



The Centurion Counselor

Fourth Quarter 2010

UNDERVALUED SECTORS

(CONSIDER!)

- CONSUMER DEFENSIVE
- MEDICAL DEVICES
- MEDICAL DIAGNOSTICS
- BIO TECH

OVERVALUED SECTORS

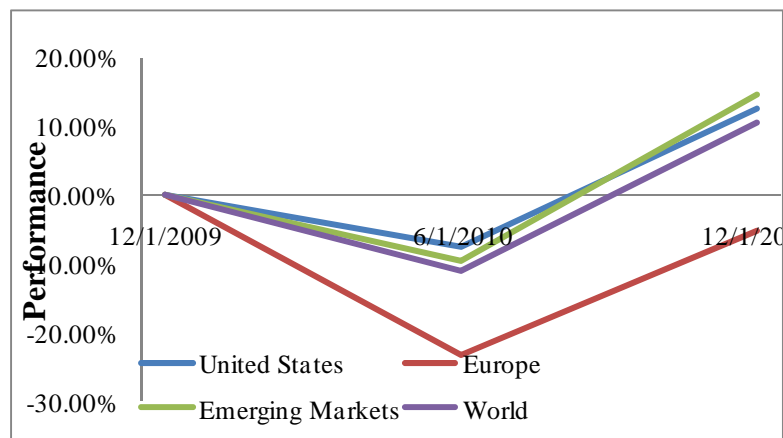
(AVOID!)

- JUNK BONDS
- EMERGING MARKETS
- U.S. TREASURY BONDS
- CONSTRUCTION EQUIP.

One Decade Down, Nine To Go

“The pessimist sees difficulty in every opportunity. The optimist sees opportunity in every difficulty.” ~Sir Winston Churchill

As we begin a new decade we will attempt to share some observations on the current economic climate and investor psychology. It's a cliché to say the equity markets act as if they are on a roller coaster, and the reality is, the market has seen wild swings in the prior decade. Virtually all markets were down in the first half of 2010, challenged by the BP oil spill and fear of a Greek default. Below is a chart showing 6 months of performance through June 30, 2010, and 12 months of performance through year-end 2010.



The Dow was up 5.2% for the month of December 2010. For the prior 9 years and 11 months of the decade, the Dow was basically flat, up only .07% for the decade.

As the New Year begins it seems that investors are once again throwing caution to the wind and chasing several bubbles; bonds, gold, oil, commodities, and a mini bubble in equities. In spite of the bubbles, we sense a mood of widespread fear and intense pessimism over Government deficits, the economy, and politicians. No one has ever accused us of being a Pollyanna, but we are firm believers in America and the power of innovation to bring on positive change. While in our daily lives we may not notice the change, we believe the internet is bringing the world closer and speeding innovation in medicine and technology. No one will hold a sign up saying 'now is the time for the national mood to become optimistic' and it will not happen overnight but gradually, without any conscious effort, optimism will return.

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Perception often causes investors to do the opposite of what they should do. We believe it is because many investors chase performance following the latest investment fads. That is, of course, until the investment fad fails and then investors vow to never do that again. During The Great Depression, a generation of investors pledged to never buy equities again. In recent times, the tech bubble caused many to once again make that pledge; only to rush in again as the Dow neared 14,000, then flee into bonds during the Lehman-inspired market meltdown. We currently see evidence of a rush into commodities that is sure to leave investors burned. It is to this investor mania that we quote Arthur Ziekkel, former head of Merrill Lynch Asset Management.

Bold type is his words, comments underneath are ours.

A fool and his money are soon parted.

Hollywood has capitalized on this theme many times including the Eddie Murphy movie Trading Places. Ponzi schemes are always available for the gullible.

There is no free lunch.

Risk and return go together like soup and sandwich or a horse and carriage. You may not get rich in one day but you can lose all of your money in one day. Leverage makes money on the way up but is a killer on the way down.

Don't put all your eggs in one basket.

Diversify. Asset allocation in the single most important thing an investor must do. Owning five different equity mutual funds is NOT diversification. The S&P 500 is not diversification! Ten stocks in the index make up 20% of the weighting as of year-end.

You cannot eat relative performance.

Measure results on a total return, portfolio basis.

Don't be afraid to take a loss.

As Jesse Livermore stated "Take your losses quickly and don't brood about them."

