September 30th 2009

To Our Clients and Friends:

This past quarter has been a good one for the S&P 500, equity markets in general, and our Risk Adjusted Portfolios (RAP's). The S&P500, with dividends, was up 15.61 % for the quarter, T-Bills were dead flat at 0%. Each of our RAP's (excluding the Opportunity and All Equity) beat their benchmarks. The Opportunity trailed its benchmark for the quarter by only 0.15% but is ahead of it year to date by 0.95%. The All Equity trailed its benchmark for the quarter by 2.3%, by 1.11% for the year to date, but is way ahead of its benchmark, (+4.39%), for the last 12 months.

What a difference a quarter makes in volatile times. **The major themes from which we expected good performance played out much as they had in past recessions, even in my short (20 years this November!) experience. High Yield Debt, Corporate Debt (not AAA), Small Cap Equity and Emerging Markets Equity provided the strongest performance over the quarter.** We did not take advantage of the strong returns in the Municipal markets due largely to my inability to reconcile myself with the argument, convincing to most, that municipals almost never default, and even those that have, reorganized and paid off at least most of what they owed eventually. I still don't believe many municipal investors will be paid back all they are owed. This is not to say that municipal bonds are not appropriate ever, I just don't see a place in our RAPs for them as yet.

ARE WE IN FOR A DOUBLE DIP RECESSION?

Since we cannot manage the economy this is not our focus. However the history I have reviewed finds double dip recessions have occurred very infrequently, even defining them reasonably is difficult, and finally their impact on markets is not predictable. So I don't know, I'd tend to doubt it, but if you don't lose your job, or your ability to produce income, and you live within your means, you don't care if it's a recession, you're fine. On the other hand, if you do lose your job, or your ability to earn an income, or you spend beyond your means, you won't care if it is NOT a recession, it will feel like one to you. Of major concern to many is: **'Have we seen most of the market recovery? What about my account's recovery? Are we destined for another drop in the market?**' The short answer is yes…depends…just like always….

Yes, by many measures the amount of recovery we have had has been substantial, and in comparison to past recoveries it is substantial. By substantial, I mean perhaps **more than ½ of what would be termed a recovery has probably already occurred. How much more than a ½ I won't even try to guess.** Most of the smart investors and analysts I trust, believe that we have a ways to go. An unusual amount of consensus in this group centers on a slight October correction, not more than 7% or so, and then a resumption of positive returns into 2010. We expect 2009 to be very positive and 2010 positive but less so. History supports this, as does the humungous wall of worry in front of us(which markets often climb), as do money flows where high quality bond funds have received 90% of this year's investment flows (and no return) and equities have been in net redemption and still have had large returns, as does cash in money markets at very high levels and at no return. There is always another drop in the market ahead, somewhere, unseen, and once it hits, you can't see the bottom. **Among the best defenses to future market declines are getting the gains while they are to be had.**

These "smart investors" I am referring to now were universally bitten hard by last year's bear. Unemployment is higher than any time since the Great Depression and forecast to go higher, foreclosures are still increasing, (some data I have seen leads me to expect to a decline in the raw numbers of new delinquent and defaulting mortgages from present levels in the months ahead, unless unemployment really spikes higher), inflation fears abound and are certainly well founded, basically **there is just a lot of bad stuff to make this MARKET recovery seem unreal.**

Those investors who are still bullish now and were bit so hard last year? All have licked their wounds and recovered successfully, outperforming handsomely this year. I would tend to agree with them now. Of course, we agreed with them last year as well. I am sorry about that, but we have also **recovered very well this year, (as has/have your account(s) as long as you stuck with your portfolio model or increased the risk.)** The techniques of these investors vary, but in all they tend to be optimists, they tend to understand that;

- ✓ while today's fears may be unique, fears as intense as today's have occurred before;
- ✓ economies as dire as today's have occurred before, and;
- ✓ when you evaluate specific assets for their specific risk/reward potentials, some of the greatest investment opportunities ever can be harvested by cool heads (some might say cold hearted) in overheated times.

