



CORE COMPOSITE

Managing Volatility and Return: The Risk/Reward Balance

Our Core Composite is designed and managed with the objective of seeking solid absolute returns on an annual basis. By working to limit volatility while pursuing more consistent portfolio growth, we endeavor to generate long term returns that are comparable or superior to broad domestic equity indices. While positive annual returns may not be achieved during severe market conditions, we believe that managing risk will provide to clients the opportunity for superior long-term returns with significantly reduced risk of failure.

Beginning conclusively in June 2007, the unusually tame domestic equity conditions of the prior several years gave way to a dramatic increase in volatility. Then, in September 2008, volatility exploded even higher as the global credit crisis spun out of control. By July 2009, volatility was declining again toward a more traditional range, with the exception of a severe spike in the spring of 2010. However, reflective of the pervasive-

ness of elevated risks, volatility again moved sharply higher in August of 2011.

Given the objectives of the Core Composite, a review of its response to the surges in volatility may provide insight into the effectiveness of its strategy over the particular periods being reviewed.

We had developed serious concerns about the degree of risk being assumed by the market well in advance of the turmoil that ensued in late 2007. As a result of those concerns, we had assumed an investment posture more defensive than we would normally structure into this model. Consequently, as the market rose during early 2007 in an environment of generally limited volatility, we gained value but at a pace that trailed the broad equity markets. However, as the summer of 2007

progressed, the depth and significance of the embedded risks became undeniable, and increased dramatically.

As this chart illustrates, throughout the turmoil and since, the Core Composite successfully buffered volatility while significantly tempering the worst period of market decline relative to the unmanaged S&P 500. With serious market risks still in place, we continue to employ defensive strategies, but we have gradually begun to place enhanced focus on positioning for potential future growth.



Chicago Board Options Exchange Volatility Index (VIX)

This chart of the VIX, which is widely used as a measure of market risk, provides graphic depiction of market expectation of increased volatility in the latter part of the period. Actual realized volatility for 2007-2011 is illustrated in the standard deviation data below.

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e market's volatility	Core Model		S&P 500	
	Daily Standard Deviation	Total Return	Daily Standard Deviation	Total Return
anuary 2007–May 2007	0.33	3.45%	0.68	8.77%
une 2007–August 2008	0.42	-0.97%	1.27	-14.06%
eptember 2008-June 2009	1.09	-16.42%	3.07	-26.65%
uly 2009–July 2011	0.61	20.78%	1.04	46.51%
ugust 2011–Mar. 2012	0.93	-1.38%	1.66	10.68%
umulative		1.99%		11.18%
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Notes

The time periods illustrated were chosen to broadly correspond to shifts in general equity market volatility. Use of different time periods will yield different results. There can be no guarantee that strategies employed will remain similar or will achieve similar results in future periods.

The Core Composite standard deviation illustrations rely upon data from a representative client account that remained fully invested in the composite throughout the period. Other accounts in the composite, even when fully invested, will experience small differences in portfolio volatility due to some variation in allocation percentages deriving from differences in the timing of entry into the model and other factors unique to each account. However, accounts fully invested in the composite over the period should not experience differences of such a significance as to undermine the principles illustrated using the representative account selected.

Core Composite performance figures are composite time-weighted total returns inclusive of all accounts in the Model throughout the period illustrated. Returns in any particular account will vary due to differences in points of entry and other related factors. Returns are net of all expenses, including management fees, custody fees, and trading commissions, where applicable, and reflect reinvestment of dividends and other earnings. The full management fee schedule is accessible in Form ADV, Part 2, which should be reviewed before establishing an investment advisory account.

Data for the S&P 500 utilized for standard deviation calculations are based upon daily market price fluctuations alone and do not include dividends.

Performance calculations for the S&P 500 are inclusive of all dividends. The Chicago Board Options Exchange Volatility Index (VIX) shows the market's expectation of 30-day volatility. It is constructed using the implied volatilities of a wide range of S&P 500 index options. As such, it is forward looking. The daily standard deviation data provided illustrates in a related but separate manner the volatility that actually transpired.

Standard deviation is a statistical representation of risk or volatility used in modern portfolio theory which functions by measuring the variability of returns for an asset or portfolio compared to its average return.

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