TEAM
FINANCIAL
STRATEGIES

Investment Committee

Quarter Analysis
10/11/2012

3rd Quarter Review

The widely followed S&P 500 Index had a good 3rd quarter of positive 6.08% returns after a decline of -3.29% in the 2nd quarter. The markets appear to be looking for the next piece of news out of the Eurozone or waiting for the Fed to save the day yet again. Markets have risen much more quickly than the economy in 2012.

For the 3rd quarter, the TFS Low Correlation Core portfolio was positive 2.11%. The TFS Balance Growth model had a positive return of 6.65% over the same time period. Both of these models have maintained positive returns in each of the 3 quarters thus far through 2012 consistent with its objective of steady positive returns.

The best performing assets in the "Low Correlation Core" model during 3rd quarter were:

- SPDR Gold Shares = 12.29% (7.5% of portfolio)
- Chevron Corp = 11.37% (2% of portfolio)
- Teekay Corporation = 7.74% (2% of portfolio)
- Royce Special Equity = 5.65% (7.5% of portfolio)
- Templeton Global Bond = 5.40% (5% of portfolio)

The worst performing assets were:

- Mid-America Apartment Communities = -3.36% (5% of portfolio)
- PowerShares DB US Dollar Index = -2.45% (5% of portfolio)
- Arbitrage Fund = - 0.47% (10% of portfolio)
- iShares Barclays 20+ Yr Treas Bond = - 0.15% (5% of portfolio)

While deflation fears were the mantra in the 2nd quarter with deflationary assets outperforming, we saw the reverse in the 3rd quarter. Gold, Energy, and stocks rallied while long-term treasury bonds, the dollar and our apartment reit (investment in rents vs home purchases) declined. Our small tactical move to sell half of the long-term treasury position and add that to energy and inflation-linked bonds during this quarter proved beneficial.

4th Quarter Analysis

Based on long-term rolling average P/E ratios and historical research we believe that broad US stock markets are in a secular bear market. We believe we will remain in a long term secular bear market cycle until 10 year rolling P/E ratios are less than 10 on the S&P 500. Do to the high valuations that were seen in the previous long term secular bull market (1981-1999), we believe it is possible that this market will reach lower valuations than past long term bear market cycles. Therefore, our long term strategies for our model portfolios seek consistent returns through low correlation portfolios.

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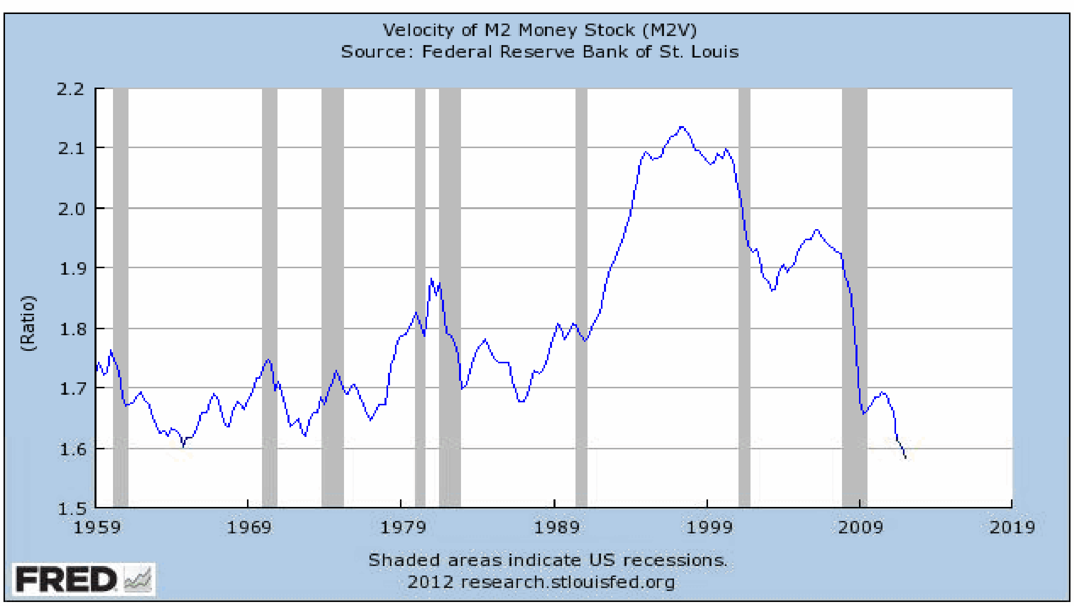
Economic Analysis – Neutral

- ***Employment – Neutral*** – The headlines on employment seem to be getting better but the underlying data is not so bright. The fact that some new jobs have come into the marketplace is great. However, it appears that this could be very temporary part time work. With manufacturing orders and capital investment from companies falling very quickly it appears that companies are waiting until after the election to make employment and growth decisions.
- ***Consumer Credit/Savings – Positive*** – Consumers credit was 8% higher at the end of August vs August 2011. It also appears that household savings rate has declined from 4.1% in July to 3.7% in August. The reading from these numbers would indicated that consumers are spending more and saving less which could be a positive for the economy. However, this does not appear to be turning into growth yet per the Money Velocity numbers.
- ***Money Velocity – Negative*** – The chart below is the same as last time. It has not been updated on the St. Louis Fed website. However, we went to the data and did our own numbers and it appears that velocity is getting worse not better. From our estimation, at this time we have moved down from ~1.5 to under 1.4 in money velocity. This is the largest sign that we have showing us the deflationary forces that the Fed is trying to battle. Their success is difficult to measure but I would say in some ways they have been successful at staving off deflation. However, as we approach 1.0 in money velocity, this could bring a whole new set of problems to our economy. A number of less than one on money velocity would mean that our country will get a negative return for every dollar that the Fed tries to pump into the economy. Would you lend money to an economy that is not producing anything with that money? If so, what rate would you charge?



