

QUARTERLY NEWSLETTER

October 17, 2011

Market Commentary:

World equity markets, as measured by the FTSE All-World Index, retreated during the 3rd quarter of 2011 providing a year-to-date (YTD) total return of -13.59% as of September 30, 2011 versus a YTD return of 4.85% as of June 30, 2011. As discussed in the previous newsletter, reversion to mean returns continues to rule financial markets. Unfortunately, my statement in that newsletter that “further pullback in the near future is quite likely” would appear prescient. The good news is that global markets now appear to be trading at a slight discount to fundamental valuation measures. This provides investors with an opportunity to purchase equities at lower prices through either the addition of new money or simply rebalancing to their targeted allocation.

During 3Q2011, the main contributors to poor equity returns were developed Europe (-22.61%)* and emerging markets (-22.56%)** economies. This said, equity markets around the globe were decidedly negative over the past quarter which reflects the fact that global markets have become more correlated over the past decade. A crucial factor that may be at play here is the ease with which investors around the globe can buy and sell securities which may, in turn, be an important mechanism for transmitting financial shocks around the globe. A recent academic paper, [“Asset Fire Sales and Purchases and the International Transmission of Fund Shocks”](#), examines this in greater detail.

Though global equity markets have are highly correlated they are not perfectly correlated, they remain only slightly correlated with investment grade bonds, and they continue to exhibit bouts of over enthusiasm and panic. Periodic rebalancing continues to provide superior results by taking advantage of relative price strength and weakness. As Peter Bernstein points out in *Against the Gods*, a “market timer” out of the market for only the 5 best days during the 3,500 trading day period between May 1970 and April 1994, was worth only 63% as the investor who maintained his market position during the entire period. Market timing is indeed a risky strategy! A better approach is to maintain your portfolio’s anticipated risk/return characteristics through efficient rebalancing.

* As measured by the MSCI Europe Index for the 3 months ending September 30, 2011

** As measured by the MSCI Emerging Markets Index for the 3 months ending September 30, 2011

Eurozone and the European Debt Crisis

International financial contagion is nothing new and is most pronounced during times when developed markets (especially the U.S.) “crash”. In fact, since the first international financial crisis of 1720 was sparked by the South Sea and Mississippi bubbles, very few financial crises have been purely national. Our current global financial situation is no exception. Largely as a result of international contagion, the Eurozone now finds itself in crisis only 10 years after the launch of the Euro which was intended to increase efficiencies and stabilize the economies of participating countries.

Several member states of both the Eurozone and the United States have found themselves in financial difficulty. The United States, however, is able to react to its states’ fiscal problems much more pragmatically. That is, the several states are bound by a common constitution, federal government, banking system, and strong sense of American patriotism amongst its citizenry. The Eurozone, on the other hand, finds itself much weaker in all of these areas, with the exception that many Eurozone influential politicians remain resolutely pro-European. The question becomes whether or not the Eurozone will be able to continue their subsidization of financially weaker states as has largely been the case in the United States since its founding.

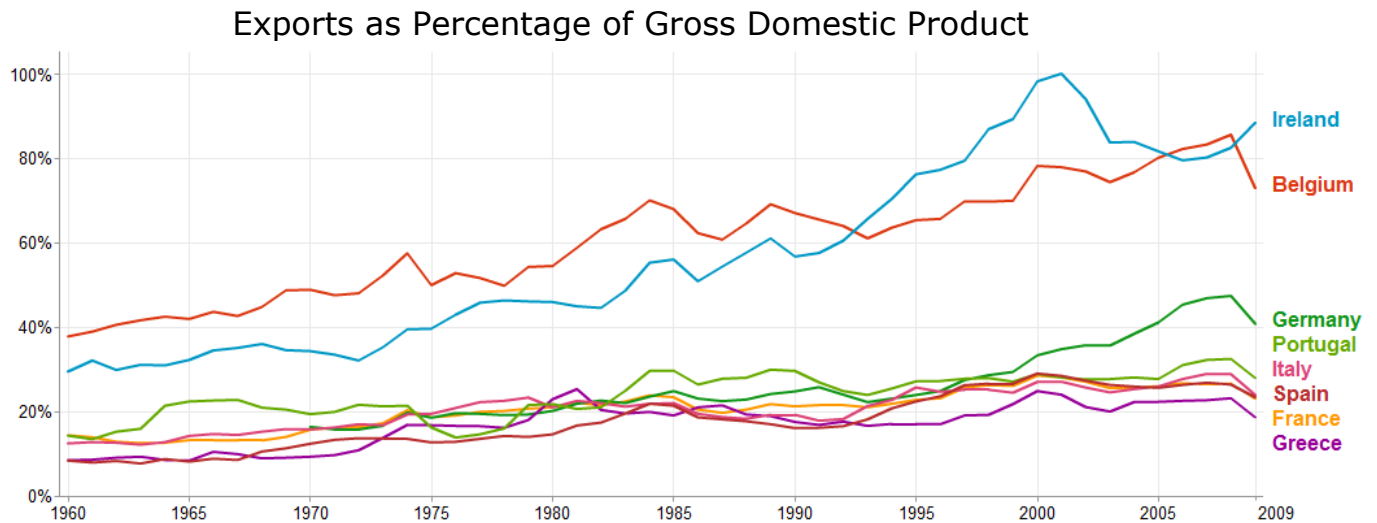
Though the debt/GDP ratio tells far from the entire story, it’s a good starting point for understanding which member countries face financial difficulty. The following table shows the debt load of various Eurozone countries.

