

Our Investment Strategy

The Dynamic Contrarian Portfolio Strategy™



MARKET VERSUS INVESTOR

The typical individual investor systematically underperforms the markets. Consider Graph 1 below.

Why do mutual fund investors realize such poor returns? Studies in the emerging field of behavioral economics suggest the primary reasons are psychological, not technical.

Among the key errors investors consistently make are:

- Chasing performance
- Selling low in a panic
- Trading too frequently

THE DYNAMIC CONTRARIAN PORTFOLIO STRATEGY™

Most investors fail because they lack a consistent and systematic approach to the markets. We provide that missing structure — a disciplined, forward-looking investment process that anticipates market moves by making decisions based on historical price and yield relationships. Over time, our strategy has added significant value (see Graph 2 on the next page).

The *Dynamic Contrarian Portfolio Strategy*™ has three basic elements:

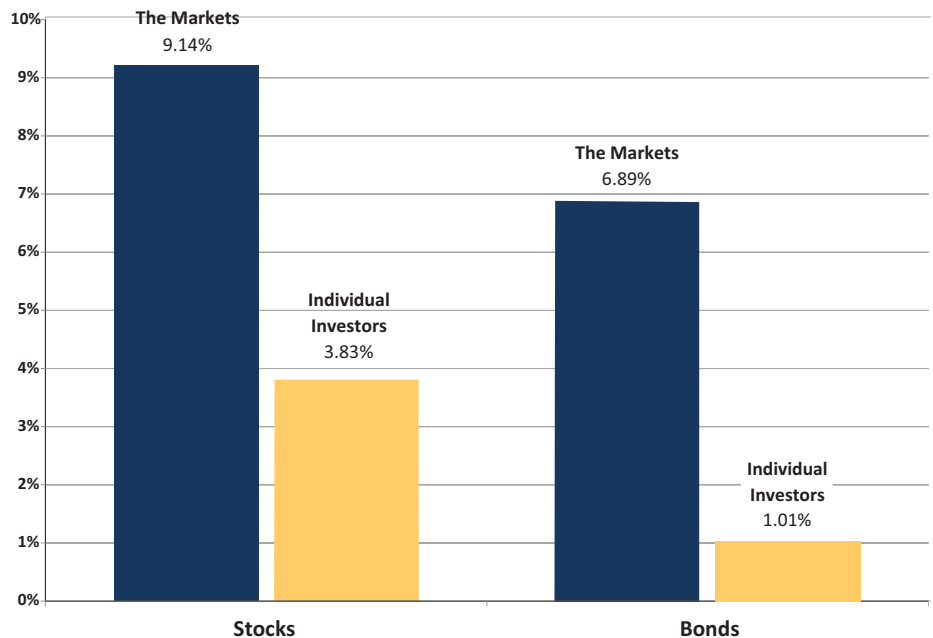
1. **Diversification**
We diversify systematically across asset classes.
2. **Contrarian Asset Allocation**
We use historical price and yield data to determine the relative value of paired asset classes. When one asset class is meaningfully overvalued, we

flow funds from the overpriced to the undervalued asset class.

3. **Discretionary Portfolio Management**
To avoid self-destructive investment behaviors, driven by emotion at market extremes, we manage all investments on a discretionary basis.

Let's examine each of these elements in more detail.

Graph 1
Average Percent Return per Year (1990-2010)¹



Source: DALBAR, *Quantitative Analysis of Investor Behavior 2011*

¹ Every year the mutual fund research organization DALBAR releases its *Quantitative Analysis of Investor Behavior*. This annual study examines the relationship, over twenty years, between the market's return and the actual return earned by investors in mutual funds. The results are invariably troubling. Shown above are the numbers for the period from 1990 to 2010. DALBAR's results are not unique. Other studies also suggest that most individual investors realize long-term returns significantly lower than market returns, and that the more actively those investors trade, the lower are their long-term returns.

Diversification

We start with a baseline asset allocation strategy. We use portfolio optimization techniques to assemble a diverse mix of portfolio assets, with a goal of maximizing risk-adjusted performance. This baseline portfolio includes from twelve to twenty-two different asset categories, depending on risk tolerance.

