

About the safety of your accounts at Pennaluna and PennTrade...

The MF Global scandal has shaken many investors and left them worried about the safety of the entire financial system.

As a result, some of you have asked us about the security of your accounts here.

This is an important question, so let's take a minute to review it.

Our thoughts on your safety here

First, we share your concern over the disturbing state of the financial system.

We too are worried by the corruption, incompetence, and greed that seem to ooze like sewage through our political and financial institutions and pollute them with dangerous toxins.

Nevertheless, we're not especially concerned about the safety of your accounts with us.

This isn't because we're reckless or we don't care about the accounts here. On the contrary. We have skin in this game too. Like you, we keep our own accounts at Pennaluna -- and you can be sure we don't want to lose our money any more than you do.

Instead, we're relaxed about this because we're convinced accounts with us will stay safe, sound and accessible through any trouble short of an Armageddon that leaves the financial system in virtual collapse. And even then we would expect all assets to be protected.

There are several reasons we feel this way.

Here's the short version:

- **No risky derivative trading here**
- **No debt, no leverage**
- **Under one percent accounts are margin ... almost no hypothecation**
- **We're privately owned, and cautious**
- **We're highly regulated, closely monitored**
- **Accounts safeguarded by National Financial Services (NFS)**
- **NFS owned by Fidelity -- a major financial institution**
- **Accounts protected by SIPC... plus added Excess Coverage**

If you have a few moments, we'll explain in more detail... as follows.

No risky derivative trading

We do not trade forex... futures... options... swaps... or similar aggressive derivatives – for our own account or for our customers. No foreign bonds either.

We do trade a small number of warrants on Canadian exchanges for customers. But these trades are modest in number and dollar size with small and easily quantifiable downside.

No debt, no leverage

We don't use debt in our business. Borrowed money is too unstable for us. Leverage can turn on you quickly, as many people have now discovered.

We took over Pennaluna management in 1991. In the two decades since then, we have carried long-term debt exactly one time... and that was to finance our purchase. We paid it off about 15 years ago.

In addition to our other activities, we make markets in a number of OTCBB and OTC stocks, as we have for over 85 years. We're conservative in this small-scale market making and generally maintain our net capital at levels at least twice as high as rules require.

So we're totally unleveraged. (Although of course we have access to more capital on short notice if we should ever need it.)

Under one percent accounts are margin ... almost no hypothecation

Unlike many other brokerage firms, our policy for years has been to allow only cash accounts.

You could go through our thousands of customer accounts and tally up the margin ones on two hands... and still have fingers left over.

The actual percentage is something less than .002 %.

We prohibit margin accounts except under unusual circumstances because we believe they can turn too risky for customers and firm alike. They leverage losses as well as gains... and a sudden big margin call in a plunging market can deliver a crushing blindside hit.

It's worth mentioning that for a margin account, you sign a separate margin account agreement. In that document, you agree to pledge or "hypothecate" your stock as collateral so you can borrow cash from the broker. You can use the borrowed money to buy more stock or for other purposes, including other trades that may involve borrowing -- like short sales, stock futures and options.

The same agreement allows the broker to lend your stock to others – for instance, short sellers who need to cover. Or the broker may use your pledged stock to collateralize its own borrowing. This is the so-called "rehypothecation" that has received recent public attention.

On the other hand, borrowing isn't permitted in a cash account. So you don't pledge your stock, and the broker can't use it.

Thus, except for the .002 % of accounts we mentioned, we couldn't lend out... or borrow against... customer securities without first getting permission, even if we wanted to (which we don't).

We're privately owned, and cautious

Pennaluna is not publicly traded. We believe this helps to keep us on an even keel.

We don't need to obsess over stock price. We aren't pressured to report good numbers every single quarter. We aren't tempted to juice up the stock so our options climb in value. We can afford to be prudent.

Our firm is almost entirely owned by current or past employees and directors or their heirs. Thus, we can continue to patiently build for the future without undue outside pressure pushing us to take risks.

Pennaluna has experienced both the best of markets and the worst of markets during its 85 years in business. The firm has always survived, while many others have not. We don't intend to kill the reliable old milk cow that gives us cream every morning just to have one night of prime rib.

Highly regulated, closely monitored

Pennaluna is a broker-dealer. That's a firm that trades securities for customers (broker) and for its own account (dealer).

As a broker-dealer, we're regulated -- some might say overregulated -- by the Financial Industry Regulatory Authority (FINRA), the Securities and Exchange Commission (SEC), the U.S. Department of Justice, the securities agency of every state where the firm is registered to do business, and probably a few others.

Among a long list of requirements, we must file detailed financial reports every month with FINRA and the SEC. This is mainly to confirm that we comply with the SEC's "net capital rule".

The net cap rule is designed to make sure a broker-dealer has enough money to meet financial obligations to customers and other creditors. Over the years, it has proven to be one of the more beneficial regulations. (Some features of the rule were waived in 2004 for Bear Sterns and certain other politically well-connected Wall Street Big Boys; this probably helped cause the crash of 2008.)

