

Investment Perspective

Third Quarter 2010

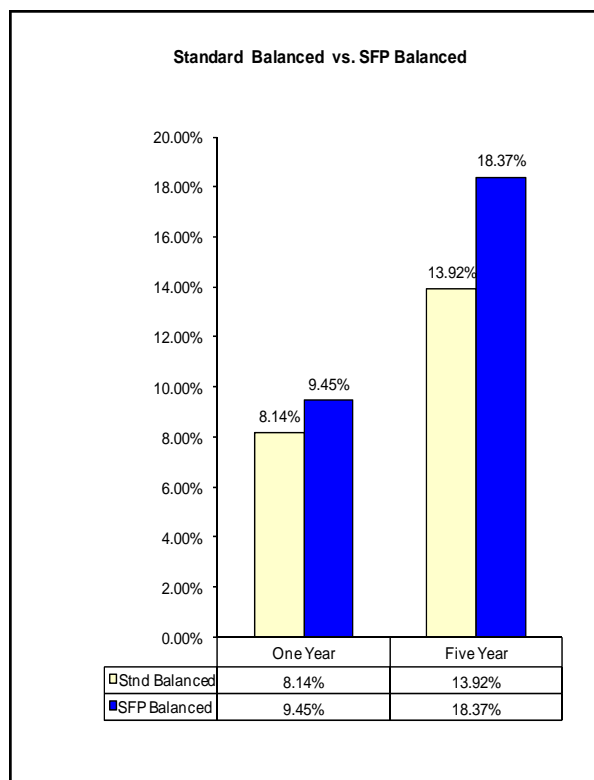
“An expert is someone who knows some of the worst mistakes that can be made in his subject – and tries to avoid them” - *Werner Heisenberg*

SFP Core Strategies*	Quarter 3	
	2010	One Year
US S&P 500	11.30%	10.07%
US Large Value	11.15%	10.50%
US Micro Cap	10.58%	14.44%
US Small Value	12.46%	13.35%
US Equity Real Estate	13.18%	30.57%
International Large Value	18.37%	2.82%
International Small Cap	17.54%	11.10%
International Small Value	16.35%	2.88%
International Real Estate	22.71%	11.71%
Emerging Markets	18.28%	20.28%
Emerg Mkts Small Cap	22.99%	35.76%
Emerging Mkts Value	20.15%	22.76%
Ultra Short Fixed Income	0.37%	1.10%
Shrt/Inter Global Fixed Inc	3.12%	7.34%
Inflation Protected Sec	2.95%	10.18%
Model Portfolios		
SFP Balanced Portfolio	8.82%	9.45%
Non SFP Std Balanced	7.99%	8.14%

Investors breathed a sigh of relief after stocks posted nice returns for the quarter following a big September rally - the best September performance in more than **fifty years**. Domestic markets were up for the quarter by 11.3 percent, as measured by the S&P 500 index, pulling year-to-date numbers back into the black.

Gains came in largely on positive corporate earnings results and diminishing fears of a double-dip recession. We also heard the pronouncement about the end of the recession, which officially concluded in June 2009. Still, most individual investors continue to sit on the sidelines in an apparent case of “once bitten, twice shy.” While the market was moving up quite nicely, investors pulled \$7.9 billion out of equity funds and instead opted to concentrate on bond and money market funds which received some \$83 billion dollars in net new money, according to Lipper FMI. We will get back to this later.

Skaggs Financial Planning, LLC (SFP) portfolios performed nicely for the quarter capturing gains and returning 8.82 percent for our model SFP Balanced Portfolio. This brings its year-to-date performance to 6.78 percent and the last twelve month performance to 9.45 percent.



While all our strategies experienced positive gains for the quarter, the highlights came once again overseas, with the strongest returns coming from the Emerging Markets. While our U.S. Large Company strategy returned 11.30 percent, the Emerging Markets Small Company fund returned just over twice that at 22.99 percent.

With a strong inflow of new dollars, bond funds also had good returns for the quarter. Our intermediate bond strategy returned 3.12 percent, while our Inflation Protected Securities strategy returned 2.95 percent. Most of these returns came from moves in the underlying bond price, not from the dividends paid on the bonds themselves. Bond prices - which move in the opposite direction of interest rates - have become quite high. (*Please see the performance table for details.*)

We are thrilled with our relative performance. The SFP Balanced Portfolio's performance versus the Non SFP Standard Balanced portfolio is as follows: 8.82 percent vs. 7.99 percent for the quarter; 9.45 percent vs. 8.14 percent for one year, and 18.37 percent vs. 13.92 percent for five years, all periods ending Sept. 30. The portfolios were designed to provide the best bang for the buck when looking at returns versus volatility, and to provide little extra return to compensate for the advisory fees we must charge. Happily, we are right on track. (*Please see the comparison chart.*)

But the unfortunate fact for most investors is that they are not on track. A 2010 study by Dalbar showed that the average 20-year stock investor earned just 3.17 percent. Inflation during that time period was 2.8 percent, so investors earned a rate just above inflation - and that does not factor in taxes.

As a quick and dirty example, let's say an individual starts saving for retirement at the age of 35 and they work until 65, 30 years longer, while saving 15 percent of their income. Assuming their savings grows at just the same rate as inflation, they have only put aside an amount equal to 4-½ years of work (15 percent times 30 years). Now how is someone supposed to fund a 20 year retirement on just 4.5 years of salary? They simply can't.

With the large losses in the early 2000s, the huge loss in 2008 and the continuing volatility, it is no wonder that investors are giving up on stocks. Over the last two years investors have taken \$160 billion out of stock funds, according to the Investment Company Institute. What are they doing with the savings? Well, during that period, \$560 billion was added to bond funds.

Is investing solely in bonds the answer? Are the current yields of one to three percent in quality bonds and bank CDs going to save the day? What about gold? How about India or China? It seems that many investors are like that swimmer just a few feet from shore who thrashes and struggles rather than simply standing up and walking. Instead, investors are moving from investment to investment instead of staying calm and simply striding ahead.

The good news in the short term is that we think the probability of steep losses is diminished by the existing fear. Furthermore, with stock prices going up despite the outflows from the average investor, we can see a scenario in which investors once again gain confidence by sustained positive market moves and improvements in the economy. This could provide very nice returns as some investors move money back into the market again.

More importantly is that during that 20-year period while the average equity investor earned an annualized 3.17 percent, the S&P 500 index was up an average of 8.2 percent. Earning that rate, the hypothetical investor above would have not 4.5 years, but 17.5 years of salary built up for retirement. This would fund well over 20 years of pre-retirement level spending without even considering Social Security. Those returns were there for the taking. There was no need to get caught up in the greed of the tech boom, the craze of the real estate bubble, or running in fear after those collapses. All that was needed was to stay relaxed and calm and to invest in a steady, diversified and smart way.

We understand the fear people have. We can hear the caution in your voices. You may be tempted to delay investments and to let cash build up. Sometimes it seems that there is safety in numbers, in following in the footsteps of your associates, friends, and family. But masses clearly don't have a good track record. Try to relax, focus on your goals and make the smartest decisions you can.

Best wishes for safe, happy, healthy and warm winter and holiday season.

Brian J. Skaggs, CFP

The information in this newsletter should not be construed as investment advice. Investment advice is only given in the context of individualized interactions that ideally result in the development of a continually evolving financial plan. *Total returns as measured by the performance of associated DFA funds - advisor fees not included in strategy performance. Advisor fees are subtracted from model portfolio performance at 8.3 basis points per month. This information is believed to be reliable, but we do not guarantee the accuracy of the information. **Past performance is not an indication or guarantee of future performance.**