Spring 2010

NAVIGATOR

A NEWSLETTER FROM
TGS FINANCIAL ADVISORS

CONTENTS

Letter from the Directors

SCORE

One score. Two decades. Twenty years. TGS was founded on February 19, 1990. Actually, the legal entity was incorporated in Delaware some weeks before. February 19th was the day we opened the doors and began answering the phones in the Jefferson Building at the Chesley Office Campus in Media, PA.

We recently looked over the pictures from those early days. David and Jim were both visibly younger and thinner. Jim's hair was darker and thicker, and David's not yet touched with gray. Only Susan is improved, both thinner and fitter than she was in the early 1990s.

What have we learned in our first score of years? Here are our thoughts:

1) We have evolved into serious, skilled and systematic investors. Over trailing ten-year periods, including the gruesome decade ending on December 31, 2009, we have consistently added performance net of fees at most risk levels for most accounts.

2) We have come to recognize that relative investment performance is not the prime driver of lifetime financial security. The keys to building and keeping wealth are saving enough and not spending too much. We have developed powerful measures to track savings and spending more accurately, and innovative reports to communicate this information clearly to clients.

3) We believe that if we both do our jobs (we manage the investments, our clients save enough and spend responsibly) we will be successful together.

There is another definition of "score," quite popular on Wall Street — a massive, all-at-once cash payoff. By that definition, we have never made a big score. No highly-leveraged short-sales. No hedge-fund style billion-dollar paychecks.

That is fine by us. We're not as big as Merrill Lynch used to be, back when there was an independent firm of that name, nor as politically well-connected as Goldman Sachs, but after twenty years we are still here, we continue to put our clients' interests first, and we are more independent than ever.

Our most important compensation is the opportunity to do important work for people we care about deeply. That seems like a nice definition of success to us.

For the firm,

Marvin Barron   David Burd   James Hemphill

Inside the Black Box

WHAT GOES DOWN MIGHT COME UP

by James S. Hemphill, CFP® ChFC CIMA

> *"All progress begins with telling the truth."*
>
> Dan Sullivan
> Founder, *The Strategic Coach*

We have reorganized responsibilities at TGS Financial Advisors. Marvin Barron, previously the Research Director, has been promoted to a new job as the firm's Managing Partner, where he is responsible for both day-to-day operations and much of the strategic planning for the firm. I have been named the firm's Chief Investment Strategist. This is my first *Inside the Black Box* article. Hopefully I can keep it as interesting as the articles Marvin wrote in previous *Navigators*.

Over the last six months, we've engaged in a comprehensive review of our investment strategy. Part of what prompted that review was concern about the downside volatility of our portfolios during the market decline of 2008-2009. That review included both extensive in-house research and consultation with a group of outside experts, our *Investment Advisory Board*[1].

One key issue we identified during the bear market was higher-than-expected downside volatility in several asset classes. To illustrate, I will focus on the performance of a single fund from our model, the Alliance Bernstein International Value Fund, compared to the benchmark Morgan Stanley EAFE Value Index. As you can see in *Graph 1*, Alliance Bernstein went down more than the index during the crash, and went up more during the recovery. Because of the harsh mathematics of portfolio losses, the 74% upside was not enough to compensate for the 66% downside, and as of year-end 2009 the fund was still down 40%.

Here is where it gets interesting. Even though this fund underperformed both on the downside and for the round-trip, the foreign large-cap value portion of our portfolios outperformed the benchmark during the same period by almost 7%. How is it possible that our portfolios outperformed the fund we used to implement our strategy?

