



Nestlerode & Loy^{inc}

investment advisors

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Another calendar quarter comes to a close and spring approaches, although not fast enough for me. Sadly, three longtime valued friends and clients passed away this past quarter. Their passing leaves a hole in our daily lives and we will miss them. For us, our client relationships are always more than just about the business of Investments.

General Comments:

The investment markets churned ahead in the first quarter of 2011, supported by large doses of federal budget deficits and the easy & cheap money provided by the Federal Reserve. The Administration is proposing still larger federal budget deficits in the coming year (fiscal year 2012, 10-1-2011 through 9-30-2012) of 1.6 trillion dollars. Yet the program by the Federal Reserve that facilitated the last round of deficits is coming to an end on June 30th. While none of us can know the future of the investment markets with certainty, we can ask some educated questions and put some limitations around the set of possible outcomes in the second quarter of 2011 and for the balance of the year. So far the doom and gloomers have been trumped by Bernanke and Geithner, as easy monetary policies have driven stock and commodity prices ever higher. Coincidentally, food and fuel prices have climbed also while housing prices continue to decline. The S&P/Case-Shiller 20 city home price index fell for the seventh straight month in March 2011 by 3.1%. Unemployment remains near 9%, consumer incomes are stagnant and the government continues to prop up consumer spending by various transfer programs (unemployment benefits and food stamps for example) to the tune of over twenty percent of consumer spending.

The private sector economy has not recovered in a self-sustaining fashion and I believe this will become quite evident at the end of QE II. The investment markets are still betting on a QE III, putting a floor under stock prices. It is amazing to me that with all the government assistance, the economy is still not recovering convincingly. The current spending, debt limits and budget battle lines are being drawn in (continued)

(continued) Washington and hopefully a sustainable way will be found to grow the private economy, get Washington's budget under control and adjust our entitlement programs to the reality of the long-lived retiring baby boomers. Changes are coming for Social Security and whatever medical care scenario develops. Following the great increase in government under Woodrow Wilson, Warren Harding cut the size of federal spending by 50% and the economy boomed in the early 1920's. Hopefully, we will find our own way to spur the growth of the private sector.

With is in mind, how did we do in 2010 in managing your portfolio and what do these numbers mean? Every account that we manage will have a one page comparison of the performance of their portfolio, compared to the performance of the S&P 500 stock market average and the Value Line Geometric Average of Stock Prices. Please keep in mind that this comparison is sometimes not a good measure, especially for those in income (bond) portfolios.

Major investment Change:

In the past four months, we have eliminated most of our holdings in municipal bond funds. Municipal investments, largely represented by Franklin Templeton's High Yield Bond Fund (FRHIX) began to decline in October and plunged in price into late January. The recovery since then has been rather anemic and unconvincing.

Several issues are important when pondering the municipal markets. First, most folks buy municipal investments to avoid paying federal income taxes on the interest earned. This makes great sense if you are in a high tax bracket. However, most investors are just looking for an interest rate of return, not growth in their principal. The first issue - deterioration in municipal bond prices - can be distressing, as the losses can far exceed the income earned. Second, trading in municipal bonds is far different than trading in stocks. Municipal bonds trade infrequently and the spreads in this dealer market are wide, ranging from a couple to eight percent or sometimes more. So municipals are illiquid and trade with a large spread: not an attractive set of circumstances. These disadvantages can be partially offset by buying municipal bond mutual funds, which provide daily pricing (a very important issue) and daily liquidity (a crucial issue). Many brokers and investment advisors use laddered bond portfolios (by bond maturity date) to diversify their municipal exposure. At the height of the municipal bond meltdown, one such advisor in Florida had his clients in 32 issues in laddered portfolios. He tried to sell his positions and received bid on only eight of the 32 issues. Essentially, he and his clients were stuck in a declining asset with no way to sell their positions. Third, bonds are priced by computer model, not by actual transactions in each issue. This means that all participants in the municipal markets are following estimates of what their bonds might sell for, not actual transactions in their holdings. Further, since mutual funds hold a large share of the municipal markets, it is questionable if the depth of the market would allow for the liquidation of

large positions. When you read your month end brokerage statement, you need to understand that the municipal prices provided are estimates and not hard bids. In a volatile market these numbers can be quite different.