Watch out for fads.

Pet rocks, beanie babies, hula hoops, and Talking Elmo were all fads that did not last. Be prepared for the unexpected and you can be sure that if it is on the cover of Time Magazine, that the fad has passed.

Take the long view.

Keep emotions out of investing. Stick with your long term plan and remember that proper preparation prevents poor performance.

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Remember the value of common sense.

Past performance is just that... past! History is a guide, not a template.

It is with this back-drop that we once again fearlessly make out predictions for 2011:

- Emerging markets will face a currency and liquidity crisis. The Chinese markets will be down for the year.
- United States economic growth will be the strongest in the first half of the year. Overall the economy will grow by 3%.
- Unemployment begins the year at 9.8% and will end the year at 9.0%
- Gold will spike up to \$1,600 an ounce before closing lower for the year.
- The European Union will face continued shocks and the Euro will come close to a breakup.
- The debt crisis in the states (California, New York, and Illinois) will get worse and the Federal Government will not be able to help.
- Equities will hit their high in the first half of 2011 and end the year slightly down.
- Treasuries, as measured by the 10-year bond, will see a 4% yield.
- The U.S. Dollar will be higher against the major currencies.
- Housing prices will rise slightly in 2011, as builders continue to limit production of new homes.
- Student loans will become the next debt crisis. College costs have gone up faster than inflation and healthcare. State budgets, once flush, are now in a deficit but college costs continue to rise. Today, student loan debt is higher than credit card debt and according to recent reports, only 40% of it is being repaid. While students may default on their loans, it is nearly impossible to discharge student loan debt, even in bankruptcy. The government can garnish the borrower's wages, withhold tax returns, and siphon off Social Security and disability payments in order to recover the funds. Collection costs stretch out the defaulted loan's term, with those payments taking precedence over principal reduction. That, in turn, allows the government to tack on extra interest.

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How did we do last year?

We will divide our 2010 Predictions from one year ago into three categories; (1) “dead on,” (2) “partially correct” or in the opinion of the judges (i.e. us) not yet fully played out, and (3) “frankly just missed the mark.”

“DEAD ON”

“Cap and Trade is dead for 2010”. President Obama and Congress spent too much time and political capital on the health care bill allowing all of the climate related bills to languish. We don’t think it will be passed this year but believe President Obama will attempt to enact it by regulatory decree. This will set up a massive battle with the House and will ultimately be decided by the courts.

“Gold will hit \$1,300 or more”. Gold rose for the ninth consecutive year closing at \$1,421 per ounce. We believe gold is in a bubble and may have an explosive move to the upside this year but will break its multi-year winning streak.

“Crowding out” will become part of the national discussion...short of the government printing money”. While there was some discussion of crowding out due to the massive federal deficits, the Federal Reserve rode to the rescue printing money and monetizing the budget deficit.

“Several Governments are on the edge of economic collapse”. 2010 saw Ireland and Greece need massive bailouts. Iceland simply defaulted.

“The Euro will face a crisis as its weaker members struggle”. For the first time in the Euro’s history there is talk of it breaking up. While breaking up is hard to do, one wonders how long the German people will stand for supporting most of Europe.

“The dollar will be stronger in spite of the large deficit”. The dollar was up slightly in 2010 as the Euro suffered. (see above)



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“PARTIALLY CORRECT”

“We will have a double dip recession and stagflation”. We were wrong about the double dip but nailed the stagflation, characterized by low growth and increasing inflation. December’s consumer price index showed that although consumer prices are up only 1.5% from a year ago, they are up at a 3.1% annual rate in the past six months and up at an even faster 3.5% annual rate in the past three months.

“Interest rates will rise and the 10-year Treasury will yield over 4.75%”. We were wrong about the 10-year yield as it ended the year at about 3.5% but rates did increase once the Government started printing money in October.

“Emerging Markets will be down... some by 30%”. Overall, emerging markets were up slightly for the year. China dropped 16% and a number of markets, such as Greece, fell in excess of 30%.

“MISSED THE MARK”

“George Clooney will retire from Hollywood to become President for Life of a small South American country”. What can we say!

“Equity markets in the U.S. will be flat to down slightly”. The fourth quarter rally doomed this prediction.

