BCN ADVANTAGE: 2011 ANNUAL REPORT

February 2012	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	-4.91% [1 2 3]	-4.80% [1 2]	-2.60% [1 2]	0.25% [1 2]
Jan ' 97 = $100,000 [4]	$493,385	$273,935	$236,075	$153,245
Beta (2011):	1.00	1.00	0.50	0.00
Risk Adjusted Return:	-4.91%	-4.80%	-2.60%	0.25%

1 Performance results are based on the Fidelity Mid-Cap Fund (-2.4% for 2011), the Vanguard Index 500 Fund (2.0% for 2011), the Dodge & Cox International Fund (-15.9% for 2011) and an average money market return of 0.25%. The results may not reflect the actual performance of BCN Advantage clients. Past performance does not guarantee future results.
2 Performance results show the year-over-year change to net asset values and do not include the reinvestment of dividends (if any) other than interest earned from the money market fund.
3 Performance results are net of BCN Financial management fees.
4 BCN Financial Inc. is the registered investment advisor. Performance from January 1997 to June 1998 was provided through Quest Securities as the registered investment advisor.

2011 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2011	100%	0%
2	02/01/2011	100%	0%
3	05/01/2011	100%	0%
4	08/01/2011	100%	0%
5	11/01/2011	100%	0%
6	12/31/2011	100%	0%
	Present	100%	0%

Having Lived Through It

For 2011, the DJIA closed at 12,218, up +5.5%. The Nasdaq closed at 2,605, down -1.8%. The S&P 500 finished exactly where it began the year, closing at 1,258. With all three indexes nearly flat, historians might mistake 2011 for a quiet year – but investors who lived through it know better.

On August 8th, the Monday following Standard & Poors' downgrade of the U.S. credit rating, their namesake index completed its 17% freefall. The markets clawed back half those losses before plunging again – to new lows by the end of September. A classic "demented W" double-bottom had formed, but the roller-coaster ride was just beginning. The S&P 500 was up +17% over 19 trading days from October 3rd through October 28th. Then, on November 1st, Greek Prime Minister George Papandreou shocked the EU – and worldwide markets – with his call for a referendum on the newly proposed bailout deal. European politicians expressed incredulity and dismay. Within days the referendum had been called off (and Papandreou forced to resign), but not before U.S. stocks suffered another 10% decline.

Of the 21,000 mutual funds tracked by Morningstar, only 29% beat their benchmarks in 2011 (by contrast, 52% outperformed in 2009, the first year of the market rally). Of the 8,000 funds tracked by Lipper, 92% suffered losses. The average U.S. stock fund lost -2.9% in 2011. Foreign funds performed much worse, losing an average -13.9%. China led all foreign funds down with a -24.0% loss. Japan funds lost -9.8%. Emerging market funds lost an average -20.3%.

The U.S. Economy Would Not "Double-Dip"

The violent sell-offs in U.S. stocks were at odds with the underlying fundamentals. A slow-growth, low-inflation, low-interest rate environment is historically ideal for stocks. Second and third quarter corporate earnings in 2011 were the best in S&P 500 history. Fourth quarter earnings were only slightly behind Q2 2007. Earnings are backward looking – they do not forecast. But deteriorating earnings will confirm an economy already in decline. 2011 earnings did the opposite – painting a much better picture than GDP numbers from the first half of the year. And corporate earnings provide a valuable indicator of the magnitude of downside risk. Severe, long-term bear markets invariably result from high levels of overvaluation. The trailing P/E ratio for the S&P 500 was sitting under 13 – more than 23% below the 83-year average of 17. The trailing P/E ratio began 2012 at the lowest

level in more than two decades (since 1990) and would require a move to nearly 1,500 on the S&P 500 to bring the ratio back to the long-term average.

The economy added 1.82 million jobs in 2011. Not good, but not indicative of recession, when net job losses number in the hundreds of thousands. With a long-awaited surge in hiring, companies added 243,000 jobs in January 2012, and the unemployment rate declined to 8.3 percent, the lowest level in three years. The unemployment rate has fallen five months in a row.