As the drama unfolds in the states, cities, townships and authorities, eventually the municipal market will find a solid bottom and once again become a viable investment choice. However, for now, I recommend your municipal assets be short-term holdings and/or minor positions in your portfolio. Fortunately, we have a number of great municipal mutual fund managers that price their portfolios daily. This gives us a real clue as to the recovery in this market.

Performance:

We continue to be cautious with your money as much of the performance in the stock market is directly due to stimulation provided by the Federal Reserve. In my 46 years of market experience, this is the first time the government has intervened directly into the investment markets to spur higher prices for stocks and commodities. Of the money we manage, nearly 16% is now in cash. We hold this cash in the face of significant uprisings in North Africa and the Arab world, a continuing drama in Japan over the aftermath of a major earthquake, tsunami and the failure of a half dozen nuclear reactors, continued financial deterioration in Europe as Portugal now is seeking a bailout, continued massive printing of U. S. dollars coupled with a zero interest rate policy, a Federal budget proposed for the most massive deficit since World War II and a persistent high rate of unemployment in the United States. We narrowly averted a government shutdown as our elected representatives (President, Senators and Representatives) wrestled with last year's budget for the fiscal year that started last October). On the state and local levels, major battles on budgets are reported on the evening news as layoffs, budget cuts and tax increases impact businesses and citizens. And yet, the stock and commodity prices keep rising.

Much of the recovery in the economy is due to the increase in the profits of the financial sector. Accounting rules were eased (two years ago April, as loans no longer need to be marked to market) and the Federal Reserve opened its discount window allowing financial firms to borrow at or near zero-interest rates and lend the money back to the government by buying Treasury paper. The recapitalization of the financial sector is being done again on the backs of senior savers who have their money invested to generate funds for monthly living expenses. This is a replay of the same situation as in 1990-1991. Money doesn't generate good returns now.

We are now approaching the end of quantitative easing part II or QE II, as of June 30th. When QE I ended last year, stock prices plunged (about 16%), only to be revived when Ben Bernanke announced the implementation of QE II from the

Jackson Hole conference in August of 2010. The crucial question is, “now what?” Does the Fed proceed directly to QE III, or does it pause and see what happens or does it do a more modest intervention, using its Permanent Open Market Operations (POMO) to continue buying Treasuries and maintain zero interest rates? All of this will have what I believe will be an immediate and substantial impact on stocks and commodity prices. Meanwhile, both gold and silver are moving higher in price as the U.S. dollar continues to weaken. This is anything but a normal recovery from a temporary recession. It bears repeating that we remain cautious about the markets, your money and the immediate outlook for the markets for the remainder of the year.

Interestingly, all managed portfolio performance for the first quarter showed our commitment to caution as we performed below par for January and February (markets rose), and jumped ahead of the market performance for March as the stock market prices paused.

Time Period	Portfolio	S&P 500 Index
January 2011	-0.18	2.26
February 2011	2.36	2.85
March 2011	0.55	0.23
Quarter 1, 2011	2.74%	5.42%



Of course the above numbers combine all portfolio objectives and represent performance after all costs. Measuring income accounts against the S&P 500 is not appropriate, of course.

Holdings and performance by size of total positions Q 1 2011

Name	Pct of Holdings	Internal rate of return
Money Market	14.93%	00.00%
Templeton Global Bond	12.68	2.17
SPDR Gold	8.61	0.76
First Trust Gas Drillers	3.98	18.63
Apollo Investment	2.17	10.76

(Data continued on next page)

Name	Pct of holdings	Internal rate of return
Penns Woods	2.17	-0.82
Applied Materials	2.08	-3.08
Annaly Capital	1.81	0.23
Ford Motor	1.75	-11.00
Citizens & Northern	1.56	14.26
Altria Group	1.50	7.37
DNP Select Income	1.41	4.36
ALPS Alerian MLP	1.37	- 0.26
Aberdeen Asia Pacific	1.29	4.23

Commentary on these holdings appears below.