We adjust the baseline to reflect each client's tolerance for risk.

We define five levels of risk-tolerance in our strategy, ranging from Low Risk (20% equities) to High Risk (100% equities). We use directed discussions to determine which risk level makes the most sense for each client.

We carefully screen available investments in each asset class and choose those we believe offer

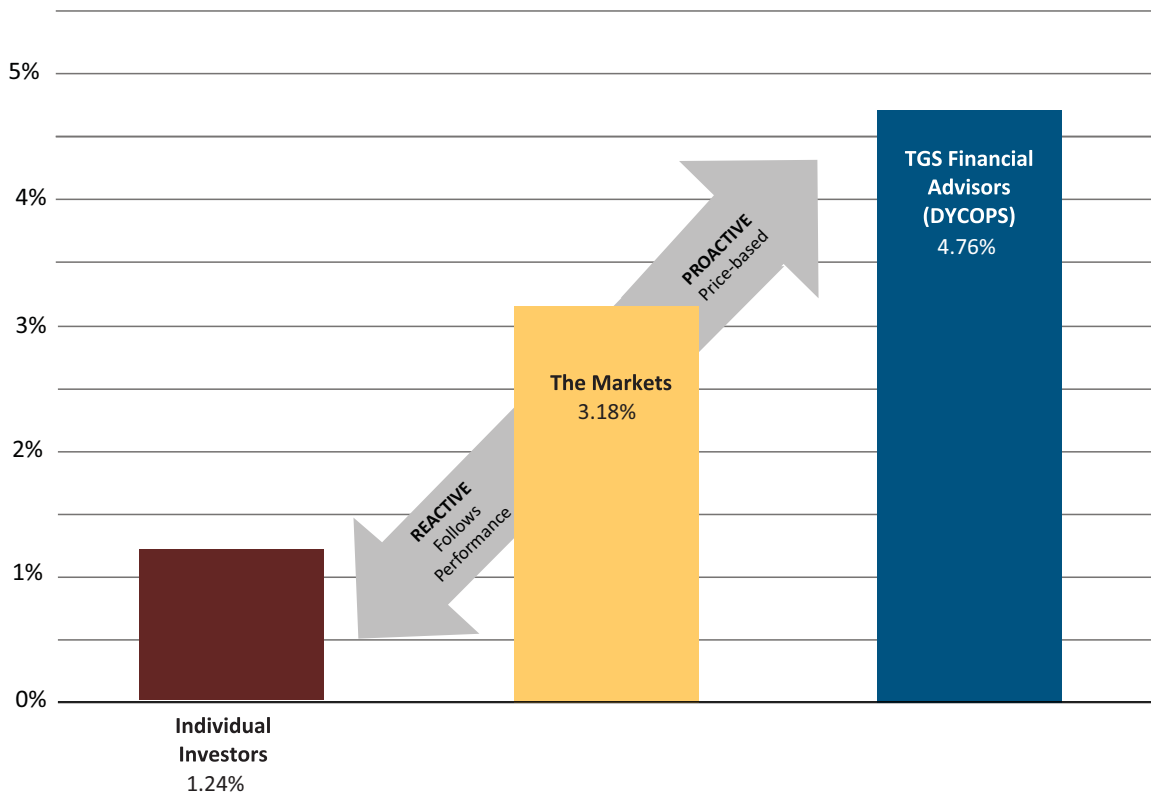
the best opportunities for favorable risk-adjusted performance.

Our screening process examines index funds, exchange-traded funds, actively-managed mutual funds, and separate account managers. Consistency within a given investment discipline is key to our choice of managers.

