

# nvest nSIGHTS

SEPTEMBER 30, 2010

## NO IRRATIONAL EXUBERANCE

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Usually September (not October) is the most dangerous month for stocks of any of the twelve. September 2010 recorded the best month for stocks since 1928 (70+ years). The S&P500 jumped +8.9% in September (best single month this year) and boosted the 3<sup>rd</sup> quarter return to +11.3% (best quarterly return of any 3 month interval in 2010). Domestic stock indexes trailed international stock funds, which averaged +16% for the 3Q.

These returns provided a psychological boost for long-term investors (still invested in the markets), which experienced a very difficult 2Q and an okay 1Q. Thus, year-to-date, portfolios (of all objectives) sport better returns than if they were 100% invested in the S&P500 index which generated +3.8% for nine months. Most all bonds even beat the YTD S&P500.

Many, many investors are not (or under) invested in stocks even after 18 months of a new bull market. They continue to favor bonds which now offer historically low interest yields (albeit better than money market fund near-zero yields). Bonds really possess bubble territory risk (low yields = high prices) which will at best earn their coupon over the next 12 months. Stocks lack investor confidence; eroded by too much "politics" in Washington and from gambling professional traders on Wall Street (daily putting-on or taking-off the risk trade via synthetic securities such as options, futures, and some ETFs). As former Fed Chairman Alan Greenspan recently offered, stocks "should and could be the best economic stimulus." With bonds expensive (and risky), a rally in stocks would boost investor wealth and encourage some increases in consumer spending. It would also help home prices. Stocks are the asset with the best relative value opportunity. Prices already reflect a somber economic outlook. Importantly, there is room for positive surprises, as there is no irrational exuberance in the market (only fear).

Client portfolios are broadly diversified via bond and stock no-load mutual funds. We believe a tactical global focus is critical as *developed* countries with debt will economically grow slower than *developing* (with low or no debt) countries. Further, we believe investors are more focused on quality investments that generate income (dividends and interest than price change) following two bear market declines of 50% in the past 10 years.

## TOO MUCH POLITICS

Investors lack confidence to invest for the long-term. Business lacks confidence to invest (large cash balances) for the long-term. All around exists a crisis of fear and lack of confidence. There is too much politics being the result of the debt bubble of 2008. Government's new normal has created an era of fear (opposite of the 1990's irrational exuberance), wherein investors want to own bonds, not stocks.

Historically, mid-term elections provide for a stronger stock market performance in the 2<sup>nd</sup> half. Reviewing 21 mid-term election years (back to 1930), the first half of the year generated an average -1% return (this year was -7.6% for the S&P500 thanks to debt problems in Greece). While we don't know how this year's 2<sup>nd</sup> half will fare (3Q was strong), the past 20 experiences generated an average +4.7% rise. The 2<sup>nd</sup> half experienced more meaningful gains. Also, the 3<sup>rd</sup> year of the presidential election cycle with a divided government bodes well for stock bulls. History shows (since 1931) the market performs best under the leadership of a Democratic President and a Republican Congress; the average stock market rise being +14.6%. Current opinion polls suggest this backdrop may be in place for 2011.

Short term, too much politics is cause for poor investor sentiment as uncertainty abounds. But, in short order we will also know election results and the expiration (or not) of the Bush tax laws. Then, 2011 is upon us, and maybe less uncertainty will provide for further economic and stock market advances.

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# nvest nsights

## QE2; WILL IT HELP?

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**“In the short term, QE2 will keep the US kicking the can down the street; but the bill is coming due.”**

### DATES TO REMEMBER:

- Early-October - Quarterly Reports Sent; 4Q 2010 Investment Management Fees Collected
- November 25 - Thanksgiving Day: Markets & Nvest Offices Closed
- December 24 - Christmas Day (observed): Markets & Nvest Offices Closed
- December 31 - End of 4th Quarter
- **REMINDER: You may request a current copy of our regulatory filing ADV Part II at any time.**

Quantitative Easing (QE2) is a new monetary policy initiative by the Federal Reserve to buy government bonds. Its design is to put dollars into the financial system and boost economic growth. We expect this effort to have some (minimal) positive stimulus effect on the US economy. With so much government (Federal, state and local) debt, and consumers in a de-leveraging (paying down debt) mode, economic growth seems most likely to remain slow with elevated unemployment. Government policy initiatives will be less effective than hoped.