The difference is cash flow. The actual performance of the portfolios we manage is a discounted cash flow calculation, not a time-weighted return calculation. Since we bought actively during the decline, a large portion of our fund position was purchased at lower prices[2]. *Our dynamic portfolio strategy helped us outperform, even though our fund choice underperformed.*

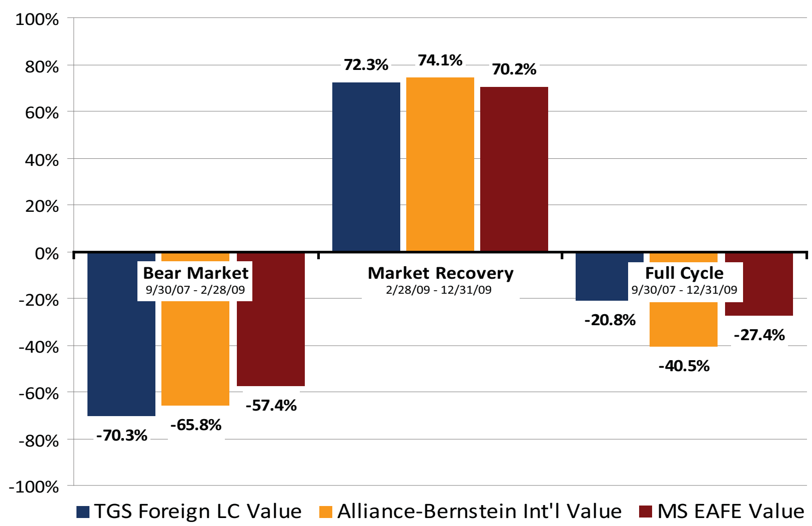
Does this mean fund choice is irrelevant? Anything but. Had we experienced less downside volatility, we would have realized even higher total returns, because we would have been starting from a higher base, when the market recovery began. Further, the ride would have been less frightening.

So why did this fund decline so sharply? The culprit was beta (β), a measure of a security's volatility compared to its benchmark, in this case the Morgan Stanley EAFE Value Index. The Alliance Bernstein fund has a beta of 1.20, suggesting that it will fluctuate 20% more (either up or down) than the underlying index. We identified this issue during the market decline. After much debate, we chose not

[1] *Please see Tom Rylko's article on page 4, which summarizes the discussion topics and findings of the IAB meeting.*

[2] *A simple way to think about this issue — we had more dollars in place on the way up then we had on the way down.*

Graph 1: Comparison of Performance



to sell this higher-beta fund during the crash. We held it into the recovery, and as expected the fund was also more volatile on the upside.

Now that the markets are up more than 70% from the low of March 2009, we are beginning to move assets from higher-beta funds to lower-beta funds. In the coming months, we will be moving from the Alliance Bernstein International Value Fund (beta 1.20, expense ratio 1.14%) to the Vanguard International Value Fund (beta 1.02, expense ratio 0.47%). In lower-risk accounts, we will be moving to the Tweedy Browne Global Value Fund (beta 0.71, expense ratio 1.41%). There are similar changes planned for two other mutual funds.

Let's get back to that round-trip out-performance. The most powerful element of our strategy through the decline and recovery was our stocks-versus-bonds measure, which compares the dividend yield on the S&P 500 to the interest yield on the ten-year Treasury note. By late fall of 2008, the dividend yield on stocks was higher than the interest rate on Treasury bonds for the first time since the mid-1950s. In our portfolio strategy, this imbalance prompted large flows from bonds toward stocks from the fall of 2008 through the spring of 2009, with highly favorable results once the markets began to recover.

Marvin has offered an intriguing idea. Since we were so successful flowing money from bonds into stocks when prices were low, should we consider a similar low-volatility to high-volatility strategy in the stock arena, owning low-beta funds most of the time, and switching to high-beta funds when stock prices are unusually cheap?

Of course this begs the question, "What is cheap?" When the Dow Jones Industrial Average broke through 10,000 on its way down from a prior peak of 14,166, we thought we were seeing bargains. Very few expected the market to continue all the way down to 6,516. We'll keep looking at this issue, but for now we are not planning a beta-switching strategy.

We are making some other important changes to our portfolio strategy, designed to reduce downside volatility, cut costs and improve full-cycle investment performance. I'll continue to discuss the technical elements of our strategy in future issues of *Inside the Black Box*.

Executive Summary

INVESTMENT ADVISORY BOARD MEETING

by Thomas A. Rylko

The past two years of market volatility prompted us to conduct a top-to-bottom review of our investment strategy. On March 25, 2010, we hosted a meeting of our *Investment Advisory Board*, during which a distinguished group of money managers and clients with industry experience weighed in on a series of topics[1]. The discussion was fruitful, and led us to adopt a series of changes to both our investment models and our methods of selecting managers. Below you will find a summary of three of the major issues we discussed and some of the solutions that emerged.