We work to drive down portfolio costs. We buy institutional-class mutual funds shares, which charge

Graph 2

Investment Performance²: Individuals vs. Markets vs. TGS Financial Advisors (2000-2010)



²The performance numbers shown are for the period 12/31/00 to 12/31/10. Performance for individual investors is derived by using DALBAR's 10-year return figures from 2000-2010, weighted 60% stock and 40% bond. Performance for markets is calculated by combining the performance of the S&P 500 and the Barclays Aggregate Bond Index, also weighted 60% stocks and 40% bonds. Performance for TGS Financial Advisors is the actual performance of a representative account at the *Moderate* risk level, net of advisory fees and trading costs.

significantly lower fees, wherever possible. We use index funds or exchange-traded funds (ETFs) in asset classes where we believe it is difficult for active management to add value net of costs.

Contrarian Asset Allocation

We track the prices and performance of twenty-two different asset classes. We use relative-price data for paired stock indexes (U.S. vs. foreign, growth vs. value, large-cap vs. small-cap), and relative-yield data for stocks vs. bonds and bonds vs. real estate securities.

We adjust the baseline to reflect current relative valuations between asset classes. We make adjustments from our baseline asset allocations to reduce our holdings of over-valued assets and increase our holdings of under-valued assets. We almost never completely eliminate any asset class from our strategy.

We systematically re-balance each investor's portfolio using multiple criteria. Every portfolio is re-balanced at least once a year regardless of market conditions. We also re-balance whenever there is a significant cash flow into or out of a portfolio, when a portfolio deviates by more than a set percentage from target weighting or when we make a global change to either

our manager/fund selections or our baseline allocations.

We never try to time the market. We believe that most market timing strategies increase costs, maximize tax bills and reduce returns. Our experience is that successful investors do not avoid bad markets; they suffer through them with discipline and courage, and take advantage of any opportunities they present.

Discretionary Portfolio Management

We manage all client portfolios on a discretionary basis. We establish the baseline strategy, choose the proper vehicles to implement that strategy, and make all buy-and-sell decisions

The Conceptual Basis of Dynamic Contrarian™ Investing

Our brains are badly designed to make investment decisions. The human brain is designed to recognize patterns, follow trends, and believe the past will predict the future. All of these intrinsic aspects of human consciousness drive us toward making decisions based on past performance; to panic at market lows and to abandon prudence at market highs.

To be successful, an investment strategy must be prospective, not reactive. Our investment strategy is designed to deliver superior risk-adjusted performance by doing the opposite of what individual investors do. We are usually buying when the mass of investors are sell-

Our discretionary management process offers the following potential benefits:

- Reduced economic risk, since over-valued asset classes are systematically under-weighted.
- Potential to enhance performance by taking advantage of pricing anomalies at market extremes.
- Peace of mind, since all investment decisions have been delegated to a trusted professional.

ing, and vice versa. *To be successful with our approach, an investor needs to be comfortable acting against the herd.*

The “strong” version of Modern Portfolio Theory has been proven not just incorrect, but dangerous. Markets are not perfectly efficient. Investors are not rational calculating machines, but emotional herd-oriented living beings. Correlations between asset classes are highly variable, and during panics can approach 1.0. (In other words, when fear takes over, everything goes down at once.)

Portfolio optimization techniques can be of long-term value, if they are price-based and use forward-looking economic return assumptions³. The investor must recognize that optimization is a process for long-term portfolio con-

“I don’t skate to where the puck is. I skate to where it is going to be.”

Wayne Gretzky

struction, not short-term volatility management. Diversification is not a perfect strategy for reducing risk, but it is the best strategy we have.

The asset-allocation mix is the key investment strategy decision, providing the greatest opportunity to impact the long-term performance of an investment portfolio. For example, in 1999 the decision about whether to buy or sell technology stocks was far more important than the choice of which specific technology stock to own.

There is no free money anywhere. No asset class has intrinsic “alpha” (superior risk-adjusted performance).

Most investments are positively correlated with each other. They tend to move in the same direction over time. There are no investments with high long-term economic returns that are inversely correlated with stocks and bonds. If you want to get rich and stay rich, and your core holdings are anything other than stocks, real estate or bonds, you had better be one heck of a market timer.

Some assets are correlated but not cointegrated (like stocks and

“In the short run, the market is a voting machine. In the long run, it’s a weighing machine.”