GOING FORWARD

Over the long term **I would expect the foreign exposure of both our debt and equity components to increase** as a percentage of the total exposures of our RAP's. When I started in the business, US Equity markets represented more than 60% of the securities available on global markets, today the US comprises less than 40% of global markets. This is a huge shift that has actually accelerated over the last year. Several economic analysts project the US to fall to just 25% or so of global securities markets within the next 20 years or so. **From a purely technical perspective then, anything less than 60% of your investments exposed to foreign as opposed US assets, is an active choice to overweight US securities in your portfolio.** With US' share of global markets declining, you can see why even the 33% foreign exposure we currently hold, (high relative to most investment advisors) actually feels a bit low to us.

Now, why SHOULD we overweight US exposures in our portfolios? It appears most of us will continue to meet most of our **living expenses in US dollars**. So by keeping most of our assets in US dollars we eliminate the risk of currency fluctuations as you convert foreign denominated assets back into dollars to spend.

The question is how much should we overweight? If you have ever lived or travelled for any extended time overseas you are aware that **currency risk is no small risk**. However, from **where does the US BUY most of its consumed goods?** Our almost ever increasing trade deficits make it exceptionally clear that more and more of the goods and services we use are coming from foreign sources. Should our US overweight be more or less than it is? Another factor to consider is the huge increase in dollars represented by the various bailouts conducted over the last year, approximately SIX TRILLION, in US dollar assets were created. **Our government has set the stage for a substantial "currency debasement"** inflation event in the US. This kind of inflation is permanent and is paid for in diminished future living standards. This is one of the key factors leading us to believe that our foreign allocation should, over time,

reflect more closely the allocation of world assets. An interesting side note; regarding US corporate profits; **while US exports account for only 10% of GDP, 50% of US corporate profits come from foreign earnings**. Our domestic US businesses are already globally allocated, well ahead of US investors.

At a recent meeting sponsored by Premier Asset Management in Chicago, both Nancy Lazar of International Strategy and Investment (ISI) and Dr. Edward Yardeni of Yardeni Research, Inc. were in close agreement; that while inflation in a conventional sense (CPI) is not likely to rise anytime soon, there is a substantial element of "asset inflation" already beginning, (the initial stages in commodities, precious, and industrial metals). Insofar as we invest in assets, our focus on "inflation" will be on "asset inflation" which will eventually drive price inflation.

You will likely see us begin to act like good bankers, and via our investments in mutual funds for you, lend to countries/companies who don't need the money, **emerging markets debt funds or ETF investments will show up in most of our RAPs**. These economies are cash flow positive, fundamentally, this should make their currency values stable or positive relative to the dollar. These economies are far more likely to grow and at a higher rate than the US as their populations rise up the lifestyle ladder.

You will, for a time, **see our hybrid funds be reduced as a percentage** of the whole portfolio as we seek to ensure adequate equity exposure to keep pace with what could be strongly positive market for a bit longer.

You will see commodities likely leave the portfolios as a dedicated fund exposure, (they will likely remain as part of one or more of the hybrid category funds). Other than as a way to hedge a significantly weakened US dollar, they may have seen a fair chunk of their gains for a time. There is also considerable risk in commodities of "demand induced" inflation, of which we may have just seen a large spike. Commodities markets are small, relative to the global currency which may be used to purchase them. So if a country like China were stocking up on commodities as a hedge against future inflation (for them translates as devaluation) of the dollar, markets would during that period of stocking up, rally sharply, only to fall later, potentially even as moderate increases in industrial production begin to occur. Oil's huge rise last year is a good example. A substantial portion of the rise could well have been tied to US regulations requiring diesel refiners to virtually eliminate sulfur in the final product. This put a huge strain on supply, which pushes price up, because only about one barrel of crude in one hundred of world supply is suitable for this kind of refining. Small markets change direction very quickly, the easy money may have largely been made here.

Technology will likely become one of the larger themes in the funds that we hold. Rapid growth economies (emerging and developing markets, India, China, Brazil, Eastern Europe, many others) will buy a lot of technology early in the cycle. If the green wave is truly a wave, technology will need to drive much of it. Technology spending has been way down, it does wear out fairly predictably and will need to be replaced. The Microsoft Windows 7 operating system alone is apparently such a huge improvement over Vista it could prove a driver of the replacement the old XP equipment businesses kept for the last five years or more.