Discussion Topic #1: Why Do We Own Bonds?

During the downturn, some of our fixed-income holdings performed poorly relative to our expectations. We needed to clarify why we own bonds, is it to build a margin of safety into the portfolio (by owning intrinsically less volatile assets), or to balance risk and opportunity in pursuit of long-term rewards (by owning assets less correlated with common stocks)?

Result #1: Play Defense with Bonds

We believe our fixed-income portfolio should tilt toward safety at the possible expense of incremental return. To move our bond portfolios in a more defensive direction, we plan to remove high-yield bonds as a baseline component of the portfolio and reallocate those funds to core domestic and international bond funds.

Discussion Topic #2: If You're So Smart, Why Ain't I Rich?

From 2005-2007 we frequently wrote about the real estate bubble and potential problems with sub-prime debt. Given our concerns, why did we fail to effectively reduce risk when the market was high? And could we have creatively taken advantage of the bubble conditions, so that we could profit when the market crashed?

[1] *Please see the enclosed one-page supplement for bios of the IAB participants.*

Result #2: Avoid Short-Sales and Other High-Risk Strategies, and Find Managers Who Emphasize Intrinsic Value

The real estate bubble was apparent for at least three years before it finally burst. We saw problems coming in speculative real estate markets and mortgage-backed debt, but we had no clue those problems would cause the spectacular systemic collapse in fall of 2008. (Few predicted it.) Our board members were wary of taking aggressive steps to try to capitalize on possible opportunities caused by bubble-era real estate market valuations. No one has the ability to time the markets and short sales are inherently very dangerous. (Several smart operators got shellacked in 2005 and 2006 when they shorted real estate or sub-prime too early.) As Keynes put it, "markets can remain irrational longer than you can remain solvent."

Discussion Topic #3: Stock Manager Selection

Over the past 18 months, we have had conversations with many of you about the underperformance of particular stock funds. As we continue to evaluate each fund and potential replacements, which factors should we focus on in our analysis?

Result #3: Return to Previous Metrics for Evaluating Stock Managers

In the mid-2000s we changed our system of scoring managers to emphasize risk-adjusted return (i.e. how much return is generated for a given amount of risk). One consequence was a move to several mutual funds with higher beta (volatility) than our prior fund choices. Going forward, we will return to our prior system of manager evaluation, which focuses on low-volatility and low expenses. Our goal is to "take the edges off" during bear markets.

Over the next few months, you will see some changes to your portfolio to reflect decisions made at the *Investment Advisory Board* meeting. TGS would like to thank the participants for their candid insights and their willingness to help us improve our processes.

Jill Echevarria

Jill previously worked as a Management Consultant for Accenture in their technology practice in Asia and the U.S. Her husband still works for Accenture. She is currently a stay at home mom with her two children, Bella, age 12, and Mark, age 9. Jill attended Duke University.

Daren Heitman

Partner and Portfolio Manager
Cooke & Bieler Investment Counsel

Daren joined Cooke & Bieler in 2005, after serving as a Senior Analyst for five years at Schneider Capital Management in Wayne, Pennsylvania. Heitman received his undergraduate degree in Finance from Iowa State University in 1989. He received his MBA from the University of Chicago while working at Skyline Asset Management as both an Analyst and Portfolio Manager.

Tom McCafferty

Marketing Consultant and Freelance Writer

Tom and has been involved in the futures business for nearly three decades as a manager, author and consultant. He previously worked as the Chief Operations Officer at Market Wise Securities, Inc., of Broomfield, Colorado. He is the former branch office manager at Securities Corporation of Iowa. McCafferty received his undergraduate degree from University of Steubenville and his Masters from St. Louis University. McCafferty is the author of several books, including <u>Understanding Hedge Scale Trading</u>, <u>In-House Telemarketing</u>, <u>All About Futures</u>, <u>The Market is Always Right</u>, and <u>Winning with Managed Futures</u>.

