

Fagan Financial Report

Registered Investment Advisors

VOLUME 14, ISSUE 1

THIRD QUARTER 2010

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TO OUR CLIENTS

The second quarter turned out to be one of the nastiest in recent memory as most major indices fell more than ten percent, pushed lower by a number of issues, not the least of which included the BP Oil Spill in the Gulf of Mexico, the "Flash Crash" of May 6th, the Sovereign Debt Issues Regarding Greece and the Threat of Contagion and the Potential for a Slowing of the Chinese Economy. Since the beginning of May when stocks were at or near a post-bear market high, the United States Economy has slowed. This is evidenced by a slew of less-than-stellar recently released economic reports including a slowdown in demand for both Existing as well as New Homes, a ratcheting down of Q1 Gross Domestic Product, a drop in Consumer Confidence as recorded by the Conference Board, and a weak labor market as determined by Initial and Continuing Claims for Unemployment Benefits as well as NonFarm Payrolls.

In our opinion, the economic and corporate data released during the third quarter should continue to point to an economy that remains in a pattern of slow growth. Notice we said "slow growth." Unlike some others, we do not expect to dip back into recession. Add to this an increase in the political rhetoric as we head toward the mid-term elections and the result should be a choppy stock market.

Despite the headwinds noted above, there exist several positives including the fact that in the aggregate the S&P 500 should produce approximately \$80 in earnings for calendar year 2010 making the stock market fairly attractive on a valuation basis. Furthermore, the rally in the dollar versus the Euro should keep interest rates low. In fact, housing affordability remains at multi-decade highs.

On the fixed income front, given the fact that generally speaking, bond prices rise as interest rates fall and that as of this writing U.S. Treasuries are at multi-decade lows, we are nearing the end of a secular bull market in bonds. However, we believe that interest rates will rise gradually from current levels; that is assuming the United States is in for a prolonged period of sluggish growth. The result will be a sweet spot for Intermediate-Term Corporate Bonds, Preferred Stock and GNMA Funds. We also believe that Inflation Protected Securities present some opportunity when combined with other assets.

Historically, when looking at the 4-year Presidential Election Cycle, this year, the Midterm Election Year, the stock market has provided little or no return. Any return that comes has historically been during the fourth quarter. We believe that this year will be no different. We are holding on to our outlook for the stock market which we first presented in writing within our Q1 2010 Fagan Financial Report that "stocks move in fits and starts, but end the year modestly higher, perhaps by high single digits." We are expecting that a reestablishment of the balance of power in our elected offices, much like the 1994 mid-term election, will provide the catalyst for a year-end push higher.

We believe that given the fact that annualized credit growth for the fifteen years leading up to this recession averaged eight percent versus only a five percent annual increase in disposable income the economy and specifically the housing and labor markets will recover over a longer than normal period of time and in a more uneven fashion. This should continue to provide opportunities for patient investors.

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NOW IS TIME TO TAKE A RATIONAL LOOK AT YOUR INVESTMENT STRATEGY

Somewhere in between the emotion of fear that investors felt just one short year ago when the Dow Jones Industrial Average hovered around 6,500 and the greed during the latter part of 2007 when the Dow peaked at over 14,100 there exists a time where investors can act in a rational manner, a place like now. At this time, it is critical to make an intelligent evaluation of your financial picture, unencumbered by emotion, to determine the right course of action. Some steps you might want to take, not in any particular order, include.

Redefine your financial objectives. This should be done before and after you take an evaluation of your current financial position. A look before may include “perhaps we will have to work until age sixty-five rather than age sixty-two” or “perhaps we will not be able to pay off our home in twelve years, but rather it may take fifteen.” Redefining or reevaluating your financial objectives prior to determining your current position allows one to weigh the merits of that redefinition. It also may help you to look at alternatives as your financial picture emerges. For example, your initial thought that you might need to work three more years may end up being modified to “perhaps we will need to work part-time from age sixty-two until sixty-five.” Regardless, if you redefine your financial goals up front it will help you to recognize the sacrifice necessary to accomplish those goals.

Calculate the value of all of your current assets. As one would do prior to making a journey, before you can determine the best route to take to reach your destination, you first have to determine your starting point. Many individuals can readily sum up their bank accounts, Certificates of Deposit, Individual Retirement Accounts, Brokerage Accounts, Stock Holdings, and Employer Sponsored Plans such as their 401(k), 403(b) or Deferred Compensation, but do not have a handle on their Defined Benefit Plan (monthly income that some employers provide to their retirees), a projection of Social Security Benefits, the cash value of life insurance policies or an approximation of the current value of their home, all of which can be sources of income.