Benjamin Graham

bonds), and some are both correlated and cointegrated (like different sub-classes of common stock, i.e. growth and value). Correlated assets tend generally to move in the same direction, but can diverge substantially and need not return to balance. Cointegrated assets are linked by economic factors, and will eventually return to balance even if they diverge substantially from each other in the short term.

We manage correlated and cointegrated assets using a price rule, and correlated but not cointegrated assets using a yield rule. We can make a logical assumption that divergent assets will return to the mean if they are correlated and cointegrated, but not if they are correlated but not cointegrated.

³ Using historical return data sets to construct portfolios inevitably introduces end-of-period bias issues that cause over-valued asset classes to be preferred over cheaper ones.

“What we learn from history is that people don’t learn from history.”

Warren Buffett

Markets tend toward efficiency, the same way a car driven by a drunk tends toward the middle of the road. The market as a whole, asset classes and individual securities are all pulled toward fair value – unevenly, episodically and inexorably. This means that bubbles will inevitably burst, and bear markets in assets with enduring value will eventually recover.

Markets are efficient at processing objective information about individual companies, but poor at overcoming the excesses of fear and greed at market extremes. The emotional reactions of the mass of investors periodically create significant valuation anomalies that the contrarian investor can exploit. Our robust price and yield rules allow us to make rational buy and sell decisions even when markets are disordered.

Because of investor emotions, the stock market is five to ten times more volatile than the real

economy. The long-term return of the stock market is a function of the growth of the real economy. Market declines are an opportunity to earn higher-than-market returns by buying assets at low prices relative to their intrinsic worth.

The key determinant of long-term success is behavior at market inflection points. Consider investors who went “all-in” with technology in 1999, or who panicked and sold in late 2008 or early 2009. In each case, they did damage to their portfolios from which they will be unable to recover, even over a generation of prudent investment management. *No client who followed our strategy made either one of those bad decisions.*

Both the stock and bond components of portfolios must be globally diversified. Holding a substantial portion of assets in foreign securities is a powerful diversification strategy, and also creates a larger pool of potentially profitable investment opportunities.

FREQUENTLY ASKED QUESTIONS

What does *Dynamic Contrarian™* mean?

Dynamic means that our allocation to asset classes changes over time. Contrarian means that those changes are made against the trend, when our price or yield rules indicate that one asset class is cheaper than another.

Can you give a real-world example of *Dynamic Contrarian™* investing?

Consider Graph 3 on the next page, which shows the relative value of U.S. large-capitalization growth stocks versus value stocks. After a generation of small relative moves, during the period of the tech bubble (1997 to early 2000) the price of growth stocks exploded.

At year-end 1999, growth stocks were almost *four standard deviations* over-priced compared to value stocks. By early 1999, we had reduced growth to the lowest possible level in our model, and boosted value to the highest possible level. Growth stocks collapsed after March of 2000, and the S&P 500 Index declined by more than 45%. During the three-year bear market from 2000 to 2003, our portfolios actually made money.

If growth stocks were so expensive, couldn't you have made more money by shorting them?

We are contrarian, not suicidal.

We believe markets will periodically go to irrational extremes, and then mean-revert toward fair value, but we have no ability to predict just how far a market bubble will expand, how long the irrational party will last or precisely when sanity will return.

