BCN ADVANTAGE: 2010 ANNUAL REPORT

January 2011	BCN Advantage Act/Mgmt	100% Invested Buy/Hold	50% Invested Buy/Hold	100% Cash
Total Return:	8.94% [1 2 3]	16.92% [1 2]	8.59% [1 2]	0.25% [1 2]
Jan ' 97 = $100,000 [4]	$518,263	$289,708	$242,369	$152,863
Beta (2010):	0.55	1.00	0.50	0.00
Risk Adjusted Return:	8.57%	16.92%	8.59%	0.25%

1 Performance results are based on the Fidelity Mid-Cap Fund (23.2% for 2010), the Vanguard Index 500 Fund (12.8% for 2010), the Dodge & Cox International Fund (12.1% for 2010) 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.

2010 BCN Advantage Signals

	Date	Market	Cash
1	01/01/2010	100%	0%
2	04/01/2010	100%	0%
3	05/19/2010	0%	100%
4	07/01/2010	0%	100%
5	10/01/2010	0%	100%
6	11/04/2010	100%	0%
7	12/31/2010	100%	0%
	Present	100%	0%

The Roller Coaster Ride

For 2010, the DJIA was up 11.0% (closing at 11,578), the S&P 500 was up 12.8% (closing at 1,258) and the Nasdaq was up 16.9% (closing at 2,653). We endured a wild ride that saw two significant corrections, the first beginning in mid-January, taking the markets down -8.1%, the second beginning in early May, taking the markets down -16%. As late as mid-September, stocks were essentially flat for the year. Finally, in the first week of September, the markets bottomed, with the major indexes reversing and closing out 2010 at multi-year highs.

A Correct – But Unsuccessful – Decision

Given the outright destruction wrought by the markets over the past 10 years, few investors were willing to sit tight in early May when the markets began to fall apart. The infamous “flash crash” on 5/6/2010 was initially written off as a technical glitch. In a matter of minutes, the DJIA declined by 600 points (nearly 1000 points on the day) and the stocks of 8 major companies in the S&P 500 fell to one cent per share. Twenty minutes later, the Dow had regained most of the 600 point drop, but the roller coaster ride had barely begun.

It is interesting to note that over 21 months, the rally that began in March 2009 has experienced more corrections (declines of at least 5%) than any market rally in decades. Through April 2010, we remained fully invested – even during the January/February decline precipitated by the sovereign debt crisis in Greece (the first of many). We made the decision to exit the markets on 5/19/2010, with the S&P 500 at 1,115. Six weeks later, the major indexes hit their low point for 2010 – a decline of -16% from April and a hairs-breadth away from a full-blown bear market. Following a snap-back rally in July, the markets rolled over again throughout August. The S&P 500 did not regain the 1,115 level until mid-September, 4 months after our decision to go defensive. The indexes did not regain their April levels until early November. Clearly, this was a major market correction.

Successful market timers do not attempt to predict tops and bottoms. When stocks are soaring – as they did through April – we must wait for clear and compelling evidence of a major trend change before exiting the markets. Otherwise, we would whip-saw clients back and forth – and leave substantial market gains on the table. During this current rally, the first significant correction (a

decline of 5.4%) occurred in June 2009, with the S&P below 900. Exiting at that point would have cost investors gains of more than 40%.

Whether or not a timing decision is correct depends on the magnitude and duration of the market correction (or rally) that follows. On that basis, the 5/19/2010 decision to exit the markets was correct. Unfortunately, the move was not successful: we did not re-enter the markets at or below our exit point.

What Happened in September

From a technical standpoint, there was nothing special about the rally that began in the first week of September. It had all the markings of the brief snap-back rally that failed in July. There was no sign of investor capitulation, with the August low forming on relatively light volume.

When the 3rd quarter ended, official unemployment was a stubbornly high 9.7% (with real unemployment, including those no longer looking for jobs, over 17%). GDP had plummeted, falling like a rock from 5% in Q1 2010 to 1.7% in Q3 2010. Corporate earnings drive stock prices and the tanking U.S. economy should have been reflected in earnings. Instead, U.S. corporations posted record profits in the 3rd quarter. They benefited overwhelming from cost-cutting, not only through lay-offs but by holding down wage and benefit increases to their remaining workforce. By late October (the end of the Q3 earnings season), the Fed announcement regarding the specifics of QE2 was only days away.

On August 27, 2010, in his annual speech at Jackson Hole, Wyoming, Ben Bernanke announced the Fed's intention to launch another round of quantitative easing: "A first option for providing additional monetary accommodation, if necessary, is to expand the Federal Reserve's holdings of longer-term securities. I regard the program (which was significantly expanded in March 2009) as having made an important contribution to the economic stabilization and recovery that began in the spring of 2009. I believe that additional purchases of longer-term securities, should the FOMC choose to undertake them, would be effective in further easing financial conditions."

From August 27th, when Bernanke signaled that a second round of quantitative easing was likely forthcoming, through November 3rd, when the Fed finally provided the size and scope of QE2, the major indexes gained 14%. Prior to November 3rd, specifics were lacking. Imagine the sell-off had the Fed not confirmed their controversial (and widely criticized) decision to go forward with QE2, with a program large enough to satisfy Wall Street.

Concerns Going Forward

According to their November announcement, the Fed will take 8 months (through June 2011) to inject roughly $100 billion per month into the economy. This is in addition to QE1 – the program initiated in March 2009 (at the very beginning of the current rally) to purchase $1.7 trillion in Treasury and mortgage debt. Quantitative easing of this magnitude is unprecedented, with the Fed essentially creating a huge asset bubble in stocks by printing money.

We will likely remain fully invested through the end of April 2011, but possibly longer if economic fundamentals begin to show real (sustainable) improvement. The next major correction (-20% or more) will occur when the Fed is ultimately forced to reverse the money flow and begin taking the $2.5 trillion in monetized debt (printed money) out of the economy. I cannot conceive of any exit strategy where artificially inflated asset prices do not decline precipitously once the Fed reverses course. My job is to have you safely back on the sidelines before that happens.

For many reasons, we do not believe the current rally is a new long-term bull market. Corporations cannot grow profits indefinitely by cutting their labor costs. The country faces seemingly intractable unemployment (net 7 million jobs lost since 2008), and ongoing problems with real estate and the debt markets (residential mortgages, along with a new threat from muni-bonds). The now chronic European sovereign debt "crisis" will continue to flare. And most telling, related to all of the above, is the dearth of initial public offerings. From 2003-2007, new issues averaged more than 200 per year, topping out at 276 in 2007. In the three years since, new issues have totaled just 212 – particularly concerning given that new businesses are the lifeblood of job creation and economic growth.

2010 was a frustrating year, but understanding the ramifications of unprecedented Fed behavior takes time. Our fundamental strategy remains unchanged. The highest priority is to minimize losses – like we did in 2008. The "mathematics of loss" can be unforgiving: A 25% loss requires a 33% gain, just to break even. A 50% loss requires a 100% gain. Because of our outperformance in 2008 and 2009, BCN Advantage clients can profit even in years like 2010, when we missed the September rally.

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.