Calculate your liabilities, including how much do you owe on revolving debt such as credit cards as well as non-revolving debt such as your mortgage or automobile loan. Furthermore, perhaps you are paying on a student loan from one of your children. Although theoretically

this is not your debt, if you are paying it, it should be considered as yours for this purpose.

There it is, a simple balance sheet. Assets minus liabilities equal your net worth, your starting point. No, we are not considering the value of your car or household items as they will most likely depreciate down to little or no value. However, if you have accumulated any such items as investments with an intention of ultimately selling, then go ahead and estimate their value and add them to your personal balance sheet.

Determine your monthly living expenses. Be liberal and include vacations, entertainment, car repairs, home improvements and holiday gifts. Once having done so, establish a budget and then keep track of your expenses over the next three months to get a better handle on your actual expenses. Be sure to enter everything. If you’re like us, you are spending way too much on day-to-day expenses such as going out to eat rather than eating home. This begs the question, which is more important going out to dinner several times a week or reaching your goals. Quality of life versus achieving your financial objectives is a personal decision and one that you will most likely wrestle with constantly. We do.

Estimate the amount of money you will need to save on a monthly basis to achieve your goals assuming an annual return of no more than six percent. Don’t go out on a limb. Be conservative in your growth projections and most likely, from these levels in the stock market, you will be happily surprised rather than disappointed in the ultimate outcome. That said, we suggest using an inflation rate of three percent or so to help you take into consideration the negative impact of inflation. There are a number of websites that you can go to, put in the current value of your investments, enter an amount that you are saving monthly and a rate of return on that investment. The website will provide you with a balance at your prescribed time.

Finally, with all of this information at hand, take another look at your financial objectives. Perhaps they will need to be modified or perhaps you will need to modify some of the discretionary items you buy. That’s up to you, but at least you will now have your roadmap to get you where you want to go. The only question is how long it will take to get there. Either way, enjoy the ride! After all, we only go around once in life.

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•Enter the email address you will use to receive the documents. Then check the box to indicate your consent to receive paperless documents and click "Agree." *Note: You will not be able to click "Agree" until you check this box.*



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LESSONS FROM THE BP DISASTER

The oil spill in the Gulf of Mexico is tragic on a number of levels, most important being the loss of eleven lives, workers on the BP oil rig. We can add to that the potential life changing disruption for the people living along the Gulf Coast, the environment, the economy and the loss of animal life. Furthermore, the potential for the spilt oil to eventually travel around Florida and up the Atlantic Coast is nearly unimaginable. That said, investors can also glean several valuable lessons from this event.

Probably the most important lesson that investors can learn from this tragedy is that diversification is of utmost importance when it comes to investing in individual securities. Let's assume that your portfolio totaled approximately \$100,000 and that at the time of the spill you owned 100 shares of BP which was then trading at around \$59.50 per share for a value of \$5,950. BP therefore represented 5.95% of your portfolio. Today, BP trades at or around \$34.50 per share and has acted as a 2.50% drag on your portfolio relative to the stock market. That's not great, but it will not destroy your portfolio. You will live to fight another day.

Investors should also diversify across sectors of the economy. Since the oil spill, not only has the stock price of BP been pummeled, but so has those of deep-water drillers as well as oil service companies. It is appropriate to slightly overweight an industry. However, to grossly overweight an industry is like playing with fire. You can get burnt. Lesson number one. Diversify among companies (at least twelve to fifteen) and across industries.

Don't chase companies solely for the dividend. The landscape is strewn with companies that used to pay high dividends only to then have to cut that dividend as a result of poor market conditions, changes in government legislation or poor company performance. Some of the "widow and orphan" stocks that investors relied on for income have severely cut their dividend over the past couple of years. Consider General Electric, Bank of America, KeyCorp and JP Morgan Chase, just to name a few. BP pays out \$3.36 per year in the form of a dividend. At the time of the disaster that would have resulted in a dividend yield of 5.65%, attractive to many investors. Today, due to the decline in the share price that yield approaches 9.00%. However, don't be surprised if BP either cuts, suspends or eliminates their dividend to conserve cash during this period of uncertainty for the company.

Finally, remember that nothing is for certain and to think you "know" what is going to transpire or you "know" that BP is a good buy at these levels is arrogant. Investing is like eating ice cream, everything in moderation. THE BOTTOM LINE – Investors would be wise to diversify across companies, across industries not invest solely for dividend income. This should help preserve sudden portfolio drops due to changes in the outlook of a company or an industry.