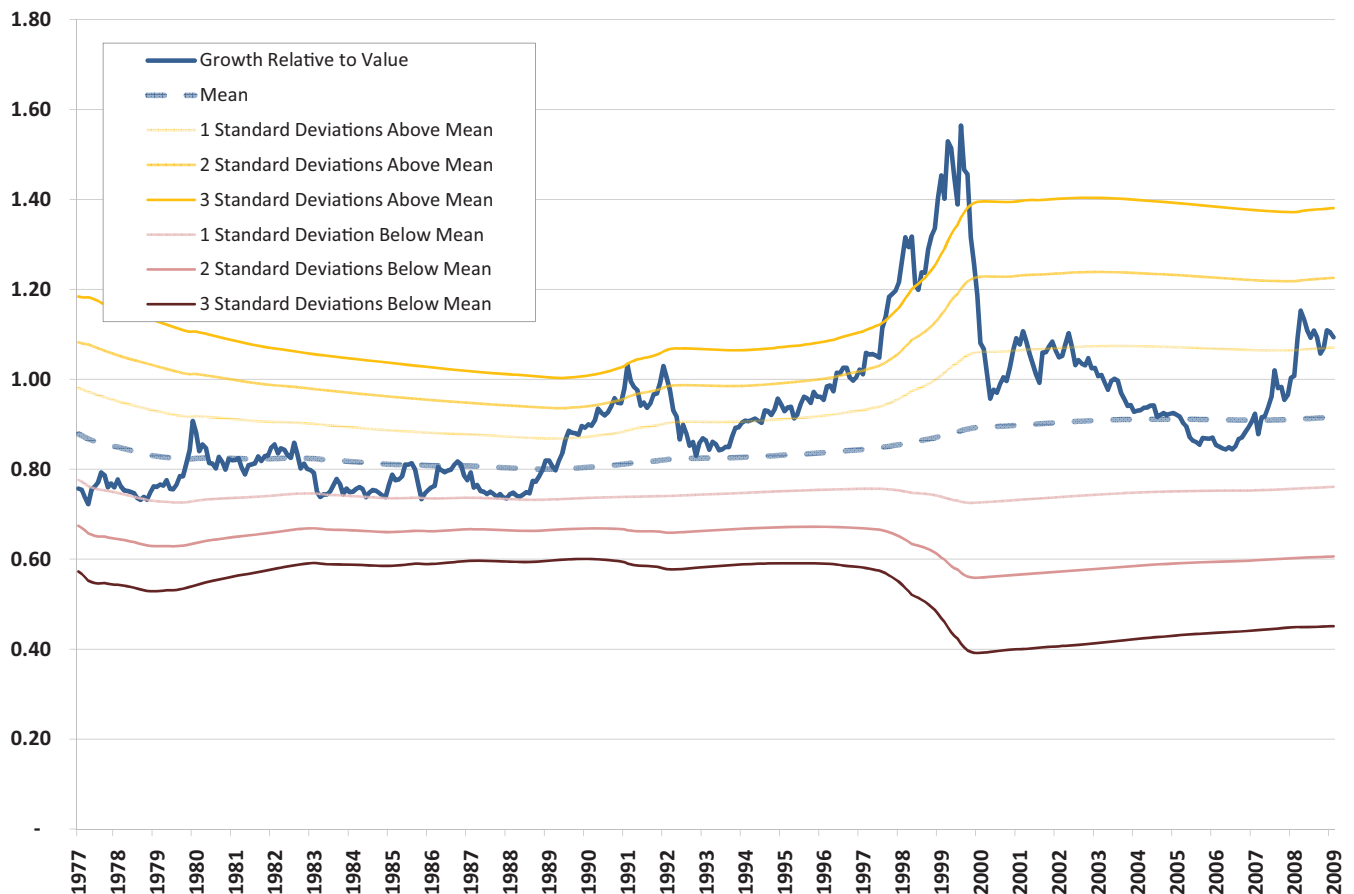
The problem with being short in an irrational market is that you can be right in the long term, but still lose all your money in the short-term. As long-only managers, our over-weighting in value stocks led us to under-perform during the last year of the tech bubble, but at no time did it expose us to the possibility of permanent impairment of capital.

How can I be sure that your approach will out-perform the market?

We do not promise to out-perform the market. Our investment process is systematic and disciplined, but it is not magic. It allows us to add value during certain specific types of market conditions, and has in the past improved performance over the full market cycle, but it does not out-perform under all circumstances.

Graph 3

Relative Value of U.S. Large-Capitalization Growth Stocks vs. Value Stocks (1977-2009)



es. It does not always avoid the pain of bear markets.

Consider the growth/value chart above. By the first quarter of 1999, we were mostly out of growth and entirely out of tech. In the last crazy year of the tech bubble, the NASDAQ Stock Index went up almost 90%, and we missed the move almost completely. In the most exciting market of the last fifty years, we underperformed by double digits.