Europe is Not the Big Problem

After the second wave of selling – with the S&P 500 sitting near 1,100 in early October – we warned against panic: "We want to take advantage of the market rally that will likely occur when market participants finally realize the eurozone debt crisis will be contained to Greece and any economic slowdown will be mild compared to 2008. Our target on the S&P 500 is 1250 by early December." The index closed at 1,257 on December 5th.

By the end of 2011, banks had nearly two years to prepare for the inevitable Greek default. No matter how their debt crisis is ultimately resolved, Greece can no longer be a Lehman situation: where the U.S. government capriciously tested "too-big-to-fail," resulting in an unexpected and massive bankruptcy that caught the entire financial community off guard.

Italy and Spain are not in imminent danger of default. Although Italy and Spain both have $2 trillion in outstanding debt, Italy is the greater concern because their government must refinance $1 trillion over the next two years. But Italy has a primary surplus (ex debt payments) and is working to balance their budget by 2013. Italy faces at most $50 billion per year in added borrowing costs, an amount reasonably back-stopped by the ECB or the newly created – and permanent – European Stability Mechanism (ESM).

Portugal's economy is expected to contract 3% this year, its unemployment rate sits at 13.6% and its public debt should reach 112% of GDP. But Portugal's debt levels are sustainable (compared with 190% in Greece) and the government has meager refinancing needs for the next several months: in September 2013, Lisbon must repay 9 billion euros.

Real U.S. Austerity in 2013?

Europe likely set the stage for the main event: What we can expect in 2013 when the U.S. must begin serious deficit reduction. Austerity does not begin during presidential election years – the federal government will continue to borrow and spend roughly $100 billion per month in 2012, over and above the $200 billion per month we collect and spend from tax revenues. All this spending should continue to lift the U.S. (and world economies) for most of 2012. The average gain for the 28 election years since 1900 is +7.3% (+8.8% if we exclude 2008) and election years with double-digit gains outnumber those with double-digit losses by nearly 3:1.

Worth noting, since 1928 there have been six previous years when the S&P 500 finished within 3% of where it started: 1934, 1939, 1953, 1960, 1990, and 1994. According to the Cabot Market Letter: "In the year following a mundane performance, the S&P 500 produced an average gain of 30%, with 5 winning years. The second year out produced a respectable 16% average gain, with four winning years." Already since Jan 1st, the DJIA has reached its highest close since May 2008. The Nasdaq has climbed more than 10% to its highest close since December 2000. The S&P is up more than 5% but remains below its 52 week high. We need to keep the market's fast start in perspective: The major indexes have merely returned to their April 2011 highs. Only the DJIA is positive for the 21st century: Since January 1, 2000 (12 years), the S&P is still down -8.4%; the Nasdaq is still down -28.6%.

Serious problems remain. The nation has 5.6 million fewer jobs today than when the recession began in December 2007, with 24 million (15.1%) considered underemployed. Case-Shiller data show the housing crash has been larger and faster than during the Great Depression. Prices have fallen 33 percent since the collapse began in mid-2006 and remain near their lows almost six years into the crisis. The national debt recently surpassed $15 trillion and is rapidly approaching the $16.4 trillion debt-ceiling. The debt to GDP ratio has surpassed 100 percent, with the federal government adding $5.5 trillion of new debt (a nearly 60% increase) since 2008. We now owe China $1.132 trillion and Japan $1.038 trillion.

This amount of unsustainable borrowing dwarfs what is currently happening in Europe, and must eventually come to an end. My job is to have our clients safely on the sidelines before the effects of real U.S. austerity inevitably take hold.

As always, we look forward with great optimism. We appreciate your faith and confidence. And we are eager to apply the lessons learned for your benefit.

BCN Financial Inc. is the Registered Investment Advisor

We are required to offer Form ADV Part 2 to our clients each year. Contact BCN Financial for a copy.