

October 30, 2009

Dear Client:

The third quarter of 2009 saw continued stock market recovery, leading to a second entry in the record books. The period from market peak on October 9, 2007 to trough on March 9, 2009 proved to be the deepest stock market decline since the Great Depression. Now, the seven-month period ended September 30, 2009 has generated the largest seven-month market return since the 1930s, as measured by the S&P 500 Index. In spite of the market's record-breaking performance, we remain cautious, as the economic recovery appears weak.

Although far less ebullient than the stock market, the economy has shown some signs of improvement in recent months, as well. Corporate earnings have risen in some industries, although most of the earnings improvements are due to cost cutting rather than increased revenues. Consumers continue to save, pay down debt and forego major purchases. Businesses appear reluctant to increase payrolls and production while consumer spending remains subdued.

Officially, unemployment is near 10%. The actual rate, however, probably exceeds 15%, including the underemployed, who have settled for part-time work, and the long-term unemployed, who have stopped looking for work altogether. Companies aren't expected to create more jobs for at least another year, so unemployment may still go higher before it heads lower.

Despite large government deficits to fund government programs, inflation has not yet become a problem. Historically, however, government deficits that are not paid for by higher taxes and spending reductions lead to rising interest rates, inflation, or both. There is additional risk of currency devaluation in the foreign exchange market. To help offset the risk of higher interest rates, we reduced the average duration of the fixed income portion late last year. To hedge against inflation, we have allocated 30% of fixed income exposure to Treasury Inflation Protected Securities (TIPS) in tax-exempt and retirement accounts. In addition, all client accounts with at least 30% in equities are poised to withstand inflation, as during periods of moderate to high inflation, equities generally outperform bonds. Clients with gold exposure in their accounts also enjoy an added measure of protection against inflation and currency devaluation.

Early this month, we rebalanced most client accounts that were at least two to four percent over their equity target. We have not added to equity positions since the beginning of the year, when we partially rebalanced client accounts. For the past seven months, we have let the market bring clients back to their equity targets. Currently, most clients are within three percentage points above or below their equity targets.

Late last year, we began using a new investment advisory agreement which authorizes the use of exchange traded funds along with mutual funds in client portfolios. We are in the process of mailing an addendum to those of you whose agreements were executed before we began using the new agreement last year. The addendum will enable us to use exchange traded funds in your portfolio, in addition to mutual funds. ETFs differ from mutual funds in that ETFs trade during the day on an exchange, like stocks do; whereas mutual funds can only be purchased from or redeemed by the fund itself, after the markets close. Initially, we plan to use ETFs to provide exposure that is not currently available from mutual funds to certain asset classes, such as gold bullion and other precious metals. However, we may in the future substitute ETFs for one or more of the mutual funds we are currently using to provide broad-based asset class exposure. If you have received but not yet returned your signed addendum, please do so today. If you have any questions about the addendum or about ETFs in general, please contact your portfolio manager.

### **News From Towneley**

Our New York office is on the move! Wes and the rest of Towneley's East Coast staff recently moved into a beautiful new office space. Our December client meetings in New York will be held at the new location, 633 Third Avenue, Suite 27B. Telephone numbers remain unchanged. Since Wes is still recuperating from recent shoulder surgery, he will not travel to California this fall. We will schedule conference calls in lieu of meetings for our clients who desire them.

In years past we have sent holiday greeting cards to our clients. In keeping with the spirit of the season, this year we have instead decided to make a charitable contribution in honor of our clients. We are pleased to announce that we will make a contribution to the Jump\$tart Coalition for Personal Financial Literacy. This organization is dedicated to improving the financial literacy of kindergarten through college-age youth. We wish you all a peaceful holiday season and a prosperous new year.

As always, we urge you to keep us abreast of any changes in your health or other circumstances that may affect your portfolio, such as job loss, planned or unplanned early retirement, or substantial losses in other investments. In addition, if you would like us to take tax losses in your account(s) before the end of the year, please let us know immediately.

Best regards,

Tracy Kuntz, MBA, CFP®  
President

**GLOBAL EXCHANGE TRADED FUND STRATEGIES**  
**3rd Quarter 2009 Performance Review**

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**Global Balanced Strategy**

Our Global Balanced Strategy, which allocates among bonds, stocks, and hard assets around the world, gained 12.8% in the third quarter. The bond portion rose 6.5%, and the equity portion, which includes stocks and hard assets, advanced strongly: 16.7%.

