



September 2, 2010

Dear Valued Client,

Equity markets, represented by the S&P 500, were down 4.74% in August as investors sold stocks amidst economic data that seemed to show growing uncertainty in economic activity. Federal Reserve Board Chairman Ben Bernanke didn't help inspire confidence among investors when he told Congress the economic outlook was "unusually uncertain". Recent evidence contributing to these comments was persistent weakness in housing, tight credit, and high jobless claims. The reasons for weakness in housing are due to 3 primary factors: 1) Demand was pulled forward from current months due to the homebuyer tax credit; 2) Continued weakness in the job market; & 3) Despite record low mortgage rates, bankers are requiring buyers to put more down upfront, which is slowing the pace of sales as consumers begin to save more of their disposable income. The good news is that housing prices have appeared to stabilize, with the average median home price of 182,600, up 0.7% from a year ago (Source: National Association of Realtors). This stability and continuity in price is important in rebuilding confidence among potential homebuyers. In sum, we believe recent activity in housing is abnormally low and should improve in the coming months as rates continue to drop to record lows, but given tight credit and increased pressure on households to save for down payments, the recovery in housing is likely to be slow, much akin to our outlook for the economy.

Probably the most eye catching move in the financial markets last month was not the downward move in equities, but rather the upward move in bonds and treasuries, as the 30-year treasury yield went from 3.98% to 3.53% and 10-year treasury yield went from 2.91% to 2.48%. The shift from stocks into treasuries is typical during periods of uncertainty, but the price investors are paying for the safety contained in treasuries is getting expensive, particularly in light of the low treasury yields and better relative value in equities. For example, the earnings yield on the S&P 500 based on 2010 estimates is expected to be 7.42%, far greater than the yields received from bonds (Source: Goldman Sachs). At what point will investors start seeking higher returns through the ownership of equities as opposed to bonds? Short-term, we don't know, but we continue to believe that stocks are priced to outperform bonds on any 3, 5, or 10-year rolling basis moving forward. Investing with the herd is not a recipe for successful long-term wealth creation. Given the upward move in bonds, we are looking closely at all of our bond funds to see where we can lower risk, while still remaining well diversified among asset classes.

If markets are inefficient in the short term in accurately assessing stock prices, and if the value of any stock is the present value of all future cash flows, then why do so many investors make hasty decisions on short-term performance and market "noise" when it has very little impact on the intrinsic value of the stock? The answer is a complex one, but it is primarily based on an emotional response of greed and/or fear, along with many bias' and opinions that enter into and impair our objectivity in making rational, well thought out decisions. If we were to apply what is common in



stocks to another asset, like a house, it would be the equivalent of buying a house after only seeing 1 room in the house. Thorough analysis of any business requires a 10-year view on how the company has performed through an economic cycle. In light of this increased investor propensity to think short-term, what are the root causes that have promoted such behavior? In our opinion, it's clear that increased access to self-directed, low cost online investment accounts coupled with the noise and over analysis from the financial media has produced an environment where trading & speculation are encouraged. Self-directed online brokerages have a vested interest in promoting this short-term, speculative mentality because it helps them increase the number of transactions performed on their brokerage platform, while the financial media has a vested interest in evoking emotional responses from their viewership so they will "stay tuned" and watch their paid advertisements. While we encourage all our clients to stay informed on current issues affecting our economy and financial markets, we also warn clients against acting on impulse amidst the news of the day. Successful investment outcomes are based on objectivity, perspective, and discipline, not impulse and emotion. Thankfully, we are pleased to have a great group of clients who understand that successful investing is a marathon, not a sprint.

As always, we thank you for your trust and support 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.*

*The opinions and forecasts expressed may not actually come to pass. This information is subject to change at any time, based on market and other conditions and should not be construed as a recommendation of any specific security or investment plan. The representative does not guarantee the accuracy and completeness, nor assume liability for loss that may result from the reliance by any person upon such information or opinions. Past performance does not guarantee future results.*

*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.*