Market Analysis -- Negative

- ***Fundamental Analysis*** *– Negative*
  - Revenue growth of S&P 500 companies – Negative – Per analysts estimates for 3rd quarter, sales were down 2.2% over the 2nd quarter and also were less than the 1st quarter.
  - Earnings growth of S&P 500 companies – Negative – Per analysts estimate of 3rd quarter earnings, earnings are 1.4% less than the same quarter in 2011.
- ***Technical Analysis*** *– Positive*
  - The S&P 500 is currently trading ½% above the 50 day moving average of 1425.32
  - The S&P 500 is currently trading 4.6%above the 200 day moving average of 1366.81
  - The 50 day moving average is trading 4.1% above the 200 day moving average
- ***External Analysis*** *– Negative*
  - Europe – Europe will probably be in this update for years to come. Now it is Spain that is on the Euro Roller Coaster. One day they are in huge trouble, the next the ECB comes out to save them. Then they are in trouble again. As Europe goes into an inflation, money printing cycle, we expect it could cause extreme weakness in the Euro currency and strength in the US dollar. However, that is not what the Fed wants right now.
  - Fiscal Cliff – It seems that the fiscal cliff issues associated with rising taxes in 2013 is taking a back seat until the election is over. The problem is whether or not there will be any time to address these issues with less than two months to find a solution and a potential lame duck session.

Price Analysis – Negative

- *In long term secular bear market cycles markets tend to trade in a large range for a very long period of time. For instance, from 1966-1981 the Dow Jones Industrial Average started at 969 in 1966 and ended at 875 in 1981. That is a 15 year period where you pretty much ended at the same place you began. However, there were 4 positive swings of more than 20% and 4 negative swings of more than 20% in that cycle. Therefore, we are breaking down this secular bear market by price quartile. If we are trading in the top quartiles of the bear market cycle that will be considered a negative for adding stock market exposure. If we are in the bottom two quartiles that will be considered a positive for adding stock market exposure. This analysis is based on first deciding that we are in a long term secular bear market.*
- *Current Price on the Dow Jones Industrial Average = 13,393.58*
- *Quartiles*
  - *Bottom Quartile = 6626 – 8486*
  - *2nd Quartile = 8486 – 10346*
  - *3rd Quartile = 10346 – 12206*
  - *Top Quartile = 12206 – 14066*

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Overall – Since our last investment committee meeting our economic analysis has moved from negative to neutral. **However, our market analysis has flipped from positive to negative and market price analysis remains negative. Therefore, we will be looking for ways to take additional precautions during the 4th quarter.**

Disclaimer: Please note that individual client performance returns may vary depending on a variety of factors: when invested into a specific portfolio, other non-model holdings etc… Please consult your most recent quarterly performance reports for your personalized returns. As always past performance is not a reliable indicator of future performance.

Portfolio Decisions

TFS Low Correlation Models:

- Sell Annaly Capital Management – Annaly has been a very good investment in the Low Correlation Core portfolio. However, we believe that the Federal Reserve's most recent round of "stimulus" will directly hurt potential growth in their company as it tightens the squeeze on Annaly's spreads.

- Buy Doubleline Total Return Bond Fund (DLTNX) – Doubleline Total Return is managed by Jeffery Gundlach. Its holdings are somewhat similar to the investment we are selling above, Annaly Capital Management. However, he is not leveraged in this fund so the Fed's asset purchases will not have the same affect. Mr. Gundlach has very broad authority in the fund to act in the interest of shareholders and we trust him as one of the best if not the best fixed income manager at this moment in time. This investment is currently yielding approximately 6.47%.

- Sell 5% of iShares 1-3 Year Treasury Bonds (SHY) – This holding has basically been a cash position that has been generating a little more dividend income than money market funds in this environment. We are still holding approximately 5% of the portfolio here as "dry powder" for opportunities.

- Buy SPDR DB Intl Government Inflation-Protected Bond (WIP) -- We are now in an environment where countries are going to have to print money around the globe. While we will likely see some amounts of inflation here in the US, many other countries will see extraordinary inflation. We believe the inflation protected government bonds of foreign countries make sense at this time as a way to profit from global inflation. We will use the 5% from SHY for this purchase.

TFS Balanced Growth

- Sell Pimco Strategic Global Government (RCS) – This is another investment that has done very well in our portfolios. We have been utilizing it in our Balanced Growth model which is used more often in smaller accounts and children's UTMA accounts. However, it is running into the exact same problem as Annaly Capital Management and we feel the best course is to take profits. RCS is up more than 15% this year.
- Buy Doubleline Total Return Bond Fund – See the notes above for buying Doubleline in the Low Correlation models.