Country	Debt as % of GDP	
	2010	2011 (Est.)
Belgium	96.7	94.6
France	82.3	86.8
Germany	84.0	82.6
Greece	142.8	165.6
Ireland	94.9	109.3
Italy	119.0	121.1
Portugal	92.9	106.0
Spain	60.1	67.4

Source: International Monetary Fund, World Economic Outlook Database, September 2011

Sustainable Debt/GDP ratios for developed countries are generally agreed to be as much as 60-70%. Though most the ratios given in the table exceed sustainable levels it’s important to recognize that year-to-year comparisons are indeed improving for some. One critical factor in determining whether a debt laden country will be able achieve an acceptable debt ratio in the future is its level of exports. That is, a country that makes products for export

essentially brings in new wealth which, in turn, helps greatly to shore up the balance sheet of that country.



This data suggests that Greece, Italy, and Portugal will not be able to rely on exports to pull them out of their respective debt problems. Further, these same countries have suffered from deteriorating balance sheets due to lower tax receipts and increased demand for public services. It would then seem the only hope for stabilizing these economies in the short run would be for the Eurozone to come to the rescue, but is this possible?

The European Central Bank (ECB) is the Eurozone's rough equivalent of the Federal Reserve in the United States. That is, though their mandates differ somewhat, the overall objective for both entities is stable currency. As a result of the global financial crisis, the ECB created the European Financial Stability Facility (EFSF) during May 2010 which is essentially an "off balance sheet" entity to assist in bail out efforts for Eurozone countries in financial difficulty. This EFSF effort was able to withstand the bailout needs of smaller countries, but Italy (the third largest economy in the Eurozone) is simply too large for the relatively small EFSF to rescue.

Relying on further ECB funding is also tricky since the ECB would need to increase the money supply in order to purchase the bonds of troubled Eurozone countries. This proposition does not sit well with Germany since an increase in the money supply would cause an increase in inflation, which is not in Germany's best interest. Since Germany is the most influential Eurozone member, the ECB depends on Germany's support which they do not have in this instance.

Another potential would be the issuance of Eurobonds. These would be issued by the Eurozone as a whole with each member country being jointly and severally liable for repayment. Proponents state that this borrowing could be had at favorable interest rates which currently exist in countries such as the U.S. and Britain. Critics hold that such bonds would not encourage troubled countries to seek solutions to their fiscal troubles, necessitate the need for European treaties, and would ultimately drive up borrowing costs for Germany. For now, the necessary support for a Eurobond solution does not exist.

Various other potential solutions have been bantered about, but ultimately the Eurozone experiment will be forced into reckoning. It could be that weaker countries like Greece will simply leave the Eurozone. This would allow these countries to escape Eurozone requirements and default on their debts. Though painful in the short run, this may be the only way for these countries to get a fresh financial start as many other countries around the globe have done in the past.

Another scenario would be that economically sound countries like Germany and the Netherlands would simply leave the Eurozone. In Germany there is currently little political support for such a move, however. The ruling CDU party as well as its various opposition parties remain steadfastly pro-European and will likely continue to escalate their past bailout decisions in order to save face. Ultimately, though, the fear of unknown consequences of a Eurozone breakup will stall a Eurozone fragmentation as long as possible.

Why Worry About the Eurozone?

