



## INVESTMENT COMMENTARY

---

---

*"DESPITE NEGATIVITY, BULLISH SIGNS ARE HARD TO IGNORE"*

*9/17/2010*

---

Welcome back from what was hopefully an enjoyable summer. Since our last letter to you in mid-July, the S&P 500 is up 3.1%. Emerging markets, where we are currently over-weighted for our advisory clients, are up even more. The average return for the specific markets we are currently invested in is 8.9% over the same period.

Although the last couple months have generated positive returns, the U.S. equity market remains stuck in a consolidation that began about one year ago and it's not hard to see why. Despite historically low interest rates, economic and employment growth have been anemic. An incredibly popular President has seen his approval rating drop precipitously. Investors have swarmed to fixed income alternatives, pulling billions of dollars out of domestic equities. I could obviously continue, but the point is that disappointment and uncertainty reign and people are shunning risk.

That being said, we believe it is likely that we are near an end to this relatively flat period in the domestic equity market. Despite the negativity that seems to be everywhere, the signals are just too strong to ignore.

Let's start with sentiment. Believe it or not, market sentiment just a few weeks ago was as low as it was at the equity market bottom in March 2009. That's how bad it had gotten. Remember, this is a contrary indicator, so low is good. Our favorite sentiment survey, the Investors Intelligence survey, bottomed out in late August and has since moved slightly higher. Both level and direction are important so where we stand right now is the best of both worlds, low but improving sentiment.

Valuations are also very important and remain attractive. For this discussion it might be helpful to provide some historical context. I'll use the MSCI index that I discussed in our last letter, which allows us to compare valuations across countries with some consistency.

The current forward four quarter price/earnings (PE) multiple for the U.S. MSCI index is 11.6x. The median over the last decade is 16.1x. That is almost 40% higher than where we are today. Worldwide, the current PE multiple is 11.4x, while the median over the past decade is 13.7x, which is 20% higher. And you have this discount to historic medians at a time when interest rates are much lower than they

have been over the past ten years. I know there are many reasons that can be given for these depressed PE multiples, but a 40% discount to the median seems to already have priced in quite a bit of bad news.

Nothing material has changed on the liquidity front. The Federal Reserve remains committed to keeping both short-term and long-term interest rates low for the foreseeable future. In fact, after having spent the past year or so neutralizing the enormous increase in money supply driven by the financial crisis in 2008, the Federal Reserve has again begun to slowly increase money supply over the past couple of months.

Let me close by highlighting one more powerful economic indicator that is sending positive signals – the yield curve. This topic alone can, and has, consumed entire books, but in the spirit of brevity I'll try to quickly move through it.

The yield curve measures the difference in rates between various fixed income maturities, most often U.S. government debt. A steep yield curve means long-term interest rates are much higher than short-term interest rates, while a flat yield curve means they are about the same.

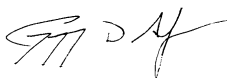
The U.S. government debt market is incredibly large and the shape of this curve is a good indicator of perceived future economic performance. Historically, when the yield curve is very steep and begins to flatten, it has proven to be a positive intermediate-term signal for the equity markets.

Currently, the yield curve (we will use the yield on 10 year treasury notes minus the yield on three month treasury bills) widened to over 300 basis points in late 2008. It has now started to flatten and currently stands at about 250 basis points. Two things to note are: 1) once the yield curve begins to flatten, it usually continues on this path for a sustained period of time and 2) over the past 50 years, when this has happened the equity markets have gone up 88% of the time over the next 12 months, and the average gain is 13.7%.

Please remember, we are investors, not traders, and anything can happen in the short-term. But we believe these indicators point toward positive equity performance over the intermediate-term.

On that note, we hope you have a terrific fall and as always welcome any questions or concerns.

Sincerely,



Gregg D Adzema  
Chief Financial Officer