October 2012

Quarterly Letter

By Martin Weil

"Don't fight the Fed!"

~ Classic Wall Street wisdom, attributed to Martin Zweig

The S&P 500 index rose 6.3% for the quarter, as US stocks staged a strong rally to close out the period. The S&P has now returned 16.3% for the year to date, and a startling 30.0% over the trailing twelve months (September 30, 2011). International stocks followed suit, with the Vanguard Total International index gaining 6.9% for the quarter and 11.5% on the year. The bond market index rose 1.5% during the quarter and is ahead a more modest 3.9% for the year.

Model Portfolio Performance[i]

Model Portfolio Performance 6/30/2012						
	Risk Benchmark	3rd Quarter	Year to Date	Cumulative Since Inception	Annualized Since Inception
All Equity	100% Stocks	5.1%	13.9%	107.4%	5.4%
Growth	80% Stocks/20% Fixed Income	4.5%	11.3%	102.8%	5.3%
Balanced	65% Stocks/35% Fixed Income	4.3%	10.2%	115.7%	5.7%
Conservative	40% Stocks/60% Fixed Income	3.4%	8.5%	110.1%	5.5%
S&P		6.3%	16.3%	48.8%	2.9%

Our model portfolios earned 3 to 5% for the quarter. Year to date, our four models have risen between 8.5% and 13.9%. Our Conservative and Balanced models are tracking the performance of their benchmarks for the year, but with substantially less equity exposure. Our Growth and All Equity models slightly lag their respective benchmarks.

The past twelve months have witnessed surprising strength in the equity markets, given a backdrop of ongoing turmoil in the world's major economies. While we have generated very good portfolio returns for clients, we did not participate as fully in the market rallies as we might have, the result of our somewhat more defensive portfolio positioning.

All of our core fixed income holdings excelled again during last quarter, with returns of 3-5% handily outpacing the bond market benchmark. Our core equity funds – FMI, Brown Brothers and Yacktman - returned 5-6% for the quarter, slightly trailing the benchmark S&P index.

Portfolio Updates

This past quarter, we increased the allocations to both developed and emerging markets equities in all four of our models, taking advantage of substantial underpricing in these assets. We added a small position in the Marketfield fund, a hedge fund-like vehicle, as an additional diversifier to our Conservative and Balanced models.

The equity share of our portfolio allocations remains heavily concentrated in large global stocks and we

are underweight small cap stocks. Conservative and Balanced portfolios remain underweight total equity risk versus their benchmarks, while our Growth and All-Equity portfolios are near or at their benchmark equity allocations.

Will You Be Able To Retire? Do You Want To?

Put simply, it may not be realistic in the long run to finance thirty years of retirement with forty years of work.

~ Axel Merk

Prior to the 20th century, "retirement" generally meant that period of life when you were no longer physically able to perform the duties of a job as an agricultural or manufacturing laborer. Broken down by the rigors of this arduous physical work, a "retiree" returned home to be supported by family until death. Median life expectancy for a US male was just 46 years in 1900.

Over the past 100 years or so, developed nation life expectancies have increased dramatically, due to substantial gains in standards of living and public health. The average US baby born in 2010 will live to 78. Today's 60 year-old US male has a median life expectancy of 85, the average US female 88. For those harboring illusions about their own potential longevity, I recommend this short quiz at Living to 100[1], for a reality check. The challenge in all of this - What to do with all those extra years? And how to pay for them?

When I started this business in the 1990's, the conventional wisdom held that most of us would retire on or about our 65th birthdays. Like prior generations, we would pack up, move to sunnier climes, and while away our days in happy pursuit of assorted leisure activities. Of course, my baby-boomer generation has always managed to surprise popular expectation. Well before the 2008 financial crisis threw a giant monkey wrench into the retirement plans of the majority of Americans, the traditional model was already breaking down.

To those approaching retirement today, that 1950's vision of a comfortable retirement, supported by Social Security and a generous company pension, must seem unbearably quaint. Social Security, never intended as more than a stopgap against destitution, will eventually need to be modified, with a later start date for benefits an obvious solution. The traditional employer pension is all but extinct in the private sector, and imperiled in the public sector. The one major addition to the retirement ecosystem since the 1960s, Medicare, is in genuine longer-term financial jeopardy. Is it any wonder that "retirement anxiety" is one of the leading topics on the finance pages of newspapers and websites?

A market response is in the works, as more and more Americans in their early to mid-60s, willingly or

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[1] *I do recommend not giving the site your normal email address as they seem to have little restraint in sending a stream of marketing information for age-related products.*

not, are delaying retirement and working longer than they might have planned. The fastest growing age segment of the labor force today, by percentage participation, is the 65-and-over demographic. At an individual level, this may not be welcome news. Many are being compelled by financial necessity to continue to work in jobs they would prefer to leave. Some are unable to find the jobs they need and risk being left with inadequate resources in their later years.