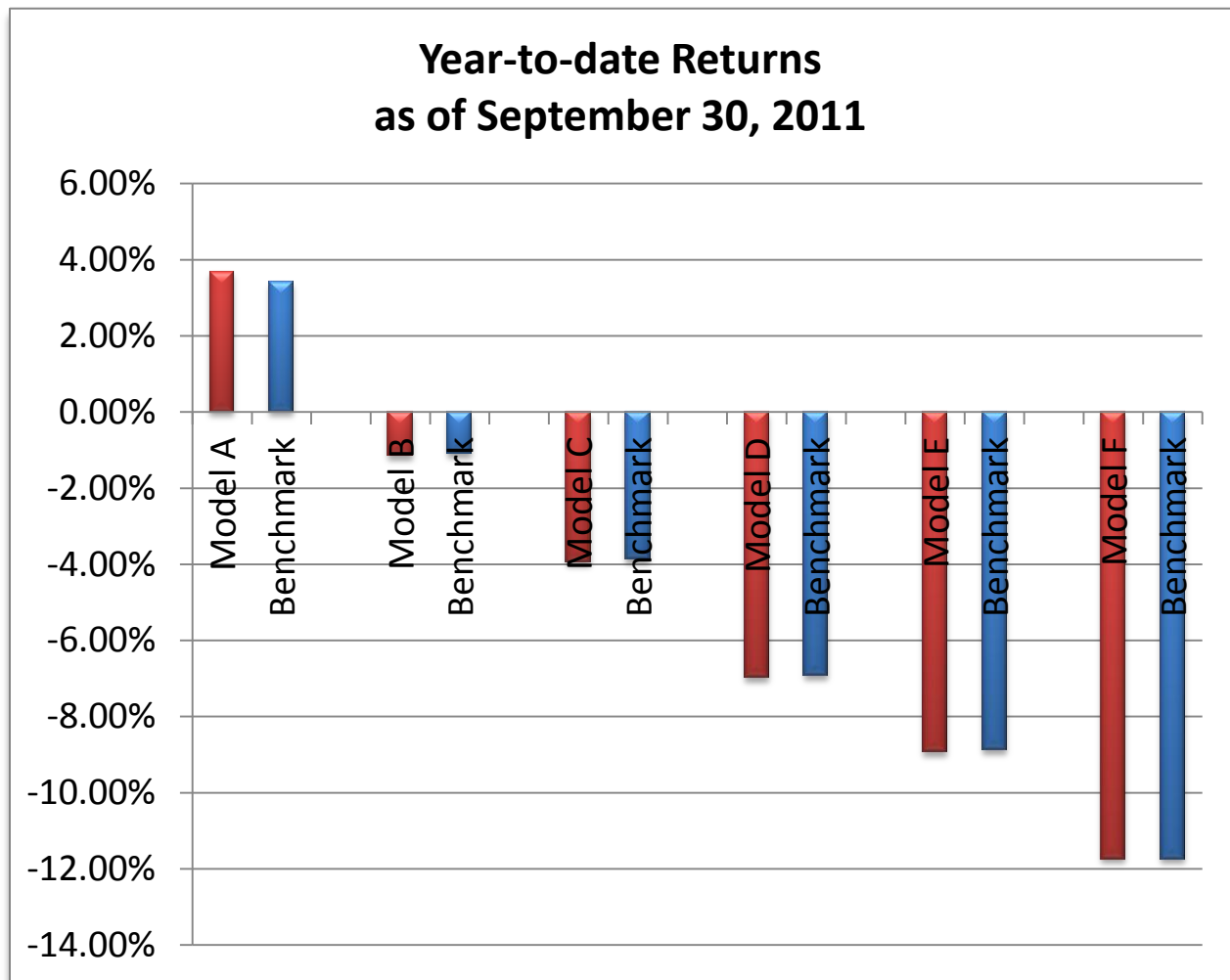
Eurozone countries currently make up approximately 6-7% of the equity portion of portfolios I recommend. Therefore, as a percentage of the whole, the Eurozone position is quite small in each of my model portfolios. This said, Eurozone difficulties could cause further international contagion since Eurozone countries are significant global consumers and producers. In the short run this could cause difficulty for non-Eurozone suppliers via lower consumer demand as well as increased pricing pressures through Euro devaluation.

Eurozone countries will pull through, however. It's hard to say what will happen in the short run, but I am confident they will be in better financial shape in the long run. Financial market history has repeatedly shown that rebalancing to target during unsettled times provides exceptional results over longer periods of time. Given the ingenuity and sophistication of Europeans I have no doubt this will continue to be the case. Additionally, though earnings in Europe are facing pressure, key fundamental valuations do currently appear attractive.

