



October 4, 2010

Dear Valued Client,

Last month, we held two client group meetings in our Oak Ridge offices to discuss our transition to TD Ameritrade, along with an overall update on the economy and the market. The response we received from our clients was impressive. We are grateful to have such an engaged and supportive client base and hope the information we provided during the meetings was helpful. For those clients who didn't get a chance to attend, our basic message was that we have been very pleased with the overall service provided from TD Ameritrade and continue to believe their integrated, low cost platform for managing assets will serve you well. During our market update, we highlighted the challenges and opportunities facing our markets, with the main takeaway that we believe the economy will slowly improve over time and that stocks should outperform bonds over the next 3-5 years given the combination of modest valuations and modestly improving fundamentals.

After an ugly month of August, the market bounced back strongly in September, with the S&P, Dow, & NASDAQ gaining 8.92%, 7.85%, & 12.04%, respectively, for the month. Better than expected durable goods orders, housing starts, and manufacturing numbers all helped improve investor's appetite for stocks. Given the uneven results of recent economic reports and the corresponding volatility they produce in the markets, the conclusion we reach is that recent volatility is a byproduct of the level of uncertainty among investors today. This uncertainty is causing many market participants to over-analyze and over-react to every economic data point, which produces price volatility as money flows between asset classes. One of the reasons we believe the equity market performed so well in September is because of how well bonds performed during August. With yields as low across the board as they are now, any return driven investor with an intermediate to long-term time horizon understands that equities, not bonds, are the preferred area moving forward if they hope to achieve attractive inflation-adjusted returns. This lack of competition in absolute returns among asset classes should be a moderately positive tailwind for stocks moving forward, particularly if the economy begins to improve.

Although investors understand that the 243 billion dollars flowing into bond funds this year have helped produce these high bond prices and low yields, many are unwilling to make significant reallocations because they want to be protected against adverse movements in the economy, which tend to effect stocks more than bonds (Source: Investment Company Institute). The quandary for investors is what to do with an overvalued and relatively unattractive asset class like bonds when it's precisely that asset class they need to dampen the volatility of owning stocks. Should an investor abandon their asset allocation in light of the increased price risk associated in owning bond funds? Of course not, but an investor can look for ways to mitigate risk within bonds by ensuring that the bond funds they own are short-term in maturity. With short-term bonds, we forego the higher yield of long-term bonds in exchange for better downside protection against rising interest rates. During the crisis of 2008, we advised clients to purchase only short-term bond funds with the highest credit



quality of AAA, but now that the banking system appears to be on better footing and the economy seems to be stabilizing, moving down the credit ladder a notch or two within short-term maturities seems like a good way to get incremental yield without taking on a lot of price risk due to rising interest rates and/or credit quality concerns. In other words, at this point we'd prefer owning short-term, mid-quality corporate bonds over short-term, higher quality treasury and agency bonds.

Regardless of how money moves between asset classes, we believe the "smart money" is not found among those making hard and fast predictions on the economy, but instead, in those who are examining enterprises on a company by company basis to identify investments with compelling valuations and attractive business models. This is what makes value investing such a compelling investment strategy because if the price paid for the company is low enough relative to its intrinsic value, investors don't need to be overly dependent upon a robust economy in order for an investment to produce attractive results over time. Consequently, value-driven, high quality stock selection will be paramount for any client seeking to preserve and grow wealth over time. Critics who believe stock selection is irrelevant amidst today's macroeconomic headwinds are likely setting themselves up for disappointment in the years to come. Although macro concerns can dictate market returns for a season, individual company fundamentals and their valuations will eventually rule the day in the end.

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

*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.*