QE2 is already influencing the markets. Since Fed Chairman Bernanke announced the idea, the S&P has rallied +9.4% and the US\$ declined -5.8% (as money in circulation is boosted, financial asset rise, commodities rise, and currency falls in value). Over the past 6 months, 5-year treasury yields dropped -150 basis points to 1.3%, equal to their record low in late-2008. And, if/as QE2 is initiated this yield may fall below 1%. To the extent yields (already very low) decline, conservative investors will continue to push into riskier assets (longer maturity bonds, lower quality bonds, dividend stocks, and etc). Bernanke is in a situation of easing until growth rebounds above trend inflation. Keep in mind, reflation of financial asset values usually happens before inflation (a lagging indicator). Thus, we expect stocks to provide better returns than bonds. From one research perspective we review (that of PIMCO), three key ideas will influence future returns and our portfolio construction:

1. The world and US economic outlook is mixed with unusually high uncertainty. This reality, in itself, is a headwind to global growth and investment returns.
2. We live in a multi-speed world, with a stark and widening difference between the outlook for growth in the *developing* world and *developed* world. This is due to differences in their current (initial) condition (debt levels, etc), policy flexibility and effectiveness.
3. The “old normal” policy actions aimed at boosting global growth via increased public and private leverage, will be much less effective in the “new normal” where global policy coordination is weak.

In the short term, QE2 will keep the US “kicking the can down the street”; but the “bill is coming due.”

## AN ATTITUDE OF DOOM & GLOOM

The plethora of doom and gloom books, articles, or media commentary is amazing. Every day new writings flood to the bookstores and newsstands further fracturing a weak psyche. Such titles include: “The Big Short: Inside the Doomsday Machine”; “The Coming Economic Armageddon”; “The Default Power: The False Prophecy of America’s Decline”; “Aftershock: Protect Yourself & Profit in the Next Global Financial Meltdown.” And, of course we are well aware of “America’s Bubble Economy”. It appears like the biggest of all ponzi schemes is sponsored by the government – BIG government. But, what do you expect from a capitalistic economic system; writers need to make a living too?! Do we really learn from this avalanche of writing that abounds following each financial catastrophe? Every prior event was characterized by the same “rocket ship lift-off” price charts signaling a bubble. Nevertheless, we should wonder if these writings capture too much attention and if we really ever learn.

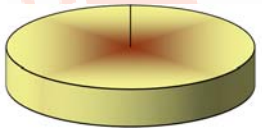
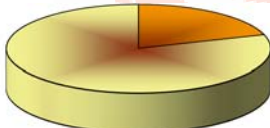
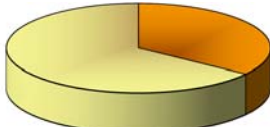
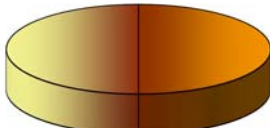
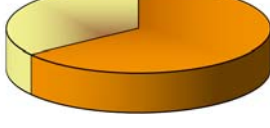

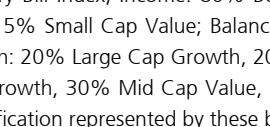
Let’s not diminish the key points. The current threat to our economy and nation is real and growing. Failing to address our unsustainable fiscal situation exposes our country to serious economic cost and risk. We should understand that we cannot keep “kicking the can down the street”; the “bill is coming due.” And, we also know how market vigilantes deal with excesses, or irrational exuberance. We can choose our kicks, but not our kickbacks.

The financial markets are a discounting mechanism. The aggregate of all investors factor together the risk, and discount them in real time. While these writings of doom and gloom will ever be published, we must be reminded the markets are daily saying “tell us something we don’t already know.” (These books don’t tell us anything we don’t already know).