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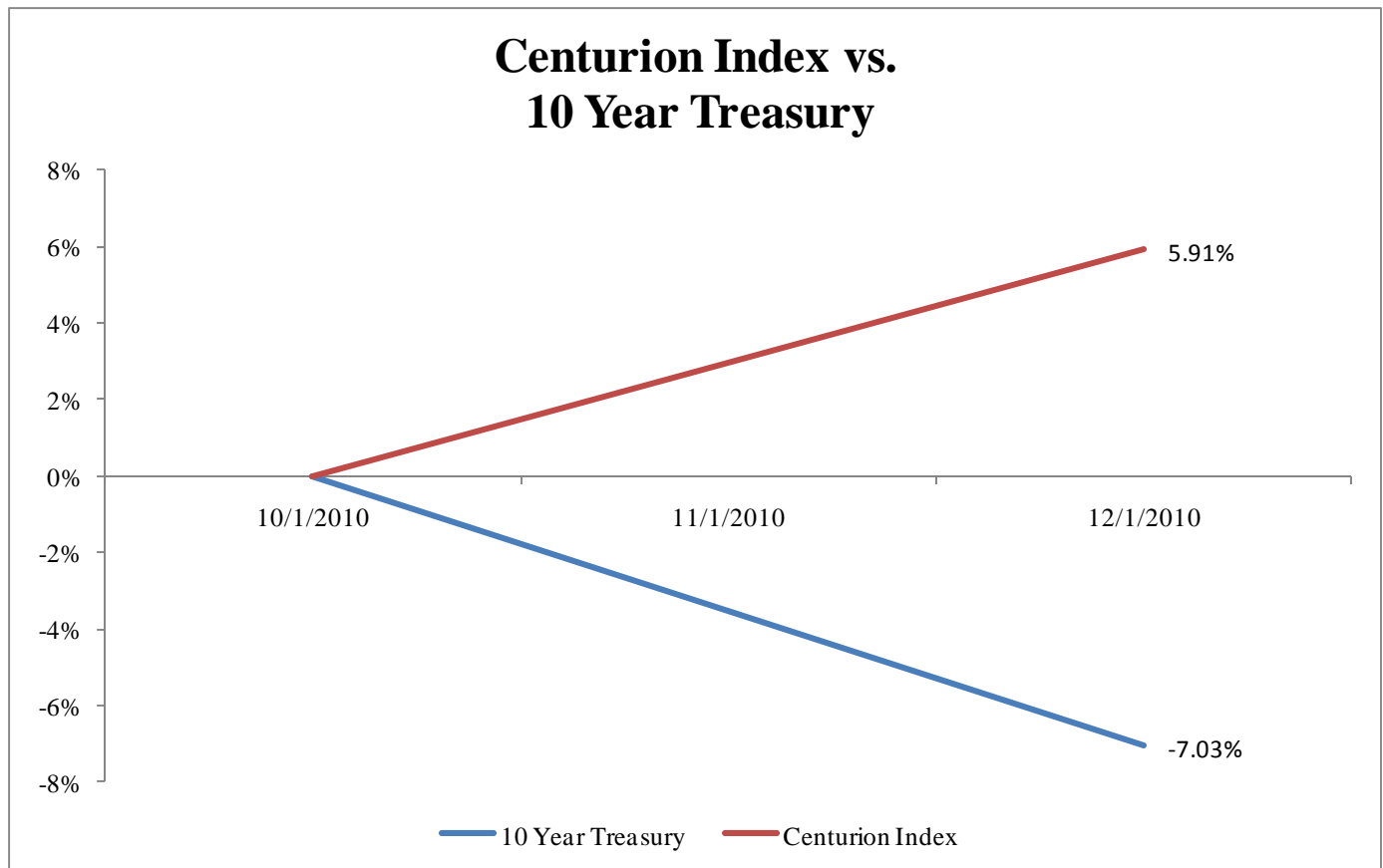


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The Centurion Index

In the last issue we stated our opinion that the 10-year U.S. Treasury was overvalued and equities were undervalued relative to the 10-year over the long-term. In order to track our prediction (and for educational purposes only) we created the Centurion Index which consisted of all equities in the S&P 500 yielding more than the 10-year Treasury. In addition all of the equities had to have increased their dividend each year for the prior 10 years. Below is the total return for the equities compared to the S&P500 and the Tr10-year Treasury.



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