



PORTFOLIO REPORT
1ST QUARTER 2011
APRIL 15, 2010

PORTFOLIO UPDATE

For the first quarter of 2011, the RCM portfolio rose 2.7% (net of all fees). While this is less than the U.S. stock market, which rose 6.4%, our portfolio is underweighted in U.S. stocks right now, so we can't expect to keep pace with a rapidly rising market. The stock market is floating on a cushion of loose money and deserves to be underweighted. We'll get back in the market, after it corrects. The portfolio risk index measures a conservative 82 (compared to the broader market, defined as 100).

COMMENTARY

This quarterly letter is delayed by a week in order to provide you a timelier update on recent changes to the portfolio. Last week, a number of security trades were completed to better position us for the coming months. Specifically, several bond funds were sold and other funds with better exposure to international currency trends were added.

Interest rates are likely to rise in coming months, resulting in an environment where fixed-coupon bonds (in particular government bonds) will fall in value. Now is not the time to be a bond owner. Indeed, Bill Gross, the so-called "bond king" and manager of the world's largest bond fund (PIMCO Total Return), announced in March that he has liquidated ALL of his holdings in government bonds.

As you know, our government is increasingly in debt. It borrows by having the Treasury Department sell bonds. Foreign investors purchase about 30% of our Treasury bonds. Since late last summer, the other 70% of Treasury bonds have been purchased by the Federal Reserve Bank as part of its "quantitative easing" (QE2) program. Where does the Fed get the money to buy the bonds? It prints it. However, this coming June, the QE2 is scheduled to end. What happens when the buyer of 70% of Treasury bonds stops buying? Bond prices will fall and interest rates will rise. This will slow down economic recovery and could lead to a decline in the stock market.

Is there a way to avoid this situation? It is possible (even likely) that the Fed will embark on a QE3 program, either immediately or after a few months, in an attempt to keep interest rates low and support the economy. In that case, the loose money will continue eroding the value of the dollar, driving up inflation, and in turn driving up interest rates. We're back in the same trap.

In addition to the specter of rising interest rates, the dollar will likely continue to decline in value, a trend that has been developing for some time, as the Fed has been running the printing presses overtime. The quantitative easing programs haven't solved the underlying economic and fiscal woes, merely papered over the problems, and handed us the prospect of rising interest rates, rising inflation and a sluggish stock market. It's the 1970's stagflation revisited.

Given this outlook, a prudent investor should underweight U.S. stock and fixed-coupon bond funds, and overweight investments that can withstand these forces. This includes variable rate income funds, foreign investments, commodities, and currencies. Last week's portfolio changes are part of this positioning. In addition to selling several bond funds, several new funds that offer even better exposure to international currency trends were purchased. These funds are linked to currency values of emerging markets (China, Latin America, South Africa, etc.). For example, one of our new funds *WisdomTree Emerging Markets Local Debt Fund* pays a yield of about 5%. Moreover, if the dollar declines by 5 or 10 percent against the foreign currencies, we capture that gain as well. All told, about 20% of the portfolio is invested in funds that have a direct currency link. The remainder of the portfolio is well positioned and remains unchanged.

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Dr. Rollins has earned both the Chartered Financial Analyst® designation and Certified Financial Planner™ credential. He was awarded the CFA® designation in 2004. The CFA charter is the only credential for investment analysis and management recognized worldwide. Recipients of the CFA charter have successfully completed a graduate-level educational curriculum, and have passed a series of three sequential annual examinations. Pass rates average about 50 percent at each examination level. In 2005, he also successfully completed financial planning coursework and passed the qualifying examination for the CFP® credential.

Company Profile

ROLLINS CAPITAL MANAGEMENT is a fee-only financial advisory firm serving individuals. Using a consistent, patient investment strategy, our focus is long-term, high-quality, personalized investments. Clients have their own individualized accounts. ROLLINS CAPITAL MANAGEMENT handles all the daily investment decisions.

Presentation Disclosures

1. Portfolio composite returns are actual total annual returns, including stock price appreciation, dividends, corporate spin-offs and divestitures, and other occasional cash and non-cash distributions. Individual results may vary from the composite due to variations in portfolio size, and timing of deposits/ and/or withdrawals.
2. Portfolio composite returns represent an asset-weighted combination of fee-paying client accounts under management during the period specified, reported net of all withheld fees.
3. Annual portfolio composite returns and benchmark annual returns use a time-weighted calculation over the period specified.
4. Annualized portfolio composite returns and benchmark returns are calculated as the geometric mean of annual returns.
5. Portfolio and benchmark risk measures calculated using methodology provided by RiskGrades®.
6. Detailed disclosures available on request.

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