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REPERCUSSIONS OF THE “FLASH CRASH”

Earlier this quarter the stock market as represented by the Dow Jones Industrial Average opened at 10,868 and by 2:20 p.m., on fears that the sovereign debt crisis gripping Greece would first spread to the rest of the European Union and then across the ocean to the United States, had fallen by 420 points. However, over the following SIX minutes the Dow would fall another 600 points in what many have subsequently described as a “Flash Crash” only to then rebound by more than 700 points over the following 40 minutes before closing the day down approximately 348 points. Many blame the sudden drop on a “fat fingered” trader who had intended to sell one million shares of a particular security and pushed a “b” rather than an “m” and ended up attempting to sell a billion rather than the million which, in turn, triggered computer trading programs which sent the markets lower in a cascading fashion. Others blame the sudden drop on a lack of cooperation and consistent procedures between the exchanges. Regardless of the cause of the decline, in hindsight there are several lessons investors can learn as a result of it. They are as follows.

MARKET ORDERS IN AN ILLIQUID MARKET CAN BE EXECUTED AT A PRICE MUCH LOWER THAN WHAT MAY HAVE BEEN INTENDED. For instance, during the timeframe noted above Procter & Gamble (PG) plunged from around \$60 per share to a little over \$39 per share as bids (what one is willing to pay to, in this case by P&G) literally dried up only to then recovery back to \$60 per share minutes later. If you had placed a market order to sell \$100 shares of P&G and had the bad luck of placing it at precisely the wrong time you could have sold at \$39’ish per share only to see the stock rebound back to \$60 in a few short minutes. The cost to you would have been \$2,000. Lesson learned.

GOOD-TIL-CANCELED STOP/LOSS ORDERS CAN BE HAZARDOUS TO YOUR FINANCIAL WEALTH. Continuing on with Procter & Gamble, let us assume that you were concerned that the overall stock market as well as P&G might go down and in order to protect your investment, you placed a stop/loss order twenty-five percent below the current market price of \$60 or at \$45/share. By definition, a stop/loss

order is an order to sell a security at a certain price, in this case \$45/share. Furthermore, a stop/loss order becomes a market order once the security reaches that price and is then sold at the market price. Unfortunately, P&G went through this price bottoming at \$39 or so per share. You therefore, would have sold P&G for \$39’ish per share, once again, only to see it rebound more than \$20 per share and close at \$60.75 per share. Lesson learned.

IN ADDITION TO OTHER CRITERIA, ALLOCATE YOUR ASSETS ACCORDING TO YOUR OBJECTIVES AND TOLERANCE TO RISK AND IGNORE THE SHORT-TERM SWINGS IN THE MARKET. The only individual who usually profits from impetuously taking action is your broker and not you. If you were staring at your computer witnessing the plunging market and decided to take some action and told your broker to “sell everything” you would have lost about 5% in relative value by the end of that day. Another painful lesson learned.

EVERYTHING IN MODERATION. Continuing on with the above example, even if you did want to sell some holdings, do just that, sell SOME holdings. Do not panic. Sell down to your comfort level, keeping in mind your objectives.

EVENTS AND CHANGES IN THE VALUE OF YOUR PORTFOLIO DICTATE PORTFOLIO ADJUSTMENTS, NOT THE CALENDAR. So often, Investment Advisors recommend reviewing your portfolio “at the end of every quarter” or “once a year.” Hogwash. Your investment portfolio is a “motion picture” and not a “static photograph.” It evolves. It changes. It progresses and regresses. Keep in tune with these changes, being careful not to over manage and be aware of market conditions which may allow you to improve your portfolio or, on the other hand, take some profits. Last Thursday could have been a time when you might have upgraded your portfolio.



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QUOTABLE QUOTES FROM INVESTMENT LEGENDS

During volatile markets like the one we have witnessed over the first half of 2010, we often go back to the basics, focusing on some of the tenets of legends in the investment business. Two individuals that come to mind are Warren Buffett, CEO of Berkshire Hathaway and the individual who wrote the book on value investing, Benjamin Graham. As you read through these quotes, try to determine if you are heeding their advice or are you like a rudderless boat being tossed about by the wind that is the day-to-day noise of the stock market.

“I don’t want to buy any stock where if they close the New York Stock Exchange tomorrow for five years I won’t be happy owning it. I buy a farm and I don’t get a quote on it for five years and I’m happy if the farm does ok. I buy an apartment house, don’t get a quote on it for five years – I’m happy if the apartment house produces the returns that I expect. But people buy a stock and they look at the price the next morning and they decide if they’re doing well or not doing well.”

~ **Warren Buffett**

“What you’re looking for is some way to get one good idea a year, and then ride it to its full potential. And that’s very hard to do in an environment where people are shouting prices back and forth every five minutes.”