But for some, this changing norm represents something more positive. In conversations with clients over recent years, it has become clear that quite a few approached the notion of retirement with anxiety. They did not, or could not, envision 30 years of … what again exactly? Many self-identify with their careers, a condition that makes the very idea of retirement as much of a threat than an opportunity. At nearly 65 myself, I believe that I am still fully compos, vital and eager to continue to pursue a career that has been enormously fulfilling. Many others in their 60s and beyond will find second, or even third, careers or other professional challenges before "settling down" at a later age to more traditional leisurely pursuits[2].

As Americans, we are undergoing a true paradigm shift[3] in retirement. This transformation has profound demographic, as well as economic, implications that will alter the investment landscape in years ahead. The challenge for financial planners will be to assist our clients to find their way through this changing landscape, and to pursue avenues that satisfy both their personal and their financial needs.

Final Thought

The US elections bear down rapidly and it is anybody's guess the effect, if any at all, the results will have on markets. A failure by Congress to deal with the notorious year-end "fiscal cliff"– the expiration of the "Bush tax cuts," the budget trigger and the debt ceiling debate – could cause renewed investor indigestion. Moreover, we have most certainly not seen the end of the Euro crisis. The negatives are there for all to see. Perhaps that is why their market impact has been diminished. Markets are forever forward-looking and they appear today to be looking past these nearer term dramas to a more positive economic future. There is no guarantee that this appraisal of the coming years will not change tomorrow. But for now at least, US and the global markets seem to be pursuing the course suggested by the quote at the outset of this letter "Don't Fight the Fed."

- **Medicare Open Enrollment** period for 2012 is October 15-December 7
- My editorial *"Still Broken After All These Years"* was reprinted online at Advisor Perspectives.

[2] *Morningstar has this excellent overview of the Social Security and Medicare issues for those working after age 65.*

[3] *One of the most overworked phrases ever, but I find it to be an accurate description of the changing retirement landscape.*

[i] **Model Portfolio Performance Disclosures:**

a) Performance shown is for each portfolio model and is not a composite of the performance of actual client accounts. While our goal is that each client account will closely mirror the holdings and performance of our models, client account performance may, and does, vary according to several factors. Some of these are listed below. In addition, there have been periods, and may again be in the future, when our evaluation of major economic and/or market events leads us to manage client account allocations in a materially different manner than is shown in our models. At these times, client performance results will vary from that of our models.

b) All MWI managed client accounts are based on one of four diversified model portfolios, composed of no-load mutual funds, exchange-traded funds and other publicly traded securities. These four models are geared to different levels of investor risk tolerance. New accounts are invested following one of these models, typically using dollar-cost averaging over a period of months, not to exceed one year. Once an account is fully invested, it is expected to track the performance of its underlying model. Exceptions to this include accounts with restrictions such as: the client-directed retention of legacy holdings and/or excess cash, substantial withdrawals or additions. Accounts smaller than $100,000 are restricted by purchase minimums at certain mutual funds and as a result do not hold all the same positions. The performance of these accounts may differ somewhat from these models. Accounts employing municipal bond funds in place of the taxable bond funds used in models will often slightly underperform on a pre-tax basis.

c) Benchmarks for each model are created to represent the neutral asset allocation for each portfolio. The Vanguard S&P 500 index fund is used to model the S&P 500 index total returns. This fund, the iShares Russell 2000 index, Vanguard Total International and Total Bond index funds are the components we use for our benchmarks.

d) Net of fees: The performance for MWI model portfolios is calculated net of our maximum annual management fee, and brokerage charges, if any. The returns of the portfolio benchmarks do not include any fees or charges other than those of the index vehicles employed in the benchmark. All returns assume dividends and income are reinvested.

e) Rebalancing: Model portfolios are routinely rebalanced every six to twelve months on the last day of a quarter. Actual client accounts may be rebalanced as needed. With tax-efficiency a part of our decision criteria, taxable accounts may be rebalanced less often and/or less completely than retirement and other accounts not subject to current taxation. This may result in performance discrepancies between taxable and non-taxable accounts managed following the same portfolio model.

f) Model allocation changes: Changes to our model allocations can and do occur at any time. When a model is changed, allocations to client accounts are changed as soon as is practical. However, changes to the model portfolios are only recorded for performance purposes on the last day of any quarter.

g) Closed funds: From time to time, mutual funds that form part of MWI model portfolios close to new investors. Clients already owning closed funds in their accounts will generally continue to hold and/or add to their positions. New client accounts will be invested in alternate funds. At year-end, MWI will substitute in its models for any funds that have closed during the year with the alternate funds available then to new clients. As a result, performance disparities may develop between older and newer client accounts, and between older client accounts and current model performance.

h) Historical performance is not a guarantee of future results. While the performance period since January 1999 includes both rising and falling stock markets, there can be no assurance that the portfolios will perform as well under future market conditions.