Performance net of fees for Q 1 2011

Portfolio Type:	2010 Returns	S&P 500
ETF Portfolios	3.94%	5.42%
Aggressive Growth	1.28%	
Growth	3.80%	
Growth & Income	2.44%	
Aggressive Income	0.98%	
Income	1.92%	
Trusts	4.91%	
Non-Profits	3.15%	

The last five investment objectives include significant fixed income positions.

Why did we underperform the stock market in Q 1? First, we had a large position in cash that earned essentially nothing. While we are actively investing this cash reserve as opportunities present themselves, we are cautious as we are anticipating a softening in stock prices. Next both the Templeton Global Bond Fund (TPINX) up 2.17% for the quarter but now up over 14% through 4-7-2011) and gold, up just 0.76% performed worse than the S&P 500. Still, gold is making new highs now in early April and the performance has picked up nicely. Our natural gas drillers ETF (FCG) rose smartly as the Marcellus Shale development moved ahead and even the politicians seem to be getting that we are a natural gas powerhouse in the world. FCG rose 18.63%.

Apollo investment rose and recovery in the business community progressed. Apollo pays nearly a 10% cash dividend.

Penns Woods Bancorp (PWOD) and Citizens & Northern (CZNC) split, with PWOD down 0.82%, while CZNC was up 14.26% in the quarter. Together with FCG, these companies are part of our Marcellus Shale holdings. Both PWOD and CZNC pay nice dividends. The Marcellus Shale development of natural gas is a bright spot in our economy and likely to get much more important, in my opinion.

Ford Motor (F down 11%), the only auto maker who didn't take federal money, had a slow quarter following the report of results for the fourth quarter of 2010. In the first quarter of 2011, Ford has recovered some as it reported sales exceeding GM's for the month of March. Ford is overtaking GM as our largest auto manufacturer.

Applied Materials is the largest producer of equipment to make semiconductors and solar cells. Although lagging so far, I believe it will pick up in price later this year. In the quarter ending January 31st, sales rose 45%, while earnings per share climbed 177%.

Annaly Capital, recommended repeatedly by James Grant, publisher of Grant's Interest Rate Observer, manages billions of dollars of collateralized mortgage obligations and other sophisticated investment products that have fallen on hard times as a result of the financial collapse that started in 2008. Annaly has managed its business quite successfully and currently pays a dividend of over 14%. The stock has traded in a range between \$11 and \$21 over the past decade and is a dividend payer as opposed to a stock that will grow its price over time. We find it appropriate for accounts seeking aggressive income.

Aberdeen Asia Pacific (FAX) is a closed end fund of debt securities, primarily Australian and Asian. We are investing in FAX primarily for the dividend return (over 6%), although we also like the exposure to the Australian dollar, which has been strong against the U.S. dollar. FAX and TPINX are what I believe are conservative ways to invest in foreign currencies that should do well against the declining dollar.

Alerian MLP (AML) is a rather new ETF collection of master limited partnerships, securities that typically pay large continuous streams of dividends from pipeline and other energy operations. AMLP was created to allow investors who want to avoid the complication of receiving K-1s for their investments while still benefitting from the generous dividend payments that MLPs typically offer. Many brokerage firms have prohibited their investors from investing in MLPs in qualified retirement plans like IRAs because of the complications that K-1s cause the firms. AMLP avoids these problems and remits 1099s at year end, just like a regular stock.

Many of you will recognize DNP Select Income, what we usually call Duff and Phelps. DNP has been part of our investment stable for decades and has paid a consistent monthly payout of 6-1/2 cents per share per month since the late 1980s. It is invested primarily in utilities and other securities that pay generous dividends.

Altria (MO) is the former Philip Morris, the major tobacco product manufacturer in the United States. We have purchased it because of its low price and generous dividend payments. It rose over 7% in the first quarter of 2011.

As we move into April, we anticipate no major changes in our largest holdings, except for investing more of the cash reserves. We believe our current selections will perform well for the balance of the year, either appreciating in price or continuing to pay generous dividends. These holdings also reflect our commitment to our basic investment philosophy



Guiding Investment Philosophy:

1. Nothing is intrinsically valuable. Everything is only worth what someone else is willing to pay for it.
2. If you have money, you cannot avoid being an investor. The only variable is whether your position is winning or not. Participation is not optional.
3. The ability to both price and immediately sell any investment allows you to continually manage your risk of loss. Investments that cannot either be priced daily or sold immediately have higher risk of loss, as the information surrounding the health of the investment is not widely available. Investments that sour often cannot be sold easily.
4. All statements about the future are merely assessments and as such are not fact. They are guesstimations, sometimes very good estimates about what might happen. But they are not and cannot ever be guaranteed. Think about this when you get your next stock tip.

