

Third Quarter 2011 Client Commentary

September 30, 2011

WHAT WE HAVE LEARNED IN 2,066 YEARS...

"The budget should be balanced, the Treasury should be refilled, public debt should be reduced, the arrogance of officialdom should be tempered and controlled, and the assistance to foreign lands should be curtailed lest Rome becomes bankrupt. People must again learn to work, instead of living on public assistance." - Cicero - 55 BC

....SO, APPARENTLY NOTHING

Providing Perspective on the Markets and Economy: George Pierce, CFP®

Continued concern over the debt burden of the developed world combined with the deeply divided political landscape in Washington, D.C. has many investors questioning the sustainability of the economic recovery following the Great Recession of 2008. Growth has slowed and we believe the chance of revisiting a recession has increased to approximately 35%. However, the most likely scenario remains that global growth will continue at its modest pace, which could offer an upside surprise for an increasingly bearish-biased market.

While these volatile markets are sending many investors scrambling for a rock to hide under to wait out the uncertainty, I believe turning over those rocks in search of investment opportunities may prove fruitful over the long term. Fear and emotion oftentimes defines short-term market reactions. However, when fear is at its pinnacle, a patient temperament, faith in your investment plan, and a commitment to opportunistic investments can ultimately turn short-term market challenges into long-term investment success.

One does not have to go far into the history books to find two periods where short-term fear transitioned into investment triumphs. Today's investment environment is causing investors to face similar challenges to those that haunted them in 2008 and again during the summer of 2010. In both of those periods, prices had declined further than their fundamental values and proactive policy action by central banks served as the catalyst to lure opportunistic investors back into the market. I believe that the same environment exists today and the same elixir is needed for these uncertain times.

The crowded trade certainly remains bearish, but policy actions to stoke the economic growth fire have begun again in earnest. The Federal Reserve Bank recently announced that they will provide additional stimulative monetary policy through Operation Twist. Moreover, many central banks around the world that had been intentionally slowing their country's growth in an attempt to head off inflation are now switching from the brake to the gas pedal to provide more stimulus to jump start growth and the stalling global economic recovery.

The market appears to be suffering much more from a lack of clarity and a wave of uncertainty than it is a degradation in economic fundamentals. While growth has undoubtedly slowed, most corporations are still on pace to post near-record third quarter profits, business spending continues to be strong, and retail sales remain positive. In fact, buoyed by surging auto production and sales following the disruption caused by Japan's springtime natural disaster, economic growth this quarter for the United States may be poised to not only be the fastest of the year, but also to be faster than the first two quarters of the year combined.

Despite this modest and far from disastrous outlook, uncertainty has outweighed optimism and question marks have outpaced clarity. The market is essentially suffering from a recession of confidence. With the mood decidedly bearish, the market does not believe in this recovery and investors do not have faith that policy makers can avert the second recession in three years. But, it is fear and emotional disbelief that often serves as the catalysts to lower expectations — and stock prices — to levels that even market bears see the value of owning. While the market still faces a challenging environment and has a wall of worry to overcome, I believe that patience and a vigorous commitment to your investment plan is the best strategy to weather this bout of uncertainty and serve as yet another example of the resiliency of the markets, the global economy, and American business. As always, if you have questions, I encourage you to contact your advisor.

As always, I encourage you to contact me with any questions.

Equity Elements: Tom Owen, Registered Securities Principal, LPL Financial

During times of market volatility, the function of the stock analyst shifts from that of an inquisitive explorer to more of a diagnostics detective for purposes of determining if a subject company's profile has been altered or if there is evidence of an adverse event or trend in place. In our approach, we ask ourselves whether or not there any check-boxes that were marked in the affirmative at the time of recommendation that would not be marked today. Is this market price action stemming from a problem within a specific business or is it based on macroeconomic elements?

Some of these check-boxes included in our analysis are:

1. Is the company capitalized in a strong, enduring way?
2. Does the company demonstrate ongoing category and market share dominance and leadership?
3. Is the business able to garner a strong operating margin combined with a high probability that the margin will be increased (widened) going forward? Dividends?
4. Is there a signature culture of excellence driven by the company punctuated by a high level of stock ownership among employees? (i.e. Do they eat their own cooking?)
5. Does the business possess a benign risk profile regarding patent, environmental and legal issues?
6. Is the company an upstanding corporate citizen?

Every day we assess these and other industry-specific criteria. When we observe a shift in performance, culture or financial strength, the company is subject to formal review with the possibility of it being removed from our recommended list.

In conclusion, we are observing that the recent volatility in the financial markets is a result of large, global factors and not of any visible challenges pertaining to the individual companies you own within your portfolio.

Methods of Evaluating Risk: Elaina Shemeta, CFP®

One of the most common measures of risk, the Sharpe ratio, tells investors whether portfolio returns can be attributed to excessive risk (both upside and downside volatility in the marketplace) or investment decisions. As your advisors, we take this one step further when evaluating portfolios and incorporate yet another measure of risk, the Sortino Ratio, to help us differentiate between upside and downside risk. The Sortino ratio is a modification of the Sharpe ratio, and removes the volatility that results from upward movements in returns and instead focuses solely on downside risk exposure. The Sortino Ratio helps us to attempt to minimize “bad

volatility” present in portfolios while keeping opportunities for beneficial upside risk intact. This helps us to more accurately assess risk in a better manner than simply looking at excess return to total volatility.

Year End Gifting: Eileen Olson, Registered Client Service Associate

As the year end quickly approaches, we want to remind those of you who would like to make gifts of stocks or mutual funds that those instructions need to be in our office prior to the end of November. Often, the transfer of mutual funds can take between 6-8 weeks to re-register the shares. If you are considering gifting a security, the instructions should be given to us as soon as possible to ensure your gift will be completed by the year-end deadline.

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult me prior to investing. All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

The Federal Open Market Committee action known as “Operation Twist” began in 1961. The intent was to flatten the yield curve in order to promote capital inflows and strengthen the dollar. The Fed utilized open market operations to shorten the maturity of public debt in the open market. The action has subsequently been reexamined in isolation and found to have been more effective than originally thought. As a result of this reappraisal, similar action has been suggested as an alternative to quantitative easing by central banks.

This research material has been prepared in part by LPL Financial.

Securities and Advisory Services offered through LPL Financial. A Registered Investment Advisor. Member FINRA/SIPC

