

Fourth Quarter 2010 Client Commentary

December 31, 2010

The most difficult subjects can be explained to the most slow-witted man if he has not formed any idea of them already; but the simplest thing cannot be made clear to the most intelligent man if he is firmly persuaded that he knows already, without a shadow of doubt, what is laid before him. - Leo Tolstoy, 1897

Climbing Out: George Pierce, CFP®

Hubris is defined as “excessive pride or self-confidence; arrogance.” If the market collapse in 2008 has taught us anything, it was that the smartest people in the room weren’t so smart after all. As bubbles develop, even the “best and brightest” lose sight of the warning signs as hubris replaces rational thought with a “this time things are different” mind-set. Time and time again, the outcome we now see in hindsight is both predictable and disastrous. As your advisors, we too can be susceptible to the irrational exuberance of heady times. Nevertheless, we recognize that the formula for our long-term investment success is maintaining consistent adherence to a discipline that works to eliminate the emotional element that so often accompanies bubbles. Our first priority is not to “top the charts” so to speak, but to identify realistic objectives for our clients, provide strategies for achieving them and monitor our progress through a process of constant vigilance and frequent contact, making adjustments when circumstances warrant. We recognize that diversification among non-correlating asset classes, although a significant part of the strategy we deploy, does not guarantee against loss, but does mitigate against the risk of significant loss.

Financial markets continued their recovery in 2010 as nearly all asset classes moved higher. Common stocks, bonds, and commodities the world over advanced. The Dow Jones Industrial Average gained 11% to 11,577 and the S&P 500 rose 12.8% to finish at 1258, reaching levels not seen since the collapse of Lehman Brothers in September 2008. With the exception of some European sovereign debt in Greece, Ireland, Spain, Italy, and Portugal, bond prices rose across the board only to pause in October when inflation fears and stronger growth expectations for 2011 pared their gains. Not to be left out, commodities had another strong year due to a falling dollar and increased inflation fears.

While we’re happy to report our expectations of an ongoing recovery, we would add a degree of caution to the outlook looking forward into 2011. The combination of low yields, low inflation and slow economic growth which has fueled the recovery in such a comprehensive fashion, is not as sustainable as it was in 2010. The first signs of a break in the upward trajectory of financial assets occurred shortly after Quantitative Easing II (QE II) in November, 2010. Although subject to debate, QE II appeared to spook the debt markets, as instead of pushing rates lower, it raised the specter of faster growth and inflation, and of course higher interest rates. At present, that fear appears to have subsided but remains a real risk to the recovery. Why? Higher interest rates could seriously stifle the recovery of the residential housing market, which could in turn substantially impact the overall economic recovery. As it is, residential real estate is already set for a shake-up as an estimated 4-6 million foreclosed homes are expected to be added to an already oversaturated market in the next several years. We will continue to closely watch this and other risks and adjust our outlook and your accounts as necessary as conditions change

Our outlook for 2011 is gleaned from our LPL Research team coupled with our investment team’s nearly 70 years of combined experience and the feedback we receive from the dozens of investment firms we maintain ongoing communication with. While there is rarely a consensus opinion and despite the challenges the financial markets face going in to 2011, we see a continuation of the rise in common stock top line revenue growth in 2011. To a lesser extent we also see opportunities in bonds, particularly in high yield corporate, select municipal, and foreign bonds. Lastly, real estate can continue to potentially provide protection in the event of higher inflation, rising interest rates, or a global crisis. We anticipate that the volatility of the markets we saw in 2010 will continue throughout 2011.

Northwest Economy: Tom Owen

The economy of the Pacific Northwest expanded at a modest pace over the course of 2010. Improving export volumes, industrial output, productivity and retail sales were among the leading elements in the increase in revenue growth reflected by nearly all companies of the region. Our outlook for the first half of 2011 shows continued economic expansion with consumer spending on goods and services providing additional fuel to the recovery. The employment picture remains soft which is consistent with what we would expect to observe at this point in the economic cycle. However, we anticipate gradual improvement in the labor market this year and into 2012, providing the long-awaited stabilization catalyst to both the housing and commercial real estate markets

Transparency: The Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010

On December 17, 2010, President Obama signed into law the Tax Relief, Unemployment Insurance Reauthorization, and Job Creation Act of 2010. The legislation includes a long-anticipated extension of the "Bush tax cuts" that were scheduled to expire on January 1, 2011. Other significant provisions include a new alternative minimum tax (AMT) "patch," a major modification of the estate tax, and a new one-year 2% employee Social Security payroll tax reduction. A summary of the key elements of this bill will be sent to you upon request.

Our Website – An excellent resource for you: Elaina Moldskred, CFP® and Ross Snyder, CFP®

We continue to enhance our website, and encourage you to access it for information on items that may be important to you. A few areas of interest that many of you may find beneficial are highlighted below. Please go to www.georgerpierce.com, and then click on "Market Updates" and also the "Learning Center"/ Articles to find more information on these topics.

1. Market Commentary (In Market Updates & Learning Center) - Given the current cycle of the market, as well as questions received from you, we are posting weekly market and economic commentary, as well as weekly perspectives on the bond market. By doing so, we hope you will take some time to read these materials, especially prior to a review. This will allow us more time to focus on your specific portfolio, versus the general observations on market conditions.

2. Municipal Bond Market (In Market Updates) – Many of you are likely already aware of the recent declines in the municipal bond market, which was magnified by a recent program on *60 Minutes*. There are certainly problems that municipalities face, as most have budget issues that will need to be addressed. However, this is not something new, and a recovering economy will help mitigate these problems to an extent. We have posted much more detailed commentary on the website specific to this. Please note that we do look at municipal bonds as an integral component of many portfolios, but are aware that even the negative news if prolonged can have an impact. We will be working with you during your reviews to assess this and to determine if changes need to be made in your allocation based on your risk tolerance and situation.

3. Social Security Planning (In Learning Center) - Those close to or already in retirement may have questions regarding Social Security. The most common question is when to begin taking benefits. As we all know, the later you wait, the higher your benefit will be. But did you know the difference in benefits from age 62 to 70 is roughly 75%? Also, there are planning strategies for married couples who can take their own benefits or half of the amount their spouse is entitled to. We have posted some general information regarding Social Security on our website. In addition, we also have several tools available to us internally to help analyze different strategies to maximize income. We encourage you to review the website for the general commentary, and call us concerning your specific situation. We can also address this in an upcoming review.

Office Manager Corner: Valerie Wilson

We are excited to announce the marriage of Kasie Nevers to Kevin Kaleva on December 4, 2010 at Salish Lodge, they spent their honeymoon exploring San Francisco. She will be officially changing her name to Kasie Kaleva. The excitement continued over the New Years weekend with Elaina Moldskred getting engaged to Mike Shemeta. He asked and she said yes, they are looking to set a date during the summer. Congratulations to both Kasie and Elaina.

As a reminder our staff is here to answer any statement and operational questions that you may have. Also, both Valerie and Tara are notaries, this is a free service we offer to our clients should you need it.

Disclosures:

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 with your financial advisor prior to investing. Securities and Advisory Services offered through LPL Financial. A Registered Investment Advisor. Member FINRA/SIPC

High yield/junk bonds are not investment grade securities, involve substantial risks and generally should be a part of the diversified portfolio of sophisticated investors.

Municipal bonds are subject to availability and change in price. They are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Municipal bonds are federally tax-free but other state and local taxes may apply.

International Investing involves special risks such as currently fluctuation and political instability and may not be suitable for all investors.