Investors and advisors need to be careful and watchful. Recent events provide a test of our values: honesty, thrift and investment with prudence. We need to invest however, for the long-term with intention and purpose. And investments should be liquid, easily sold; never own an investment that controls the investor. Rather, the investor should be in control of when to buy/sell any investment. There are no “free lunches” with any investment; always understand the risk and opportunity. “The real measure of our wealth is how much we should be worth if we lost our money” (JH Jowett).

# BENCHMARKING AS OF SEPTEMBER 30, 2010

Summary of index portfolio returns compiled by Nvest Wealth Strategies, Inc.

INDEX PORTFOLIO	STOCK/BOND ALLOCATION		TOTAL RETURN THROUGH 9/30/10				
			3QTR	YTD	12 MONTHS	3 YEARS	5 YEARS
 Capital Preservation	0%/ 100%	<i>Cumulative</i>	1.6%	4.1%	5.2%	11.6%	20.8%
		<i>Annualized</i>			5.2%	3.7%	8.9%
 Income	20%/ 80%	<i>Cumulative</i>	3.6%	4.6%	6.6%	5.5%	17.8%
		<i>Annualized</i>			6.6%	1.8%	3.3%
 Balanced Conservative	35%/ 65%	<i>Cumulative</i>	5.2%	5.0%	7.8%	1.4%	15.9%
		<i>Annualized</i>			7.8%	0.5%	3.0%
 Balanced	50%/ 50%	<i>Cumulative</i>	7.2%	5.0%	8.3%	-3.4%	14.6%
		<i>Annualized</i>			8.3%	-1.1%	2.8%
 Balanced Growth	65%/ 35%	<i>Cumulative</i>	9.0%	5.2%	9.0%	-7.9%	12.7%
		<i>Annualized</i>			9.0%	-2.7%	2.4%
 Growth	80%/ 20%	<i>Cumulative</i>	10.7%	5.5%	9.8%	-12.2%	10.9%
		<i>Annualized</i>			9.8%	-4.2%	2.1%
 Aggressive Growth	95%/ 5%	<i>Cumulative</i>	11.7%	6.0%	10.7%	-14.5%	9.8%
		<i>Annualized</i>			10.7%	-5.1%	1.9%

The index returns reflect returns of various mutual fund averages compiled by Morningstar and allocated as follows: Capital Preservation: 90% Bond Average, 10% Treasury Bill Index; Income: 80% Bond, 10% Large Cap Growth, 10% Mid Cap Value; Balanced Conservative: 65% Bond, 15% Large Cap Growth, 15% Mid Cap Value, 5% Small Cap Value; Balanced: 35% Bond, 20% Large Cap Growth, 15% Mid Cap Value, 8% Small Cap Growth, 7% Small Cap Value, 15% International; Growth: 20% Large Cap Growth, 20% Mid Cap Value, 10% Small Cap Growth, 10% Small Cap Value, 20% International; Aggressive Growth: 10% Bond, 20% Large Cap Growth, 30% Mid Cap Value, 10% Small Cap Growth, 10% Small Cap Value, 20% International. You cannot invest in these indexes or averages. The level of diversification represented by these benchmark averages is materially different than actual client accounts; therefore, clients may experienced different levels of performance volatility. Past performance is no guarantee of future results.