~ **Warren Buffett**

“To invest successfully over a lifetime does not require a stratospheric IQ, unusual business insights, or inside information. What’s needed is a sound intellectual framework for making decisions and the ability to keep emotions from corroding that framework.” ~ Warren Buffett. We ask you, when you are investing, are you deciding to buy or sell with your heart or your head?

“Individuals who cannot master their emotions are ill-suited to profit from the investment process. The investor’s chief problem – and even his worst enemy – is likely to be himself.” ~ **Benjamin Graham**

“Most businesses change in character and quality over the years, sometimes for the better, perhaps more often for the worse. The investor need not watch his companies’ performance like a hawk; but he should give it a good, hard look from time to time.”

~ **Benjamin Graham**

“Basically, price fluctuations have only one significant meaning for the true investor. They provide him with

an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal. At other times he will do better if he forgets about the stock market

and pays attention to his dividend returns and to the operating results of his companies.”

~ **Benjamin Graham**

Finally, our favorite, “the market, like the Lord, helps those who help themselves. But unlike the Lord, the market does not forgive those who know not what they do.” ~ **Warren Buffet**

THE BOTTOM LINE – Be rational when investing. Keep emotions out of it. Spend some time learning how to invest and if you can’t or won’t spend the time or are ill-suited to invest by yourself, contact a professional. We’d like to apply for that job.

WARREN BUFFETT
Chairman of Berkshire Hathaway

BENJAMIN GRAHAM
American Economist / Professional Investor
Author:
Security Analysis
The Intelligent Investor

MUTUAL FUNDS

Largest Mutual Fund Holdings as of June 30th, 2010.

<i>Domestic Equity Funds</i>	<i>International Equity Funds</i>	<i>Hybrid/Fixed Income/ Muni Fund/ETF</i>
Schwab 1000 Fund	William Blair International Growth	Payden GNMA Fund
Baron Asset Fund	Tweedy Browne Global Value	Loomis Sayles Bond Fund
Parnassus Equity Income Fund	Janus Overseas Fund	PIMCO Total Return
Oakmark Fund	Harbor International Fund	iShares Lehman Bros TIPS
Marsico Focus Fund	Vanguard International Growth	Ridgeworth High Income

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RISK – REWARD – PREDICTABILITY - PROBABILITY

For all of us, two of our primary concerns in life are maintaining our standard of living, both financially and in regard to lifestyle, and caring for our families. At different stages in our lives these concerns are defined in varying manners. Regardless of what stage you are in life, generally the following three factors must be considered prior to making a decision, financial or otherwise. These factors must be considered because they will impact the two primary concerns noted above. They are risk, reward and the probability of a particular outcome.

First, identify the potential consequences of an action along with the consequences of inaction. Then, ask yourself, “what is the potential RISK of this action (or lack of action) relative to the REWARD (return) you are going to receive or what you intend to avoid. Furthermore, by taking action what is the PROBABILITY of the intended result being realized?”

As these three factors pertain to investing and phrased in a similar manner to the question in parentheses above, but with particulars added, consider the following.

Investors must ask themselves, “What is the risk of subscribing to the belief that the stock market is not the appropriate vehicle for your long-term investment needs due to the fact that over the past decade it has gone nowhere?” The risk is that you are wrong and that the American Economy and therefore the U.S. Stock Market will eventually recover from this malaise. However, you will not participate in this growth as your investments will be out of the market. Furthermore, even if you are correct in your belief, over a long period of time there is not a direct corollary between stock market returns and the performance of the economy where the specific company is domiciled. For example, the Japanese economy has been mired in a slump for the past two decades and yet, prior to the “unintended acceleration” scare, the stock of Toyota Motor Company performed very well.

Conversely, investors should also ask, “What is the reward of over-allocating assets on a percentage basis to stocks relative to the risk that I am willing to take?” Given the low interest rate environment in which we are and will most likely be living in over the next year or so, investors into fixed-income instruments like Certificates of Deposit and Bonds are searching for more income and growth. Some wisely and others unwisely have begun to shoulder portfolio risk by investing into the stock market and as a consequence have reduced the predictability as well as the probability of a specific outcome.

Finally, ask yourself, “what is the cost of being wrong relative to the benefits of being right?”

THE BOTTOM LINE – We recognize that this column is broad in nature and intentionally vague at times. However, when investing if you focus on all four factors, risk, reward, predictability and probability, you will make fewer mistakes than if you focus on three or less.

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- A Recap of the financial markets, including company specific and economic news.

- “The Record Review” – an outline of our column that appears in the Troy Record every Sunday.

