QUARTERLY NEWSLETTER

October 7, 2012

Market Commentary:
Global equity markets experienced a general rally during the 3rd quarter of 2012, with year-to-date returns around the globe reflecting a more upbeat economic outlook. As I stated in my last newsletter: "Exactly when or how Europe regains its monetary footing remains to be seen, but make no mistake, when it does the market will react swiftly and unexpectedly. Those not invested in 'difficult' markets will most likely not participate in excess returns when they materialize." Markets are now more expensive than three months ago, so investors that continue to wait on the sidelines are now faced with an even greater dilemma: hope that markets fall (but such markets have been proven to be too scary for these investors to buy into) or wait for more optimistic news (which will result in even higher equity prices).

Below are the cumulative returns of major market indices for the nine months ended September 28, 2012:

Benchmark	Year-to-date
S&P 500 Index[1]	16.44%
MSCI US Small Cap Value Index[1]	14.63%
MSCI EAFE Index[1]	10.08%
MSCI EAFE Small Cap Index[2]	13.20%
MSCI US REIT Index[1]	14.89%
MSCI Emerging Markets Index[1]	11.98%
Barclays Capital US 3-7 Year Treasury Bond Index[2]	2.19%
Barclays Capital US TIPS Index[2]	6.25%
Barclays Capital U.S. MBS Index[2]	2.80%
Barclays Capital U.S. 5-10 Year Corporate Index[1]	9.95%
Barclays Capital U.S. Aggregate Bond Index[1]	4.07%

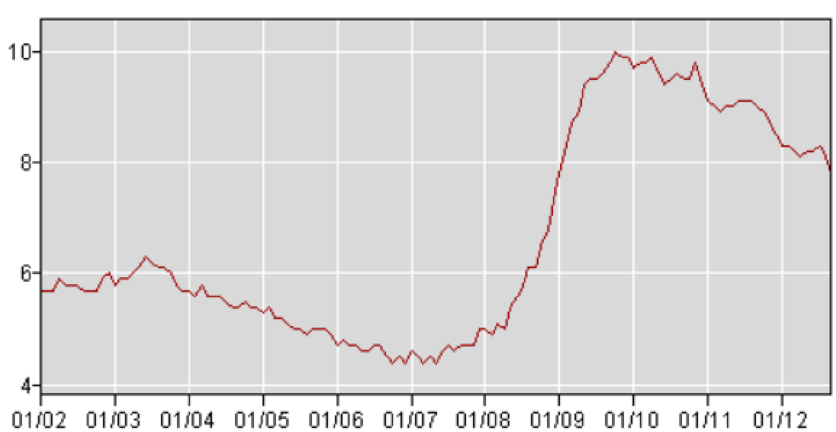
1 Source: Vanguard. Visit **www.vanguard.com** for a description of each index.

2 Source: BlackRock. Visit **us.ishares.com** for a description of each index.

On September 13, 2012, the Federal Reserve announced its intention to launch QE3 which will consist of open market operations to purchase long term mortgage-backed debt. Economists predict these open market operations will ultimately purchase $600 billion of such debt. Within a couple of weeks after the Fed's announcement, the rate on long term mortgages dropped to 3.36% (according to Freddie Mac). This is the lowest rate since long-term mortgages began in the 1950s, thus it appears that the Fed's action is resulting in their desired outcome. That is, drive interest rates down so that money is driven toward more risky endeavors.

With these low interest rates investors will likely continue to seek higher yields in investments such as longer term bonds, lower rated bonds, and high dividend paying equities; but make no mistake: **higher returns cannot be had without assuming more risk.** A better approach is to maintain a globally diversified equity portfolio while targeting a bond allocation that's appropriate for your ability and/or need to assume risk. Even though bond yields are not attractive, maintaining a high quality limited duration bond allocation will continue to dampen the inevitable near term volatility of equities.

On Friday, October 5, 2012, the Bureau of Labor Statistics announced that the unemployment rate dropped to 7.8%. This is the first time that unemployment has been under 8% since early 2009 (or before President Obama took office). This is generally good news since more workers means more consumers and more taxpayers, but it may also lead to greater inflationary pressures. Though the Fed has signaled its intention to keep inflation in check, I'm skeptical of its ability to do so. That is, inflation is a good thing for debtors (the US government is a big one), the first line of defense against inflation is to increase interest rates (which is horrible for debtors), and the spending public doesn't think that high interest rates are any fun. You may recall Paul Volker's extremely unpopular decision to increase interest rates and tighten the money supply which he announced on October 6, 1979 during a rare Saturday news conference now called Volker's "Saturday Night Massacre". To put that conference into perspective, Volker announced a target discount rate of 12%; it's currently targeted at less than 0.25%! Controlling high inflation in the future would be no less difficult than it was in 1979.



Historical unemployment rate; source: Bureau of Labor Statistics

No one knows what the future holds, but I'm optimistic. In 20 years' time equities will very likely be worth more, and cash will inevitably be worth less. In the meantime investors should appropriately position their portfolios against all of the potential risks that can be effectively hedged against, and then sleep well knowing that they've done all they can.

In the meantime, bonds (which provide near-term safety) appear all-but-certain to be losers over the long term. That is, given current interest rates, the long-term real return on bonds is likely to be near or less than zero. Additionally, given the strong 3rd quarter equity rally, domestic equities now appear to be a bit expensive on a fundamental basis while foreign developed market equities appear to now be fully priced. This necessarily means that expectations for exceptionally high equity returns going forward should be muted.

It's important to stay focused on long term results. Though equity markets have had a remarkable rally since the first of the year, this will not persist indefinitely. In fact, higher returns in the near term necessarily mean lower returns going forward. Intelligent and disciplined investors recognize that chasing returns is at best a flawed strategy. Instead, these investors learn to control what they can: asset allocation, asset location, and fees. They then periodically rebalance to take advantage of relative strength and weakness in the marketplace as well as maintain the anticipated risk/return profile of their portfolio consistent with their risk tolerance and time horizon. Though this strategy is sound, it is not easily followed. That is, it will cause investors to sell well-performing assets in order to purchase those which have not performed as well. At no time has this strategy felt comfortable, but it has consistently yielded superior performance over longer periods of time.

Remember: *Develop a financial plan according to your unique situation and manage your assets according to a well thought out and documented investment policy. Doing so will greatly increase the probability you will actually meet your financial goals.*

This letter is intended to address broadly defined financial planning issues. If you need assistance developing a wealth management program tailored to your unique situation, 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.

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