# SELECTED MUTUAL FUNDS - TOTAL RETURN PERFORMANCE SUMMARY

As of September 30, 2010

BOND FUNDS - TAXABLE	STYLE	3RD QTR	YTD	12 MTHS	3 YEARS	5 YEARS
<i>Taxable Intermediate Bond Average</i>						
Wells Fargo Ultra Short	AS	1.1%	3.1%	4.9%	1.6%	2.6%
Vanguard Short Federal	HS	1.1%	3.9%	4.0%	5.5%	5.2%
American Century Short Duration	HS	1.3%	3.4%	4.0%	5.4%	N/A
PIMCO Low Duration	HS	2.0%	4.8%	6.3%	6.4%	5.7%
Vanguard Short-Term Investment Grade	HS	2.1%	5.3%	6.6%	5.2%	5.1%
American Century GNMA Income	HI	0.9%	6.0%	6.4%	7.3%	6.1%
Wells Fargo Government Securities	HI	1.7%	6.9%	6.7%	7.0%	5.8%
PIMCO Real Return	HI	5.6%	13.9%	15.9%	9.4%	6.4%
PIMCO Total Return	HI	3.8%	9.9%	10.9%	10.9%	8.4%
PIMCO Diversified Income	AI	7.4%	14.3%	18.4%	9.8%	8.1%
Artio Global High Income	LI	6.9%	9.2%	14.7%	8.4%	8.3%
Calamos Convertible Securities	LI	6.5%	4.7%	7.9%	1.6%	4.7%
<b>BOND FUNDS - TAX EXEMPT</b>						
<i>Tax-Free Intermediate Bond Average</i>						
Vanguard Muni Limited Term	HS	1.4%	2.9%	3.3%	4.3%	3.9%
T. Rowe Price Tax Free S/I	HS	1.7%	3.4%	3.9%	4.9%	4.2%
Vanguard Muni Intermediate Term	HI	3.3%	5.9%	5.0%	5.8%	4.9%
Vanguard Ohio Long-Term	HL	3.3%	5.7%	4.9%	5.7%	4.9%
<b>STOCK FUNDS - DOMESTIC</b>						
<i>S&amp;P 500 Index</i>						
<i>Equity Fund Average</i>						
Janus Advisor Risk Managed Growth	LG	11.1%	5.2%	13.3%	-6.8%	-0.4%
Marsico 21st Century	LG	9.5%	1.6%	7.1%	10.5%	1.6%
John Hancock Large Cap Equity	LB	12.0%	3.3%	7.5%	-2.3%	7.3%
Vanguard Index 500	LB	11.3%	3.8%	10.1%	-7.2%	0.6%
TCW Dividend Focus	LV	12.5%	4.7%	10.2%	-10.2%	-1.4%
Diamond Hill Long/Short	LV	5.2%	-4.8%	1.0%	-4.8%	1.3%
Munder Mid-Cap Growth	MG	11.7%	10.4%	16.5%	-6.3%	2.2%
Columbia Mid-Cap Value	MV	12.1%	7.6%	13.7%	-6.9%	1.5%
Century Small-Cap Select	SG	13.6%	13.1%	18.8%	-4.8%	-0.3%
William Blair Small-Cap Growth	SG	5.6%	1.9%	4.4%	-5.3%	0.4%
Neuberger & Berman Genesis	SB	8.8%	6.4%	13.6%	-1.9%	3.3%
Diamond Hill Small-Cap	SV	9.8%	10.3%	15.8%	0.3%	2.1%
Wells Fargo Small-Cap Value	SV	10.7%	5.2%	14.4%	-3.9%	1.3%
<b>STOCK FUNDS - INTERNATIONAL</b>						
<i>Morgan Stanley EAFE Index (Foreign)</i>						
Harbor International	LV	17.0%	3.3%	9.1%	-6.0%	7.0%
Oakmark International	LV	14.4%	8.0%	12.7%	-1.8%	5.8%
Allianz NFJ International Value	LV	14.7%	3.3%	10.0%	-7.2%	6.6%
Tweedy Brown Global Value	LV	8.6%	6.5%	14.9%	-4.0%	3.7%
William Blair International Growth	LG	16.8%	11.9%	17.0%	-9.0%	3.4%
Oppenheimer Developing Markets	LG	20.7%	16.4%	27.1%	4.5%	15.3%
<b>STOCK FUNDS - SPECIALTY</b>						
PIMCO Commodity Real Return	LB	14.6%	7.5%	20.0%	-2.3%	-0.4%
Princeton Managed Futures	LB	1.4%	1.4%	N/A	N/A	N/A
Vanguard Special Health Care	LG	8.8%	1.9%	8.8%	-0.7%	3.7%
JP Morgan US Real Estate	MV	12.6%	21.0%	32.7%	-7.3%	1.4%

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