- “Widely Helds” – a look at the price action and news releases from the most widely held stocks.

- A spotlight on one or some of our **mutual fund holdings or EFT holdings**.

- A look at the upcoming week, including economic data and earnings reports.

- Monthly notable changes to our investment portfolios after the close of the prior month.

- * Periodic interviews with other industry professionals, including mutual fund managers, insurance professionals, accountants & attorneys.

- * Periodic interviews with local men and woman making news that affects our lives.

The **RECORD** Read the Fagan Financial Report every week in The Sunday Record

CORPORATE NEWS & EARNINGS REPORTS

(Please note that all opinions are as of the date indicated and are not meant to be a specific recommendation on your particular situation, but just a general opinion on the appreciation potential of the stock at its current price.)

Largest Holdings Regardless of Asset Class					
Ranked by Market Value as of June 30th, 2010.					
Percent of Total Assets Managed	Company Name	Symbol	As of June 30th, 2010	As of May 31st, 2010	
13.48%	Cash & Equivalents		1	1	
6.00%	Payden GNMA Fund	PYGNX	2	2	
2.84%	Apple Computer	AAPL	3	3	
2.33%	Loomis Sayles Bond Fund	LSBRX	4	4	
2.16%	Hewlett Packard	HPQ	5	5	
1.98%	SPDR Dividend ETF	SDY	6	6	
1.85%	PIMCO Total Return	PTTDX	7	7	
1.58%	McDonald's Corp.	MCD	8	10	
1.55%	JP Morgan Chase	JPM	9	9	
1.52%	General Electric	GE	10	8	
1.37%	iShares Lehman Bros TIPs	TIP	11	12	
1.30%	Intel Corporation	INTC	12	11	
1.29%	Conoco Phillips	COP	13	13	
1.24%	MasterCard, Inc.	MA	14	16	
1.22%	Ridgworth High Income	STHTX	15	17	
1.21%	Nike, Inc.	NKE	16	15	
1.20%	Schwab 1000 Fund	SNXFX	17	14	
1.04%	Cisco Systems, Inc.	CSCO	18	18	
1.03%	MetWest Tot Ret Bond Fund	MWTRX	19	21	
1.02%	Baron Asset Fund	BARAX	20	19	
0.98%	Exxon Mobil	XOM	21	20	
0.98%	Pepsico, Inc.	PEP	22	22	
0.95%	Johnson & Johnson	JNJ	23	23	
0.88%	Vanguard GNMA	VFIIX	24	24	
0.81%	S&P 500 DR's	SPY	25	25	

Common Stock & Equity ETF Portfolio Holdings**					
Ranked by Market Value as of June 30th, 2010.					
Percent of Common Stock	Company Name	Symbol	As of June 30th, 2010	As of May 31st, 2010	As of Apr 30th, 2010
7.05%	Apple Computer	AAPL	1	1	1
5.36%	Hewlett Packard	HPQ	2	2	2
4.92%	SPDR Dividend ETF	SDY	3	3	20
3.92%	McDonald's Corporation	MCD	4	6	5
3.85%	JP Morgan Chase	JPM	5	5	4
3.77%	General Electric	GE	6	4	3
3.23%	Intel Corp.	INTC	7	7	9
3.21%	Conoco Phillips	COP	8	8	6
3.08%	MasterCard, Inc.	MA	9	10	7
3.00%	Nike, Inc.	NKE	10	9	8
2.57%	Cisco Systems	CSCO	11	11	10
2.44%	Exxon Mobil	XOM	12	12	11
2.43%	Pepsico, Inc.	PEP	13	13	12
2.35%	Johnson & Johnson	JNJ	14	14	13
2.00%	S&P 500 ADR's	SPY	15	15	14
1.87%	Emerson Electric Co.	EMR	16	16	15
1.63%	iShares DJ Select Divd Index	DVY	17	18	17
1.62%	Ford Motor Company	F	18	17	16
1.51%	Bank of America	BAC	19	19	18
1.47%	Celgene Corp.	CELG	20	20	19
1.23%	Pfizer, Inc.	PFE	21	21	22
1.18%	Diageo, PLC ADRs	DEO	22	27	28
1.18%	Visa, Inc.	V	23	24	25
1.11%	Darden Restaurants	DRI	24	23	31
1.11%	Oracle Corporation	ORCL	25	26	26
1.09%	Mosaic Companies	MOS	27	22	24
1.07%	Microsoft Corp.	MSFT	28	25	23
0.66%	AFLAC Inc.	AFL	42	44	21
N/A	Alpha Natural Resources	ANR	N/A	N/A	27

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