichotomy in the stock market currently going on that concerns us. A new internet craze has emerged, in our opinion, with the IPOs (Initial Public Offering) of a number of internet companies. Many of these companies trade at very high multiples compared to their sales and many do not even turn a profit. Aggressive investors might argue that they are paying for large future profits, but history tells us that investors often over-estimate future potential. No doubt, these companies are changing our everyday world and economy, but our argument is focused more on their current valuation. For instance, two of the companies we are referring to are trading at over 9x and 30x times their sales, respectively. Anecdotally, most companies traditionally trade between .5x and 2x sales. Our problem with the future profits argument is that these companies are not that new. Many of these so-called new age companies are nearly 10 years old yet profitability continues to elude them, probably due to high overhead and reinvestment costs. To conclude, we think that some of these new IPOs will make people money, but eventually the majority of the companies in this space will likely end poorly for investors.

Similar to the late 1990s time period, there are a number of proven companies that currently trade at fairly low multiples of earnings. As a whole, at the end of June, the average P/E ratio for the S&P 500 was 15.8, lower than the 60-year average of 16.3. Also, with bond interest rates at historic lows, equities seem like the much better value, albeit with much greater volatility. Therefore, we remain bullish on the equity markets.

For the remainder of the year we expect negative news about the housing market, sovereign debt, and political unrest worldwide to cause volatility but these issues will likely persist for years. More important to us are whether there will be improvement among these issues, as much of the bad press is already priced into most securities. It is our opinion that we will continue to see greater corporate profits in the future which will ultimately determine the value of these stocks.