Brian McShane

Director of Cedar Hill Advisors, LLC

Brian has been working with financial institutions in the Mid-Atlantic region for over 25 years. He previously worked at Ryan Beck as a Bank Analyst. McShane received his undergraduate degree from Haverford College in Economics. His areas of expertise include bank merger and acquisitions, capital formation, branch purchases and sales, bank stock pricing and trading, as well as more general strategic advisory services. These include long term strategic planning, long-term capital planning and educational board retreats.

Chris Niemczekwski

Founder Marshfield Associates

Chris founded Marshfield in 1989. While at Columbia, he was exposed to the Graham and Dodd school of security analysis and investing, an approach that has influenced his thirty years in the investment field. In addition to formulating and guiding Marshfield's core investment philosophy and discipline, he conducts research and focuses on long-term strategic firm planning. From 1981 to 1989 he was President of Justin Asset Management. Chris chairs the Finance Committee of the Corcoran Museum of Art and is a member of the Board of Managers of Swarthmore College where he serves as Chair of the Investment Committee.

Charles de Vaulx

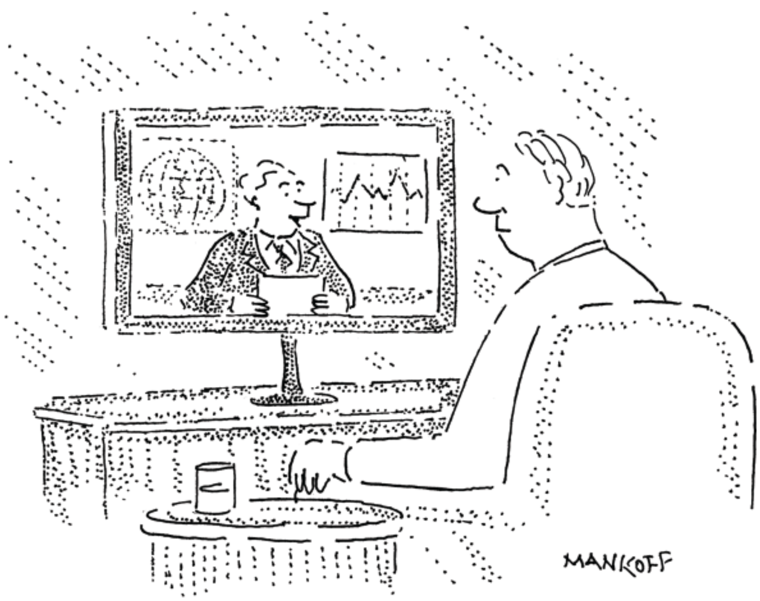
Partner and *Portfolio Manager*
International Value Advisors, LLC

Prior to IVA, Charles was Chief Investment Officer of the Global Value Group at Arnhold S. Bleichroeder Advisers, LLC, where he managed the First Eagle Global and Overseas Funders. In both 2005 and 2006, de Vaulx won the Absolute Return Award for "Fund of the Year" in the Global Equity's category for his management of ASB's Sofire Fund Ltd. He was also awarded *Morningstar's* International Stock Co-Manager of the Year in 2001 and was Runner-Up in 2006. De Vaulx joined Societe Generale Bank as a credit analyst in 1985. After joining SoGen Funds as a securities analyst in 1987, he was named Associate Portfolio Manager of the SoGen Funds in mid-1996 and Co-Portfolio Manager in late 1999.

THE MARKETS *at a Glance (ending March 31, 2010)*

	ANNUALIZED RETURN		
INDEX	*One Year*	*Five Year*	*Ten Year*
Dow Jones Industrial Average	46.9%	3.3%	2.5%
Standard & Poor's 500 Stock Index	49.8%	1.9%	-0.7%
Morgan Stanley Europe, Australasia, and Far East Index (EAFE)	54.5%	3.8%	1.3%
Barclays Capital Aggregate Bond Index	7.7%	5.4%	6.3%
Barclays Capital Municipal Bond Index	9.7%	4.6%	5.6%
Six Month Certificates of Deposit	0.5%	3.5%	3.1%
Inflation (Consumer Price Index)	2.3%	2.4%	2.4%

Inclusion of these indices is for illustrative purposes only. Keep in mind that individuals cannot invest in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investors' results may vary. Past performance does not guarantee future results.