It is very unlikely we will be as busy trading this quarter as we were through the fourth quarter of 2008. I sure hope we won't anyway.

Financial planning thoughts should dominate your personal considerations through year end. Within the next few weeks, you will receive an invitation to **a simple, free, web based financial planning application we now have available for you**. For some it will be entirely uninteresting, for others it is the chance to regroup and start afresh. For some it will be great for their children or employees. **For us it is a wonderful way for us to become more aware of your personal goals and objectives, and to understand your concerns.** It is very basic, but the communication it can help guide is the really important part. So please try it out.

An almost universal consideration for early in 2010 is the IRA to Roth IRA conversion opportunity available to all, regardless of income, for the first time. There are some tricky details to the rules regarding Roth conversions, particularly in 2010, which likely make doing a Roth conversion a good idea for most clients except possibly those living substantially on income from their regular IRA's. **I'll be sending a detailed letter just on this opportunity.**

ON A PERSONAL NOTE

During the last three months **life has dramatically changed for my family**. In order not to hold anyone in suspense, **Rosie (my wife) was diagnosed with lung cancer, but is doing well now.** We expect her treatment (an oral medication called Tarceva) for her EGFR Positive, Non-Small Cell, Adenocarcenoma with Nonmucinous Broncheoalveolar features, to get her some time, **perhaps years,** for an even better treatment to be developed. For awhile this summer we thought that we may have Rosie for perhaps only a few more months, we think this is far less likely than before. **Rosie is representative of a new group of cancer victims, women around the ages of 40 to 55 or so with NO risk factors for lung cancer such as direct or indirect cigarette smoke exposure. Fortunately, this group, often with this type of lung cancer, responds far better than traditional lung cancer statistics imply to available treatments.** The experience has been extraordinarily overwhelming to us. The downside is obvious, but we have been blessed in ways we could not imagine in going through this. I have written the story of it and it is posted on **Rosie's www.Carepages.com/Carepages/RosieBaldwin web site**. All are welcome to come read it. We are fighting this scourge publically; doing so has been the one of the keys to things having gone so well for Rosie and us since her diagnosis. Burt Constable of the Daily Herald newspaper wrote about the response to Rosie's cancer in our community, it too has been overwhelming and heartwarming. That story is at http://www.dailyherald.com/story/?id=324276.

I wish you all well for the fall and onset of winter. Please keep in touch. If I am not available at the office, please call my cell phone if you have questions. If I cannot speak at the time I won't answer. We have set up methods whereby I can voice dictate notes back to the office for your records so we can keep track of things even when I am out. I am out periodically due to the demands of taking care of Rosie and my increased role in doing the same for our three daughters.

I cannot end this letter without telling you how you were taken care of this late summer and fall as I took all the time necessary to pursue Rosie's diagnosis, determine the best possible treatments and get them arranged. **High among my many blessings are Paul and Susan. They have put in long hours ensuring that everything ran smoothly here** the days, and in the beginning, weeks when I was not able to come in to the office or even be available for calls. Both have anticipated what needed to be done and prepared the items that needed my attention to be done quickly and efficiently when I was available. I didn't have to ask or even tell them how we'd accomplish things, they simply picked up and did everything before I even had the chance

to know I couldn't. The only thing either of them ever wanted to know from me was *"what else can I do?"* In the midst of all this they worked on **completing the implementation of a new reporting system**, that will make some of our work much more efficient, make your reports easier to get to, and it will update them on a daily basis. The coolest parts are: **daily performance reporting** should you want it, and we will be able to **pull in your performance data from 401(k)s and thousands of other custodians** you might have money invested with for monitoring or management if you want it. Getting this done continues to take a lot of time because with all the pluses, **there are a couple of details of the system that we are not yet content with, so we have not yet released it to you.**

The things that matter in life are the irreplaceable elements, each person, your experiences with them, and today. You only get each of these things once. Make them rich and you will be too.

Sincerely,

Benjamin G. Baldwin III CFP® ChFC
President