CORE EQUITY PORTFOLIO REVIEW

Second Quarter 2011

PERFORMANCE COMMENTARY

The second quarter of 2011 was thankfully devoid of the extreme natural and man-made upheavals and unrest that struck around the globe during the first quarter of the year. The three-month period just passed witnessed concerns about a more mundane event: slowing economic growth. We will comment on the U.S. and non-U.S. economic scene later in this report, but reactions to declining real estate prices and re-sale activity in the U.S., coupled with an unarguable slowing of growth in the faster growing economies of China, India and Brazil, lead to a sedate correction of stock prices in the U.S. markets. On the heels of the first quarter's strong 5.9% performance, the U.S. equity market (as measured by the S&P 500 Index) was up a mere 0.1%, resulting in year-to-date performance of 6.0%. Smaller U.S. stocks did not fare as well during the second quarter: The Russell 2000 Index, a measure of U.S. small company equity performance, was down 1.6% while the Russell MicroCap Index, a measure of very small U.S. company equity performance, was down 1.7%. As a result, the smaller company stocks as a whole are lagging behind their larger counterparts year-to-date.

	Periods Ending June 30, 2011					
	Quarter	Year-to-date	1 Year	3 Years	5 Years	10 Years
Core Equity Composite – NET	**2.6%**	**5.8%**	**32.7%**	**6.3%**	**7.8%**	**8.1%**
S&P 500 Index	0.1%	**6.0%**	30.7%	3.3%	2.9%	2.7%

Composite performance is reported **NET** of fees and expenses. Please refer to the disclosures at the end of this report.

In general, the market's tepid performance favored the more conservative portfolio structure of the Core Equity strategy. As detailed in the table above, Core Equity posted a reasonable gain for the second quarter, and performed well ahead of the S&P's 0.1% return. As the market's fear of slowing economic growth materialized, Core Equity's slightly defensive posture via a fair number of healthcare-oriented stocks provided stability. **Cardinal Health (CAH)**, **CVS Caremark (CVS)** and **Novartis (NVS)** were among the top five contributors to the quarter's performance, as were **Websense (WBSN)** and **Pepsico (PEP)**. Share price gains for this group ranged between ten and sixteen percent. Interestingly, all but Websense were among the minority of stocks last quarter that posted flat to negative returns in a very robust market. As we noted in our First Quarter 2011 review, stocks of less volatile companies "provide welcome stability to the portfolio, retarding declines when the market drops. But at times that stability inhibits the portfolio's upside potential in stronger markets." Those very stocks redeemed themselves in the quarter just ended.

Performance detractors during the quarter were limited to a handful of names. **Adobe (ADBE)**, **Google (GOOG)**, **General Electric (GE)**, **Express Scripts (ESRX)**, and **Verizon (VZ)**, saw share price declines ranging from 2 to 5%. In conjunction with their relatively modest (less than 4%) weightings in the portfolio, the damage inflicted by these negative contributors was minimal. (Note: the calculation for contribution to return considers a position's size as well as its share price gain or loss, recognizing that the larger the position the greater its impact on total portfolio performance, and vice versa.)

STOCK COMMENTARY

Little has been written in past reviews about **Novartis**, a long-time Core Equity holding (since early 2008) which was the top contributor this quarter. We have long referred to Novartis as "the Johnson & Johnson of Europe" although lately that may not be the compliment it once was. Several years ago Novartis saw the difficulties ahead

for large pharmaceutical companies in general due to a dearth of promising new drugs in the pipeline, and thus began a lengthy acquisition and divestiture effort. The resulting company is exposed to generic drugs and consumer products, making the company's sales and earnings more stable albeit at a slower rate of growth. Undoubtedly, Novartis's stock price was the recipient this past quarter of investors' attraction to larger, more stable companies. But we believe there is more. At eleven times 2011 earnings, Novartis' stock remains attractively valued and its sales and margins will benefit from the generic wave to come.