"On Wall Street Today, the stock market corrected its previous correction, and is pretty sure it's got it right this time."

Source: The Cartoon Bank

QUOTE *of the Quarter*

"They may well have been the correct responses, but we may find that weaning ourselves from the medicine is harder than solving the original (problem)."

— Warren Buffett
Berkshire Hathaway Chairman and CEO

Buffett's response, at the Berkshire Hathaway's annual shareholders' meeting on May 2nd, to a question about economic stimulus measures.

Tax Update:

CAPITAL GAINS

by Vincent R. Barbera CFP®

We find ourselves in an uncomfortable position.

In 2003, Congress lowered the maximum dividend and capital gains tax rates for most dividends and all capital gains from 20% to 15% for qualifying taxpayers. Taxpayers in the 10% and 15% tax brackets were eligible for an even lower rate of 5%. In 2008, the rate for taxpayers in the 10% and 15% tax brackets fell to 0%. As originally enacted, these tax rate cuts were temporary and were scheduled to expire at the end of 2008. In year 2003, Congress extended these cuts for two more years, through December 31, 2010.

Next year, starting in 2011, the hammer comes down. The long-term capital gains tax rate reverts back to 20%, which is a 33% increase on what we have been accustomed to paying. (Imagine if your cable or water bill increased by 33% in one year!) The special tax treatment on dividends expires completely, with the top rate on dividends scheduled to rise to 39.6% in 2011.

President Obama has proposed significant tax-law changes, beginning in 2011. For example, Obama is proposing to keep tax rates on long-term capital gains and most dividends at 15% for most taxpayers, but would increase rates to 20% for upper-income taxpayers.

We'll be watching these tax issues carefully. Where appropriate, we may choose to accelerate the realization of capital gains into the 2010 tax year by selling securities. As always, we will pay close attention to the intersection of tax planning and prudent investment strategy, especially for our clients in the upper marginal tax brackets. We will not sell just to sell, only if we find that there is an opportunity to meaningfully reduce a future tax bill.

As we look to the future, Benjamin Franklin's words remain true, "In this world nothing can be said to be certain, except death and taxes."

TGS and Raymond James' Relationship

CLIENT Q&A

I have trouble understanding the relationship of TGS Financial Advisors to Raymond James Financial Services (RJFS). How did that relationship change in 2008?

In 1990, David Burd and Jim Hemphill moved from large wire-house brokerage firms to open an independent brokerage office of Raymond James. At the same time, they founded a new corporation of which they were the sole shareholders, TGS Financial Advisors. Later in 1990, that new company completed registration with the U.S. Securities and Exchange Commission as a Registered Investment Advisor (RIA).

The office grew, the staff grew, commission revenues steadily declined while fee-based revenue increased. By 2006, less than 5% of the firm's revenues were commissions in any form. In 2008, we made the decision to surrender our brokerage licenses and become a fully-independent RIA firm, and made the transition to Raymond James Financial's *Independent Advisors Division* (IAD). Raymond James remains TGS Financial's principal custodian, meaning they are responsible for holding our clients' assets and executing trades at our discretion.

I'm not sure I like having all my money with Raymond James, and I have issues with some of their disclosure language.

Back when we were brokers, regulators required us to have all assets on which we charged fees with Raymond James. Not any longer. We are now truly platform-independent. We manage money and charge fees primarily on assets held by Raymond James, but we could do the same thing at Fidelity, Charles Schwab or Pershing if we chose. We are pursuing the option of adding additional custodians. This would give each client an option about where their investments would reside, and allow us to select custodians based on specific capabilities and services.

Unified Strategy, Consolidated Billing, Simplified Fees

ACCOUNT CENTRAL

Almost two years ago TGS Financial Advisors, an independent Registered Investment Advisor (RIA), made the transition from Raymond James' *Independent Contractor Division (ICD)* to the *Independent Advisors Division (IAD).*

There were many factors that lead to the decision to become fully independent. Some of the most important reasons were directly related to simplifying and improving your experience as a client.

