

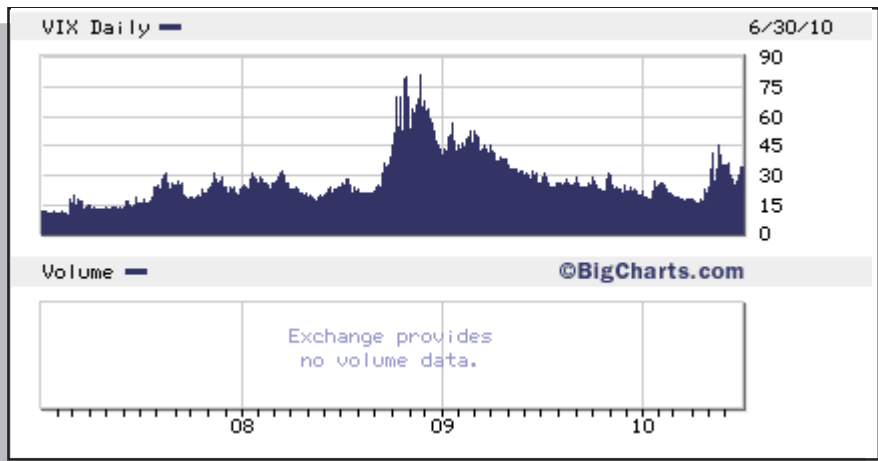


# MANAGING VOLATILITY AND RETURN : THE RISK / REWARD BALANCE

by Gordon Wegwart, President, Chief Investment Officer

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. After subsiding for a time into a more traditional range, it spiked again during 2nd quarter 2010. Given the objectives of the Core Composite, a review of its response to these surges in volatility may provide insight into the effectiveness of its strategy over the particular periods being reviewed.



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 2007-2010 is illustrated in the standard deviation data below.

We had developed serious concerns about the degree of risk being assumed by the market well in advance of the turmoil that ultimately ensued. 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 market’s embedded risks became undeniable, and volatility increased dramatically.

As the chart below will illustrate, throughout the turmoil, and since, the Core Composite successfully buffered volatility while significantly tempering even the worst period of market decline relative to the unmanaged S&P 500. With serious market risks still in place, we have continued to maintain a significantly defensive stance through June, 2010.

	Core Model		S&P 500	
	Daily Standard Deviation	Total Return	Daily Standard Deviation	Total Return
January 2007 - May 2007	0.33	3.45%	0.68	8.77%
June 2007 - August 2008	0.42	-0.97%	1.27	-11.39%
September 2008 - June 2009	1.09	-16.42%	3.07	-26.65%
July 2009 - March 2010	0.59	12.57%	3.07	29.20%
April 2010 - June 2010	0.78	-4.69%	1.56	-11.43%
Cumulative		-8.13%		-19.10%

\* See Related Notes on Reverse

## 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 and peak to trough return examples above each 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 performance and 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 II, Schedule F, 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.