Websense is another longer-term Core Equity holding (since early 2009) that posted a strong second quarter in an otherwise weak market and continues to have, we believe, a profitable future ahead. Securing Websense's future is its position as a leading solutions provider for a strong (and unfortunately permanent) growth trend: the institutional need to secure information technology assets. Websense specializes in protecting the security of a company's information assets against Web-based threats. Along with consumers, institutional information workers utilize downloaded text, video and audio files and access many different web sites as part of their jobs. Many of these information tools expose an organization to security threats as they can be used by cyber thieves and spies as conduits through older, obsolete defenses. Those attempting to break into corporate information assets are no longer primarily teenaged computer geeks on a joyride: attacks in the last few years have been traced to organized crime and foreign governments that utilize well-organized assaults based on very sophisticated programming algorithms. Websense has designed and is now marketing a well regarded line of tools that will help companies defend against the rise in data security threats related to employees' growing use of Web-delivered information.

On the negative side of the ledger, **Express Scripts** was down a bit this quarter due to concerns about pricing competition in the pharmacy benefit management (PBM) market. PBM's such as Express Scripts act as intermediaries between significant buyers of pharmaceuticals (e.g. large payor/HMO's like Aetna, government agencies or even very large corporations) and the companies producing the drugs. Another PBM held in Core Equity, CVS Caremark, has become more competitive in its attempts to win service contracts by using aggressive pricing strategies. During the second quarter CVS Caremark won a significant piece of business from Express Scripts. The news of that win put a damper on Express Scripts' stock price.

Express Scripts is a Core Equity holding for one primary reason: it, along with other PBM's, will enjoy sales increases and margin expansion in the next few years from the coming slew of generic drug introductions as several major drugs come off patent. Though a loss for the branded pharmaceutical manufacturers, this development is a plus for the PBM's as they enjoy higher margins on generics. Further bolstered by the success of its recent acquisition activity, we continue to believe Express Scripts is well positioned to benefit from the generic drug wave ahead. The loss of the one contract by Express Scripts, though sizable in revenues, should be a minimal hit to earnings in 2011.

General Electric's stock was down during the quarter despite the company's issuance of relatively upbeat news about its longer-term prospects. Given GE's large financial segment (GE Capital), it is understandable that GE stock is prone to the same concerns investors bring to their consideration of bank stocks, and financials in general suffered during the quarter due to concerns about the credit risks of Greece, Spain, Portugal, and Ireland. However, GE has been laboring painfully to reduce its finance operation and return its primary focus to its original mandate: to help finance the sale of its own industrial products. While the slimmed down GE Capital will maintain some banking-style services around the world, it will, in another year or so, be a smaller division of GE than it was several years ago. This is fine with us as we originally purchased GE for the truly unique position it enjoys in many of its industrial businesses: commercial airplane engines, electric power capital equipment, energy capital equipment, railroad engine manufacturing, etc. We believe most of GE's industrial businesses will generate greater than world GDP growth rates over the next several years, and the company is ideally structured to serve the non-U.S. markets.

PORTFOLIO ACTIVITY

Portfolio restructuring during the second quarter was minimal. In April we used cash on hand to acquire shares of **Google** for Core Equity portfolios. Google, as most computer users know, has become one of the most popular sites for conducting Web searches. Google maintains a very strong market share in the search business and its profitability is very high. However, of late Google has been accused of being a 'one-trick pony – although a hell of a pony.' In other words, the only successful business line Google has created is Web search. In addition to this criticism, Wall Street analysts are a bit worried about a mid-April management change at Google. Larry Page, one of the two founders of Google, has taken over as Chief Executive Officer, moving former CEO Eric Schmidt to the position of Executive Chairman. Page felt Google was becoming complacent, more worried about preserving the bottom line than investing for the future. Of course, Page's emphasis on preparing for the future means spending money now, which translates into lower margins and a hit to Google's current profitability. While Wall Street has not been pleased with the short-term impact of Google's long-term strategy, our take is that Google has put itself in an excellent position to invest in those trends its sees as the path to a profitable future. Google has both very strong cash flow and a young executive team that will support whatever direction it takes. The company's Android operating system, used in smartphones and a new generation of tablet and slate devices, promises to further Google's search franchise. Google is also aggressively competing with Apple and Amazon to secure its portion of the 'digital storefront,' that is, to create revenue from users' downloading of digital entertainment whether it be books, magazines, movies or TV shows. At its current price we believe Google's stock is attractively valued on the search business alone. The company's prospects for establishing and growing some of its other business lines make the story that much more compelling.