One change that immediately went into effect was the ability to invest in institutional-class shares, which have lower annual costs for clients. Since the transition, we have moved substantial client dollars from retail-class mutual funds to institutional-class shares. We estimate that this switch will save clients more than $100,000 in fees each year.

It was our intention to implement a number of other changes soon after the IAD transition in mid-2008. However, the markets got in the way. With things back on track, we are very excited to be able to rollout *Account Central*, a TGS program that delivers simplified fees, a unified investment strategy and consolidated billing.

Simplified Fees	*Unified Strategy*	*Consolidated Billing*
Wrap Fee Program	Outside Asset Management	Targeted Billing
ACCOUNT CENTRAL		

Let's take a closer look at the moving parts of each program:

Simplified Fees: *Wrap Fee Program*
Our new *Wrap Fee Program* allows TGS to absorb Raymond James Financial Services transaction fees, which can be up to $19.95 per trade, instead of passing them along to clients. There will be no change in our fee schedule associated with the new wrap program. We will simply absorb these fees.

Unified Investment Strategy: *Outside Asset Management*
In the past, we advised clients on the changes we recommended for outside accounts, such as 401(k), 403(b), and other retirement plans, and relied on them to put those changes in place. We've observed that many of our suggestions have been implemented late or in some cases not at all, resulting in negative performance consequences. The firm now has the ability to process daily downloads of account information from various outside financial firms (e.g. Vanguard, Fidelity). We can now actively manage, on a fee basis, many outside accounts not held at Raymond James. Managing these accounts directly will help us keep your entire portfolio properly aligned with our investment strategy. We'll also be able to provide daily pricing and accurate performance reporting.

We believe that managing all accounts directly will make things simpler for clients and should also help to improve investment results.

Consolidated Billing: *Targeted Billing*
In coordination with actively managing outside accounts, we can now provide clients with targeted billing. Targeted billing allows us to deduct all fees from a single account. This may provide significant potential tax benefits and a simplified billing structure.

During your *Annual Progress Report™ (APR)* meeting, we will be discussing each program and how it may benefit you should you choose to participate. If you have questions about the programs, or would like to participate prior to your annual meeting, please contact us so we can discuss the details of your situation and get the ball rolling. We are excited about this opportunity to serve you better.

TEAM NEWS

On Saturday, April 17^{th} Rainey Rylko's daughter and son-in-law, Carrie and Jason Conwell, welcomed their first child, a little girl named Caityln Elizabeth Conwell. Rainey is thrilled to be a grandmother.

MAKE*under*

In an effort to provide you with relevant and useful information we're working to simplify the Navigator content and layout. No fluffy, generic or flashy pieces.

The most obvious layout changes this time around are the addition of a table of contents and section headers (*Markets, Laws and News*). *Markets* summarizes the firm's thoughts and analysis of the financial markets (including any adjustments we're making in our investment strategy and how it may effect you). *Laws* highlights and explains recent changes in policy. *News* communicates the important happenings in the TGS community that we think you'd like to know about.

Please feel free to share your thoughts and suggestions to help us improve our communications by contacting Shauna Mace at (610) 892-9900 or shauna.mace@tgsfinancial.com.

Book Recommendation

The Catcher in the Rye

by J.D. Salinger | Reviewed by Shauna P. Mace

In memory of author J.D. Salinger, who passed away on January 27^{th} of this year, our book recommendation is Salinger's classic novel, The Catcher in the Rye.

We expect that many of you have read The Catcher in the Rye. If you haven't, or if it's been a while, we highly recommend that you put it on your summer reading list.

After sixteen year old Holden Caulfield gets kicked out of prep school, we get a chance to spend a couple days inside his head as he kills time in New York City, hoping to prevent his parents from discovering that he's gotten the boot again. We learn about his past, the important people and the not-so-important "phonies" in his life; and the happiness, pain and struggle of being Holden.

Holden's journey reminds us how complicated life can be as a teenager trying to find one's place in life. Caulfield is confused but not nihilistic. He dreams of being "the catcher in the rye" — an invisible guardian, keeping innocent children from falling over an unseen cliff.

Happy reading!

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