We're also audited every year by a CPA firm registered with the Public Company Accounting Oversight Board (PCAOB). The Sarbanes-Oxley Act of 2002 created the PCAOB. Accounting firms are required to register and submit to PCAOB inspections before they can issue audit reports of broker-dealers.

In addition to this multiple review and supervision, all of our trades and trade reporting are constantly monitored... and beyond that we are also subject to inspection and requests for information at any time for any reason by any of these authorities.

Thus we work constantly under the keen eye of a circling pack of watchdogs.

Given all this scrutiny, how MF Global could collapse without some regulator noticing its predicament is a mystery more profound to us than quantum physics.

Accounts safeguarded by National Financial Services (NFS)

We work directly with you day to day, executing and reporting your trades, handling wires and check requests, answering questions, solving problems, and performing other services.

But we no longer handle the back office clearing chores ourselves. We stopped about 15 years ago, when the regulatory, capitalization and logistical burdens made it too costly for a small firm like ours. Most others stopped too.

Instead, most brokers now clear through a group of large, well-capitalized clearing firms. Pennaluna clears through National Financial Services, which holds and safeguards your account. NFS is capitalized at levels that are orders of magnitudes greater than we could ever be.

NFS is one of the three largest clearing providers in the nation... with nearly 300 client firms holding \$500 billion in assets under administration. It is closely regulated by the SEC, FINRA, and other agencies like the securities exchanges.

NFS is stable, conservative and dependable. You can read its semi-annual financial statement here: <http://www.mybrokerageinfo.com/pdfs/SOFCDecember2010.pdf>

Perhaps more important is the fact that NFS is a Fidelity Investments company.

NFS owned by Fidelity -- a major financial institution

Fidelity Investments owns NFS... and Fidelity is one of the world's foremost financial organizations.

Fidelity provides financial products and services to over 20 million individuals and institutions, and maintains over \$3.6 trillion in assets under administration.

Founded in 1946 by Edward C. Johnson and headquartered in Boston, it has grown into a giant institution employing nearly 40,000 people. But it remains controlled by the founder's own family.

Ned Johnson is the founder's son. A low profile Forbes billionaire and philanthropist, he started work at Fidelity in 1957. At age 81, he remains Chairman and CEO, although he recently gave over a few of his duties to close associates -- notably including his daughter, Abby Johnson.

Fidelity is privately held... with the voting stock reportedly owned solely by the founder's family and select employees.

These are conservative Bostonians who operate carefully. Their native caution is enhanced because their own family and personal wealth is at stake -- not the money of unknown public shareholders or faceless institutional bond investors.

We've learned from personal experience that NFS and Fidelity are extremely risk averse.

These are not the sort of people to take chances that might kill the goose who has laid millions of golden eggs for the Johnson family over the past 60 years.

You're protected by SIPC -- plus added Excess Coverage

Both Pennaluna and NFS are members of the Securities Investor Protection Corporation (SIPC).

If funds of a failed brokerage are insufficient to satisfy customer claims, SIPC coverage acts to protect each customer's account(s) up to a ceiling of \$500,000... including \$250,000 maximum for cash claims. Money market funds held in a brokerage account are considered securities. See full details at www.sipc.org .

In addition to this SIPC coverage, NFS provides added "Excess of SIPC" coverage from Lloyd's of London, together with insurers Axis Specialty Europe Ltd. and Munich Reinsurance Co.

The Excess of SIPC coverage would only be used when SIPC coverage is exhausted. Total aggregate Excess of SIPC coverage available through the policy is \$1 billion. There is no per account dollar limit on coverage of securities, but there is a per account limit of \$1.9 million on coverage of cash awaiting investment.

This is the maximum Excess of SIPC protection currently available in the brokerage industry.

Both SIPC coverage and Excess of SIPC coverage are limited to securities held in brokerage positions, including mutual funds if held in your brokerage account and securities held in book entry form. Neither SIPC nor the additional coverage protects against loss of market value of the securities.

Summing up

What's the bottom line?

Well, we all know that life is a very uncertain proposition.

Long ago, the Roman philosopher Pliny the Elder observed, "The only certainty is that nothing is certain." And Benjamin Franklin famously declared that, "Nothing in this world is certain but death and taxes."

Recalling these wise words, we're not about to claim we can be absolutely, positively, 100% certain that every account here would be completely safe under every circumstance to be imagined.

Nor would we claim it utterly impossible for Pennaluna.... FINRA... NFS.... Fidelity... SIPC ... and the United States government... to all somehow fail to safeguard our accounts.

But we will tell you straight up that we're absolutely convinced of the following:

- Your accounts – and our own – rest in uncommonly strong and protective hands
- Even in a worst-case scenario any disruption would be brief and accounts would be shielded and preserved

Thank you for taking the time to read this.

We greatly appreciate your trust in us.

Ron Nicklas
President
Pennaluna & Company Inc./PennTrade Online Trading