



Letter from the Chief Portfolio Manager

Keep Your Money in the Market

We've been through ups and downs before.

By Burton G. Malkiel

Ed. note: We were impressed by this article by Burton G. Malkiel when we first read it in the Wall Street Journal in October 2008. We believe Mr. Malkiel's observations and conclusions are as relevant in today's market environment as they were then.

As the world economy reels under the weight of the worst financial crisis

since the Great Depression, we have been left with a broken financial system. Financial institutions around the world have suffered life-threatening, self-inflicted wounds by purchasing over a trillion dollars of complex mortgage-backed securities backed by dodgy loans based on inflated real-estate values. These assets have been financed with enormous leverage and with short-term debt. Just prior to its "rescue," Bear Stearns had a debt to equity ratio of over 30 to 1, making it susceptible to a "run on the bank," although Bear was not a commercial bank but rather part of the "shadow banking system" built on derivatives.



Scott Spiering
Founder & CEO

The long-run solution to the present crisis must involve substantial deleveraging and a recapitalization of our financial institutions. In the meantime, credit has been essentially frozen and a world-wide recession seems almost inevitable.

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Investment Review



Jonathan L. Chatfield, CFA
Portfolio Manager

Equity Price Retrenchment in the 3rd Quarter

The third quarter was disappointing to investors who were hopeful the economy was finally emerging from its malaise as tentatively

positive economic results were posted earlier in the year. Fears of "double-dip" recession escalated during the quarter against the backdrop of the Greek debt crisis that many feared would result in a default. Many feared a contagion would have a similar effect to the Lehman default, and could cause the credit markets to freeze up as they did in 2008-2009, leading to a similar economic crisis and once again sparking a run on risk assets. The long-term viability of the Euro was called into ques-

tion and investors and commentators became more and more gloomy about the outlook as the quarter wore on.

The S&P 500 was down more than 14% during the quarter, (small-cap and non-U.S. stocks fared even worse) as a retrenchment in equity prices caused long equity portfolios to suffer substantial negative rates of return.

Meanwhile, bond prices were up in a flight to quality, with the yield on the 10-year Treasury bond drop-

ping near its lowest level ever.

The European Central Bank has since come up with a plan

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Market Index Returns YTD 9/30/2011

Dow Jones Industrials	-5.7%
S&P 500	-10.0%
Russell 2000	-17.0%
MSCI EAFE	-15.0%
MSCI US REIT	-5.7%
S&P/GS Commodity Idx	-9.3%
BarCap US Aggregate Bd	+6.7%

“...well diversified investors should, at the end of each year, consider rebalancing to ensure that your portfolio composition remains consistent with the risk level appropriate for your financial circumstances and tolerance for risk.”

“No one has consistently made money by selling America short...”

Letter from the Chief Portfolio Manager *(continued)*

But just because stock markets have panicked, investors should not. The best position for investors today is not "fetal and 100% in cash." We are not going to have a depression, and we have survived financial crises before. A century of investing experience, as well as insights from the field of behavioral finance, suggest that investors who bail out of equities during times like these are almost always making the wrong decision.

It is very tempting to try to time the market. We all have 20/20 hindsight. It is clear that selling stocks a year ago would have been an excellent strategy. But neither individuals nor investment professionals can consistently time the market. The herd instinct is extraordinarily powerful. When the economy and the stock market were booming in early 2000, investors could easily convince themselves that prosperity would continue without interruption and that stocks catering to the "New Economy" were surefire tickets to wealth. Individuals poured more money into equity mutual-funds during the last quarter of 1999 and the first quarter of 2000 than ever before. And not only was the timing wrong but so was the selection of funds. The money flow was directed to the hot Internet funds. Investors liquidated "value" funds that owned less exciting businesses,