Towards the end of June we eliminated our entire position in **Adobe**. The stock was introduced to Core Equity portfolios in early 2009 when the equity markets were becoming unglued. We saw that period as a chance to acquire the shares of a very high quality software franchise growing at a reasonably attractive rate for a very good price. Since then, the stock price has appreciated quite a bit, and our opinion of the company's future growth prospects is waning. Specifically, the two primary sources of Adobe's historical growth, the creation of a suite of products and the acquisition of major PC software to combine with that suite, are near the end of their run. In the future, the company's rate of growth will increasingly depend on the secular growth of its end-user markets. Although we think the end-user markets can continue to grow at an above-average rate, we don't think it justifies paying a large premium. Additionally, Adobe faces risks in moving its products to the popular subscription, cloud-based distribution model. (You will undoubtedly hear more from us about 'cloud computing' in future quarterly reviews, as we believe cloud computing is a real trend that will affect many corners of the software and service market.)

Proceeds from the sale of Adobe funded a simultaneous purchase of shares in the for-profit education company **Apollo Group (APOL)**. This investment may seem a bit controversial in light of the attention Congress recently focused on Apollo and its industry peers. The for-profit education industry has been under pressure, and rightfully so, for employing very aggressive sales tactics that served to populate their programs with students who have dubious chances of completing their first year, much less earning a degree. Such tactics produced too many unemployed dropouts who owe money on government-guaranteed loans.

In response, the Department of Education initially proposed about a year ago severe new rules under which the for-profit schools would have to function pending Congressional approval. The schools responded immediately and began altering their operations in preparation for meeting those requirements. However, when the final rules came out about two weeks ago they were not as onerous as originally feared due to broad support of the for-profit school industry among both Republicans and Democrats. We believe the changes brought about by the prospect and then subsequent adoption of regulatory revisions are good for the industry and we are now positive on the future outlook for the for-profit group in general and on Apollo in particular.

With the easing of political pressures on the group, fundamental factors such as supply and demand and pricing are once again driving expectations of these companies and their stocks. Some of the positives we see ahead for the industry and for Apollo include:

1. Capacity of the not-for-profits, especially the state-supported schools, will continue to be cut, directing student flow to the for-profits.
2. It is the for-profits that tend to push new education models that are not only more efficient, but more effective.
3. Apollo in particular used the regulatory pressure to restructure its offerings towards adult learning, that is, the education of working adults seeking four-year degrees versus providing two-year or vocational programs. Providing four-year degree programs has been Apollo's approach for years and we believe it will be a driver of success for the company in the future.
4. Apollo is more active than its competitors in the acquisition of non-U.S. schools and creating a for-profit model in developing countries.
5. When it became apparent that severe rule changes were coming, the for-profit education companies themselves curtailed enrollment efforts. Now that the new rules are in place, we believe enrollments will begin to climb in the next few quarters, followed by an increase in total student population and thus setting the stage for growth in revenues and earnings.

MARKET COMMENTARY

We are not professional economists, but like other portfolio managers we must acknowledge the environment we invest in and consider how larger economic factors might affect our holdings individually or collectively. Hence the following comments.

Greece and Europe: In response to the excess debt challenging Greece and several other European countries, certain European creditor countries are forcing an extended curtailment of consumption on the debtor countries. We do not believe this approach provides the debt-burdened economies with the relief required to overcome their over-indebtedness. In fact, whether the indebted is an individual, a corporation, or a government, there is really only one way to solve the problem for all involved: the lender must reduce the principal amount of the debtor to a point where the indebted will be able to pay its obligations. It's clear to us that the arrangements put into place to manage the Latin American debt problems in the 1980's should be utilized again, in Europe. In short, holders of European sovereign debt will need to take a cut in the principal owed to them, to the point that the indebted country can operate on a somewhat normal basis, as opposed to implementing activity smothering 'austerity' measures such as those most recently proposed for Greece. Some European officials worry that reducing the principal Greece owes will lead to further principal reductions on other countries' debt; it is this 'run on countries' scenario that finance ministers fear most. Some government intervention will be necessary to alleviate such fears, but we believe government action is better used to reduce the principal owed than by smothering economies and slowing tax receipts.