5. Diversification doesn't protect you from losses. The notion that price correlation is a constant is wrong. Investments that are not price correlated in rising markets can become correlated in falling markets, as investors in the 2007-2009 markets now realize. The only way to protect you from losses is to pay attention to price changes daily and to sell if investments are declining beyond normal variations.
6. Investing is all about making mistakes. If you select individual investments, sooner or later, you will buy something that declines. You must be willing to sell your losers to limit your losses. Great investment operations are ones that manage mistakes (by selling before they are damaging to the overall portfolio) and let the good choices run.
7. All investment decisions are independent variables. Just because you made the right decision last time, implies nothing about your next decision. You may apply this to market 'gurus'. The fact that their last major investment prediction was amazingly right has no bearing on their next major investment prediction. While we have performed better than the S&P 500 over the last 13 years, four months and eight days (up 80.33%, versus up 37.41% for the S&P 500 and down - 12.92% for the Value Line Geometric Average which measures the average U.S. stock price performance), this guarantees nothing about the next thirteen years. We will, however, be investing and paying attention to work at providing great investment performance over time.

There are probably more rules that will help us be better portfolio managers. You are encouraged to tell us if you have a favorite not included above. Something about
humility comes to mind.



Nestlerode & Loy, Inc. – What's New?

Over the past few months we have upgraded the office computers to new Dells running Microsoft windows 2007 and Office 2010. Since we started computerizing our operations in 1983 we have gone through a hardware and software upgrade every few years. We have discarded the old boxy monitors and now have dual flat-screen monitors throughout the office.

We recently replaced our telephone system and now have a new Allworx system with voice mail and other neat features. Rest assured, when you call us during the business day, you still will never have to deal with an electronic attendant. We are committed to real people helping you with your concerns.

After fourteen years with Advent's AXYS portfolio management software, we are moving to Cornerstone's Power Advisor portfolio management software. The conversion

will happen this calendar quarter and be complete before the end of May 2011. While some of our historical data will become history, the new system is clearly superior to our old system.

In terms of business strategies, we have decided to close our discounted brokerage operation, Discount Brokerage of Pennsylvania. Our focus and forte is in doing investment research, designing and implementing investment management strategies. Focusing on what we do best will allow us to service you, our Investment Management clients, even better. Please note that all transactions in managed accounts will continue to be done at transaction rates below our current discount brokerage rates.

We continue to develop our staff. Judy Loy completed and was awarded designation as a Chartered Financial Consultant® or ChFC®. As financial planning's highest standard of knowledge and trust, the ChFC® program prepares professionals to meet the advanced financial needs of individuals, professionals and small –business owners. ChFC's can identify and establish specific goals and then formulate, implement and monitor a comprehensive plan to achieve those goals. Individuals who earn a ChFC® have the expertise necessary to provide advice on a broad range of financial topics including financial planning, wealth accumulation and estate planning, income taxation, life and health insurance, business taxation and planning, investment and retirement planning. "Furthering our education is an important priority at Neslerode and Loy. I am proud to be able to offer our clients the higher level of knowledge this additional education provides," says Loy. "Our entire team of advisors and associates are continuously enrolled in programs and classes that can help us better serve our growing client base."

I attended the first annual NARO (National Association of Royalty Owners) in State College, learning about the investment opportunities, problems and concerns regarding the development of the Marcellus Shale. For those of you interested in this topic, I write a column for Pennsylvania Business Central on the Marcellus Shale issues. In addition, the Marcellus Shale Coalition distributes periodic email updates highlighting developmental, governmental, and regulatory issues. They can be reached at www.marcelluscoalition.org.

Finally, we have arranged for our 75th year celebration to be held at the Centre County Country Club in conjunction with the Chamber of Business and Industry for Centre County Business After Hours program, on Thursday, April 12th, 2012 – next year. Put it on your calendar – we hope you can join us.



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