



August 5, 2010

Dear Valued Client,

After months of debate and lobbying, President Obama signed the Financial Regulatory Reform Bill into law on July 21st. As is the nature of most regulatory reforms, the impact on institutions today is largely benign, with market forces themselves enforcing self regulation. The impact of the bill will likely be seen years in the future, assuming banks revert back to making bad loans. Specifically, the bill does 3 things: 1) It creates a new consumer protection agency which will provide oversight and enforcement of rules governing the sale of various financial products; 2) It expands the powers of the Treasury to identify and curtail systemic risk, particularly as it relates to “too big to fail” banking institutions; & 3) It regulates the trading of derivatives, requiring them to be cleared through an exchange, and it also limits proprietary trading of FDIC insured banks. These regulations seem reasonable to us and will hopefully help in preventing future financial meltdowns. Ultimately, though, regulations have no power if the regulators are not doing their job properly, so enforcement is just as important as structure. One critical piece missing from the reform puzzle are the rules that guide the operations of Fannie Mae & Freddie Mac. Although government is quick to point the finger and reform private industry, it must look at itself and reform these government owned entities if real progress in reform is to be made.

For the markets, July was a pretty good month as the S&P 500 bounced back 6.8% for the month, bringing the average back to roughly break even for the year. Given the slow and uneven nature of the economic recovery, we continue to foresee a give and take environment where 5-10% upside and downside moves are made over short time periods, as traders nervously respond to both confirming and contradicting economic data. On a year-over-year basis, however, we would not expect the market to make any significant moves to the upside or to the downside, as we don't view stocks as neither expensive nor cheap in aggregate. Nevertheless, we still think on a 3, 5, or 10 year rolling basis, stocks will modestly outperform bonds. Bill Gross, Co-Chief Investment Officer of PIMCO, had a good quote in a recent interview with *Money* magazine, where he said: “The most important thing to recognize is that if you're looking for 10% (annualized) returns to pay for college or to retire on, they're not going to be there. We've been an asset-growth based economy for so long.....now instead of having money work for you, you've got to work for your money¹.” Bill's comments highlight the fact that in order to compensate for the lower average returns likely to be earned in stocks (6-7% vs. 10%), investors who still have some years left before retirement will need to make up the difference by saving more on a monthly basis. For those already in retirement and taking distributions, this means periodically reviewing your withdrawal rate to ensure you're staying on track in terms of maintaining your retirement lifestyle without worrying about outliving your money.



Finally, moving to portfolio management, as some of you may or may not know, every time we decide to make a change in a mutual fund selection that is held within your portfolio, it is discussed and debated every month at our investment committee meeting. During our monthly investment committee meetings, we review the performance of our recommended funds and model portfolios, and discuss areas of concern and opportunities that we should consider given the current market environment. Our purpose through these meetings is to proactively enhance the level of accountability in our asset management process. During one of our recent meetings, we discussed a fund we've owned for many years, American Funds Capital Income Builder. American Funds Capital Income Builder was initially purchased in client accounts because it represented a good "all-in-one" fund that provided clients with good diversification, with an attractive balance between domestic & international stocks, as well as bonds. Although we don't overemphasize short term returns when analyzing a fund, we were disappointed with returns the fund has provided relative to comparable funds in its category. The reason for underperformance in this fund is due to two factors, one being the size of the fund and the other being the restrictive nature of the fund's investment objective. The size of the fund is 71.3 billion, which impairs the fund's flexibility in terms of how it buys and sells individual stocks. Going forward, we think the fund's size will continue to hinder its return potential. Secondly, we think that the fund's investment objective of reaching for dividend yield is restrictive and impedes the fund from investing in undervalued, higher quality businesses that pay a lower dividend yield. Consequently, we sold Capital Income Builder collectively across all IRA accounts and will slowly move out of the fund in taxable accounts as well, upon examining the taxable implications on an account by account basis. Overall, however, we like how our fund selections and model portfolios are currently positioned and believe they will continue to provide investors with attractive risk-adjusted returns over time relative to a comparable selection of index funds. Conservatism, flexibility, and selectivity will be the keys to navigating this market environment.

As always, we thank you for your trust and support and look forward meeting with you soon.

¹ *The quote from Bill Gross was taken from the August 2010 issue of Money magazine.*

The S&P 500 consists of 500 stocks chosen for market size, liquidity and industry group representation. Each stocks weight in the index is proportionate to its market value. The S&P 500 is one of the most widely used benchmarks of US equity performance.

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Diversification can be thought of as spreading your investment dollars into various asset classes to add balance to your portfolio. Although it doesn't guarantee a profit, it may be able to reduce the volatility of your portfolio.