The strategy benefited from a weak dollar, massive money creation, and investors' renewed enthusiasm during the third quarter. Bond yields generally go down as bond prices go up. Yet, despite global bonds' strong third quarter gains, global bond yields, as measured by the Barclays Global Bond Index, lost less than a quarter basis point (.025%), due in large part to subdued inflation and excess liquidity in the banking system. Low interest rates and our current overweight in higher risk bonds, compared to the index, have helped the bond portion gain 10% year-to-date.

The equity portion had a fabulous quarter, as well, lagging the MSCI World Index by less than 1%. The equity portion's third quarter performance was slightly hindered by our 10% position in commodities. The CRB Commodity Index gained less than 7% in the third quarter. Industrial metals was the only solid advancer. Crude oil, after breaking above \$75/barrel in June, moved sideways, and gold, after breaking the \$1,000/ounce mark on September 16, finished the quarter up almost 8% better against the U.S. dollar.

Year-to-date, our Global Balanced Strategy is up 19%. Due to this past quarter's stellar equity performance, equities and hard assets now account for roughly 65% of strategy assets. At quarter's end, the strategy was allocated as follows: 16.3% in U.S. bonds, 18.4% in foreign bonds, 26.4% in U.S. equities, 28.0% in foreign equities, and 10.9% in hard assets.

**Developed Markets Strategy**

Our Developed Markets Strategy, which invests in equities and fixed income securities of industrialized countries, delivered a strong result of 19.6% for the third quarter. The bond portion gained 6.5%, and the stock portion turned in its highest quarterly return since inception: 22.5%.

Due to continued weakness of the U.S. dollar, developed markets again outperformed U.S. markets during the third quarter. In the past three months, the U.S. dollar has lost more than 4% of its value against other developed country currencies. Unfortunately for dollar-based consumers, our rock-bottom interest rates have caught the eye of the carry traders, speculators who profit from selling low interest rate currencies and using the proceeds to buy high interest rate currencies. Carry trading further depresses the value of the borrowed currency and fuels global asset bubbles, such as the five year bubble that finally burst last year.

The bond portion is entirely invested in international treasuries ETFs. In August we added two additional bond index funds to shorten overall duration and to provide inflation protection. ISHG tracks the S&P/Citigroup 1-3 year International Treasury Bond Index, and WIP replicates the Deutsche Bank International Government Inflation-Linked Bond Index.

The equity portion outperformed the MSCI EAFE Index by nearly 3% during the third quarter, primarily because the strategy was underweighted in Japanese stocks compared to the index. Due to its new government, a stronger yen, and its heavy reliance on exports, Japan's third quarter stock market rebound was much weaker than that of other developed nations.

In mid-August, we lowered the equity target to roughly 70% of the strategy by reducing European equities by 16%. At quarter's end, the equity portion of the strategy was allocated as follows: 16% in Asia, 52% in Europe and 3% in Canada, and 29% in foreign bonds.

### **Emerging Markets Strategy**

Our Emerging Markets Strategy, which invests in less-developed economies, finished the third quarter up 15.7%. The bond portion gained 10.2%, and the stock portion earned a record 18.3%, its largest quarterly return since inception.

During the third quarter, emerging markets continued to rise across the board: market stocks, bonds and currencies all finished higher. Emerging market investments benefited from the weak dollar, slacker credit environment, and investors' revived appetite for risk. Over the past three months, the U.S. dollar lost more than 5% of its value against emerging market currencies. Over the past six months, the spread between emerging market bond and U.S. Treasury yields has narrowed nearly 400 basis points, while emerging market equity multiples rose to late 2007 levels.

The bond portion, which is invested in a mix of foreign sovereign bonds to reduce portfolio risk, marginally lagged the JP Morgan Emerging Markets Debt Index, but finished 2% ahead of international treasuries, as represented by the Barclays Capital International Treasury Bond Index. Emerging market bonds benefited from currency appreciation and rising demand for higher risk bonds.

The stock portion of the strategy underperformed the MSCI Emerging Markets Index by less than 2% due to our underweighting in Latin American stocks. During the third quarter, we gradually scaled back the equity portion target to 50% because of less attractive equity valuations, particularly in Latin America. The region, however, outperformed the broad index by nearly 4%, and its returns have nearly doubled since last March's market low. Brazil, the largest economy in the region, surged ahead 27.6% in dollar terms during the third quarter, half of which is due to currency gains.

At the end of the third quarter, 47% of the strategy was invested in bonds, and 53% in equities allocated as follows: 18% in Asia, 9% in Latin America, 10% in the Middle East and South Africa, and 16% in Eastern Europe.