

Investment Perspective

Second Quarter 2009

“Inflation is the one form of taxation that can be imposed without legislation” - *Milton Friedman*

SFP Core Strategies*	Quarter 2	
	2009	One Year
US S&P 500	15.93%	-25.85%
US Large Value	22.58%	-31.93%
US Micro Cap	24.76%	-23.56%
US Small Value	23.94%	-27.74%
US Equity Real Estate	30.55%	-43.04%
International Large Value	33.93%	-30.24%
International Small Cap	31.49%	-28.47%
International Small Value	31.78%	-26.98%
International Real Estate	27.61%	-38.55%
Emerging Markets	33.14%	-24.21%
Emerg Mkts Small Cap	47.06%	-18.06%
Emerging Mkts Value	44.78%	-25.04%
Ultra Short Fixed Income	0.96%	3.84%
Shrt/Inter Global Fixed Inc	1.43%	5.32%
Inflation Protected Sec	0.00%	-1.96%
Model Portfolios		
SFP Balanced Portfolio	15.92%	-15.78%
Non SFP Std Balanced	9.79%	-13.34%

During those dark days of February, with the S&P 500 down over eighteen percent for first two months of the year, it would have been hard to imagine that by July, the stock market would be up for the year. But that's just where we are.

Stock market returns, an economic leading indicator, have been tremendous for the quarter. The S&P 500 gained about 16 percent, wiping out earlier losses and ending up about three percent for the year-to-date. The performance of the S&P 500, was, though, dwarfed by other market segments.

In the United States, the smaller companies and the value companies turned in percentage gains in the low to mid twenties while the real estate securities were up more than 30 percent. Developed overseas countries also saw great progress with our strategies - up well over thirty percent. The Emerging Markets fared even better with results for our preferred funds, with gains between 33 percent and a whopping 47 percent in just three months! These lopsided gains have been forcing us to sell some positions, but that's what rebalancing and disciplined investing is all about.

Still, these gains have not wiped out losses for a full one-year period. As you can see from the performance table, a new investor who began last July is still down, and the economy continues to falter while unemployment continues to rise.

On a relative basis, our portfolios did well this quarter. The SFP Balanced Portfolio returned 15.92 percent versus 9.79 percent for the Non SFP Standard Balanced Portfolio. This was due to heavier weighting in overseas stocks along with small and value company stocks. This was also a nice turnaround. As the markets have dropped, the SFP Balanced Portfolio underperformed. The one and three year performance periods are still lagging. (*Please see comparison chart.*)

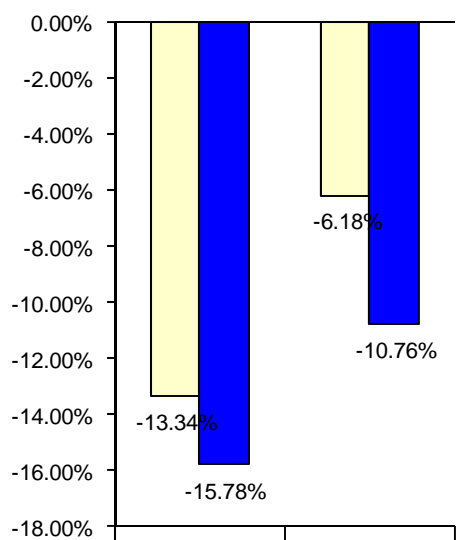
The market turmoil we've been experiencing naturally leads us to think about risk. None of us like seeing our assets decline. It's only human to have such concerns. But in the context of financial planning goals, one must consider other risks that can keep us from obtaining our goals. The primary risks to consider are as follows:

Price Risk – risk of declining asset values from market fluctuations.

Inflation Risk – risk of losing purchasing power.

Longevity risk – risk of outliving your savings.

**Standard Balanced vs. SFP Balanced
With S&P 500**



□ Stnd Balanced
■ SFP Balanced

Price risk can be thought of as a fairly short-term risk that is best addressed by acquiring short-term investments with guarantees such as Treasury Bills or FDIC insured accounts.

In the grand scheme of things, price risk isn't usually what causes someone to run out of money. We're not talking about the gamblers who concentrate their money in one area hoping for the big strike. Sensible investors owning a diversified portfolio with reasonable risk levels rarely go bust due to market dips.

Inflation and longevity risk are medium-to long-term risks that can be more difficult to address. Some people choose real assets like gold or real estate to address these risks, but these don't usually do the trick. You are really looking for assets that are likely to grow in value, namely, stocks.

These are the risks that usually get people. Folks simply outlive their money or fail to recognize the eroding impact of inflation over long periods. Investors who only choose bank CDs face this problem.

For a comprehensive solution, we can't have a portfolio decimated by market moves, eroded by inflation or depleted by time. There's always a trade off. If we protect against price risk, we increase the likelihood of problems with inflation or longevity. If we only invest for the very long term, we might not have anything left for the shorter term.

To get an idea of how this plays out in the real world, let's look at some historical results for ten-year investment periods from January 1926 to May 2009 (overlapping and rebalanced monthly). The chart below shows statistics for six portfolios. They range from Portfolio 1, an all U.S. stock portfolio, to Portfolio 6, an ultra-conservative all Treasury Bills portfolio. The numbers you see are adjusted for inflation using the CPI. In other words, these are real returns. If you had a 10 percent return, but inflation was 3 percent, you'd only end up with 7 percent.

REAL RETURNS JANUARY 1926 - MARCH 2009						
	Holdings as Percentage		Annualized Real Returns	Annualized Volatility (Standard Deviation)	Worst Ten Year Period	Dates of Worst 10 Years
	Stocks	T Bills				
Portfolio 1	100	0	6	18.9	-39.6	Mar 99 - Feb 09
Portfolio 2	80	20	5.2	15.1	-30.9	Mar 99 - Feb 09
Portfolio 3	60	40	4.3	11.4	-22.0	Dec 68 - Nov 78
Portfolio 4	40	60	3.2	7.7	-17.2	Dec 38 - Nov 48
Portfolio 5	20	80	2	4.2	-29.4	Dec 38 - Nov 48
Portfolio 6	0	100	0.7	1.8	-42.1	Mar 41 - Feb 51

As you'd expect, the average return is highest for stocks and lowest for bonds. Also, the volatility is highest for stocks and lowest for bonds. What you may not expect is in the shaded lowest ten-year column. As you can see, the worst ten-year investment period in real returns was a loss of purchasing power of more than 42 percent on a portfolio. Which one was it? The supposedly ultra-conservative 100-percent government guaranteed Treasury Bills.

It's clear the most sensible and truly conservative investment portfolios must contain some stocks. Surviving the worst ten-year period in U.S. stocks has been painful. We hope the recent gains continue, but we must always remember we must be satisfied with a sensible approach. We cannot control all outcomes. Give yourself a break and enjoy the summer.

Brian J. Skaggs, CFP