whose stocks sold at only modest multiples of their earnings and book values. The herd instinct works exactly the same way in bear markets. Nervous investors convince themselves that every "light at the end of the tunnel" is a train coming in the opposite direction. Panic is just as infectious as blind optimism. During the third quarter of 2002, which turned out to be the bottom of a punishing bear market, investors redeemed their mutual funds in droves. My own calculations show that in the aggregate, investors who moved money in and out of equity mutual-funds underperformed the buy-and-hold investors by almost three percentage points per year during the 1995-2007 period. Look at history: The market eventually bounded back from the damaging stagflation of the 1970s and the savings-and-loan crisis of the early 1990s, when a whole industry had to be rescued. Stocks also recovered from the Asian crisis of the late 1990s. Similarly, investors who held on after the more than 20% one-day stock-market decline in 1987 were eventually well rewarded. So what should investors do? By all means, young 401(k) investors, and those in their prime earnings years, who are stashing away funds from every monthly paycheck, should stay the course. If you decide to eschew equities during periods of ubiquitous pessimism, you will lose all of the advantage of "dollar cost" averaging (buying more shares when prices

are low than when they are high). Asset allocations should be shifted to safer securities over time as the investor ages, but only gradually and on a set schedule as through a "target maturity fund."

If you are now approaching retirement and failed to move to a more conservative asset allocation, you should not do so now in response to a time of panic. If anything, well diversified investors should, at the end of each year, consider rebalancing to ensure that your portfolio composition remains consistent with the risk level appropriate for your financial circumstances and tolerance for risk. But this is likely to mean shifting into equities and not out of them.

We will have a serious recession now, but a 1930s-style depression is highly unlikely. We will not let the money supply decline by 25%, as we did in the '30s, and automatic stabilizers (like unemployment insurance) are now a significant element of fiscal policy. Don't forget that the U.S. economy is still the most flexible in the world and our "innovation machine" is alive and well. No one has consistently made money by selling America short, and I am confident the same lesson is true today.

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Mr. Malkiel is a professor of economics at Princeton University and the author of "A Random Walk Down Wall Street," 9th ed. (W.W. Norton, 2007).



Dená Baker
Financial Planning

Saving for Retirement and Education at the Same Time

You want to retire comfortably when the time comes. You also want to help your child go to college. So how do you juggle both?

The first step is to determine what your financial needs are for each goal. After you know your needs, the next step is to determine what you can afford to put aside each month. Once you've come up with a dollar amount, you'll need to decide how to divvy up the funds.

Though college is certainly an important goal, you should probably focus on your retirement if you have limited funds. Remember, your child can always attend college by taking out loans (maybe even with scholar-

ships), but there's no such thing as a retirement loan!

If the numbers say you can't afford to educate your child or retire with the lifestyle you expected, you'll have to make some adjustments. Consider deferring retirement a few years or working part-time during retirement. Maybe make some changes to your lifestyle now or in retirement. You might be able to adjust your current spending habits.

Sending your child to a less expensive school might be an option. Don't feel guilty—some lesser known liberal arts college or a state university may provide your child with a similar quality education at a far lower cost.

For more help with planning for retirement or college education funding, give us a call. We'd be glad to help.

Reminder

Contact Anchor Bay regarding any change in your financial condition.

Ongoing communication between the client and the adviser is critical to the effective management of your assets. It is imperative that Anchor Bay is up to date regarding your financial condition. Please keep us informed of any changes in your financial goals, concerns, or time horizon so that we may incorporate

them into your financial plan and make the appropriate adjustments to your investment portfolio. Such changes might include the purchase or sale of a house, any large expenditure you may be planning for which we need to provide liquidity, or any change in your tolerance for risk which may require adjustment to a more conservative portfolio.

Investment Review *(continued)*

to backstop Greek debt, and the U.S. has committed to aid the bailout as well, giving some stability to the financial markets and sparking a rally in the second week of October, helping equity returns.

As the quarter unfolds we are cautiously optimistic that earnings will surprise on the upside and that economic growth will stay positive, albeit at a slow pace. The environment should support continued modest gains in stock prices, which have rebounded from their September lows.