Model Portfolio Performance Summary

The following graph depicts performance results from model portfolios and vehicles utilized during the first three quarters of 2011. The RED bars reflect the returns associated with my recommendations for the 9 months measured, while the BLUE bars reflects those of the global marketplace as a whole. Each bar reflects a model portfolio consisting of a bond/stock allocation, with Model A being the least volatile and Model F the most.

You will notice that each of the recommended models closely tracked the respective benchmarks.



Absolute return performance is not the whole story, however. Instead, returns should be measured in relation to risk, which in the investment world is measured in terms of volatility. Nine months is unfortunately too short of a time frame to measure volatility. Instead, this risk measure will be provided after a full twelve months.

In Closing

Though returns have been largely negative for the nine months ending September 30, 2011, it's important to stay focused on long term results. Historically, 1 in 3 years have provided negative stock returns, and it seems we may be experiencing such a year. Intelligent and disciplined investors recognize that higher volatility (i.e., risk) is why stocks have outperformed bonds over long periods of time, however, and periodic rebalancing seeks to take advantage of relative strength and weakness in the marketplace as well as maintains the risk/return profile of an investor's portfolio consistent with their risk tolerance and time horizon.

Remember: *Diversify utilizing a sound investment strategy and stay on target. You will be rewarded.*

If you need assistance developing an investment program and identifying appropriate investment vehicles, then seek the assistance of a fee-only NAPFA registered financial advisor who is also a CERTIFIED FINANCIAL PLANNER™ professional having the proper education and experience.

A handwritten signature in blue ink that reads "Troy".

Troy Sapp, CFP®
Commencement Financial Planning LLC

Year-to-date Model Performance Discussion and Disclosure

Global equity markets experienced a significant pullback during the three months ended September 30, 2011 which caused equity returns to turn negative year-to-date. Of the equity asset classes modeled, U.S. REITs have lost the least year-to-date followed by U.S. Large Capitalization stocks. Conversely, Emerging Markets lost the most followed by Small Capitalization Foreign Developed Market stocks. Commencement Financial Planning LLC (the "Advisor") believes that small capitalization stocks will outperform large capitalization stocks over the long term, thus tends to overweight them in its model portfolios when compared to the market as a whole. If large capitalization stocks had an even stronger relative performance during the first three quarters of 2011 than small capitalization stocks, the models would not have performed as well compared to their benchmarks.

The Advisor's model investment portfolios for the period also utilized Treasury Inflation Protected Securities (TIPS). TIPS tend to outperform when actual inflation is higher than anticipated by the market and/or during times when the market is suddenly willing to pay a premium for inflation protection. If TIPS had not outperformed Treasuries, Agencies, Mortgage Pass-thru, and investment grade bonds; the Advisor's model portfolio would not have performed as well compared to the benchmarks.

On July 31, 2011, the Advisor added short term investment grade bonds to its recommended model portfolios. The Advisor believes this investment will provide lower returns but also lower volatility over the long term than intermediate investment grade bonds as found in its benchmark. The Advisor believes the lower anticipated risk of this newly added asset class outweigh the potential downside of lower returns.

More information regarding the Advisor's investment strategies can be found within its most current Form ADV Part 2.

The stated returns include internal fund fees, but do not include fees charged by the Advisor, potential brokerage fees, or potential taxes. See the Advisor's most current Form ADV Part 2 for its fee schedule. Brokerage fees vary depending on the broker utilized. Taxes could result from income and/or capital gains distributed by the funds during the period as well as from the realization of capital gains due to fund share transactions as a result of portfolio rebalancing.

Performance results assume no contributions or withdrawals are made during the period, all fund distributions are reinvested, and all investment portfolio models/benchmarks are rebalanced to targets semi-annually.

Benchmark portfolios consist of the Vanguard Total World Index ETF (VT) which is designed to track the FTSE All-World Index; and the Vanguard Total Bond Market ETF (BND) which is designed to track the Barclays Capital U.S. Aggregate Float Adjusted Bond Index. The target allocation of stocks and bonds for each benchmark reflect the stock and bonds allocation targets of each respective investment portfolio model. The Advisor has adopted this method to provide what it believes to be the best performance measurement tool.

Investing provides the potential for both profit and loss. Past performance is not indicative of future results. Investment model portfolio performance provides hypothetical returns, does not represent actual trading, and has inherent limitations. Actual performance would have differed according to investment inflows or outflows; the timing of rebalancing; the taxability of income and gains; unique expense levels; and decisions particular to each investor.

The Advisor did change its recommended model portfolios and investment vehicles during the period measured. From time-to-time the Advisor will make such modifications to the investment model portfolios and/or investment vehicles.