How will this affect the markets? In the near-term, ham-handed approaches by governments will cause volatility in the markets, and by that we of course mean downside volatility. The longer-term effects on the markets depend on the remedy. If governments agree to principal reductions but execute such with soothing emoluments, we believe there can be growth again. If governments continue down the path of enforcing unrealistic levels of debt, then we believe we will see an extended period of subpar growth. If the European monetary authorities decide to loosen monetary control, it would likely mean inflation although it would alleviate the immediate debt challenge. Which path will the European governments take? We can only watch and react. Our hope is that the governments will courageously face the challenge, but our expectation is that they will pursue the path of least resistance until the indebted countries' pain level reaches a breaking point.

U.S. Housing Market: The continued troubles in U.S. housing are a secular worry, but they would benefit from the same medicine prescribed above: mortgage principal reductions would clear the balance sheet problems of a large swath of U.S. consumers. Remedies proffered by mortgage-holders in the past few years primarily involve temporary interest rate reductions. This has done little for homeowners as it turns them into renters given that there is no or negative equity building in the homes in which they live. Experience has shown that mortgage principal reductions lead to better outcomes for both parties laying claim to the house, the mortgage holder and the owner. Principal reductions imply pain to the mortgage holders, but also imply pain to those companies that guaranteed the mortgages, including the government agencies Fannie Mae and Freddie Mac. If some sort of principal reduction program is not put in place, we expect to see sub-par growth for the U.S. consumer and therefore limited demand for those companies strictly serving the U.S. consumer.

In sum, the excess levels of debt that have built up since the mid-2000's will continue to limit economic appreciation in the developed markets until they are cleared. Remedies that do not involve a reduction in principal are likely to further extend the current slow-to-no-growth economic environment as debtors take years to pay off their obligations.

DISCLOSURES: The Core Equity Composite is comprised of discretionary taxable and tax-exempt accounts of similar risk and investment objectives that are managed according to Princeton Capital Management's conservative, equity oriented investment strategy. Prior to 1/1/09 this strategy and its composite were marketed as Princeton Capital Management's Growth and Income investment product. While the strategy has not changed, it was renamed to reflect its intended strategic role within an investment program. Accounts are included in the composite at the beginning of the first full calendar month each account is fully reflective of the investment strategy. The S&P 500 Index is an unmanaged index considered generally representative of the U.S. stock market. Results are calculated internally using Advent portfolio accounting software and information provided by outside custodial firms. Composite and index performance valuations and calculations include dividends, interest and other earnings and are stated in US dollars. Performance figures for periods one year and longer are annualized. Composite returns are asset weighted and are reported net of fees and commissions. Performance results for individual accounts may vary due to the timing of investments, size of positions, fees, and other reasons. A client's returns may be reduced by other expenses incurred in the management of the client's portfolio. Additional information regarding policies for calculating and reporting returns is available upon request. PAST PERFORMANCE SHOULD NOT BE CONSTRUED AS A GUARANTEE OF FUTURE PERFORMANCE. The specific securities identified and described do not represent all of the securities purchased, sold, or recommended for advisory clients, and the reader should not assume that investments in the securities identified or discussed were or will be profitable. The stocks named as the top or bottom five contributors to performance for the period are based on a representative portfolio (Princeton Capital's oldest Core Equity wrap account portfolio; also a member of the Core Equity composite) and have been identified through a report generated by Princeton Capital Management's Advent portfolio accounting system. Further detail on the contribution to performance calculation, which takes into consideration the weighting of every holding in the representative account, as well as a list showing every holding's contribution to performance for the period, is available by contacting Princeton Capital Management at info@pcminvest.com.