Few investment managers out-perform the market long-term, and absolutely nobody out-performs consistently every quarter. The attempt to “beat the market” is the central reason that most individuals achieve long-term returns one-third to three-quarters lower than the market.

What sorts of clients do you serve?

Our ideal clients are intelligent, mature and patient investors with clear long-term goals. We look for

clients who want to build financial independence that lasts a lifetime, and whose own good habits make that desire a realistic and attainable objective. We work with successful individuals who choose to delegate the complex and challenging task of running their investment portfolios to a competent and trusted partner.

While we serve a broad range of clients, our practice is concentrated in three segments: retirees and individuals planning toward a retirement transition within five years, business owners, and medical professionals.

How are you compensated, and what do you charge to manage a portfolio?

Our investment practice is fee-based. We are paid as a percentage of the assets under management for each client. All fees are disclosed prior to beginning an advisory relationship, and the quarterly fees assessed to client accounts are also fully disclosed on

account statements. We also charge financial planning fees for work we do on non-investment issues.

What about taxes?

We pay careful attention to tax effects. For example, for a client in a higher tax bracket, we might choose to own municipal bonds instead of government/corporate bonds in a taxable account. We monitor realized gains and losses in taxable portfolios and work to offset gains where possible. We prefer to buy investments producing ordinary income (i.e. taxable bonds and REIT's) in tax-deferred retirement accounts, and assets producing qualified dividends and long-term capital gains in taxable accounts.

I've read that I should just buy an S&P 500 Index Fund. Why is your approach better?

Buying a S&P 500 Index Fund should be the baseline investment strategy

⁴ Inclusion of these indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results

⁵ This is not a solicitation of purchase nor an offer to sell any specific mutual fund. Mutual funds are offered by prospectus. Prior to purchase of any specific mutual fund, you should request the prospectus for that fund, which will specify the fund's charges and expenses, and review it carefully before investing or sending money.

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⁷ Please note that international investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility.

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to which all other strategies are compared. The index strategy offers several key advantages. First, because shares within the fund are only bought and sold when companies are added to or removed from the index, portfolio turnover and the resulting taxable capital gains are kept very low (0% in 2008 but historically between 1% and 2% for Vanguard's S&P 500 Index Fund). Second, the total costs of an index fund strategy are very low (0.18% of assets annually for the Vanguard Index 500 fund). These are both important benefits.

There are two potential problems with an index-only strategy. First, in the past there have been extended periods when the S&P 500 Stock Index delivered relatively poor returns. For example, during the decade of the 1970s, the S&P 500 Index delivered returns more than 250 basis points below inflation, even before taxes. During the 2000s, investors in the S&P 500 actually lost money for the entire decade, even before inflation. In both cases, investors who relied solely on the S&P were unable to realize acceptable returns over a period of more than ten years.

Second, during episodes of extreme investor behavior, the capitalization-weighted S&P 500 Index will reflect the irrational pricing environment. In late 1999, more than half of the value of the S&P 500 represented only 30 growth and technology stocks. A more broadly-diversified

“The market can remain irrational longer than you can remain solvent.”

John Maynard Keynes

portfolio has the potential to deliver acceptable returns in a broader range of market environments than a portfolio with any one asset class – including the large-capitalization U.S. stocks represented by the S&P^{4,5}.

I am trying to make a decision about where to invest my lump-sum retirement distribution. I've interviewed an equity manager with a very strong long-term record. Why should I choose your asset-allocation approach, instead of this manager's stock discipline?

You should consider the fact that most investment performance reflects style, not skill. Often the manager with the very best relative performance over the trailing period may deliver much worse relative performance going forward, when his investment style goes out of favor. This has often happened in the past^{6,7,8}.

Can't I make more money in individual stocks than with a diversified portfolio? Won't the returns on a concentrated portfolio of superior stocks be higher?

If we can know the future, a portfolio concentrated in the best-performing sector will always out-perform a broadly diversified portfolio. If you know the future, you certainly don't need our services. We do not believe it is possible to reliably and consistently predict the future.

If you agree that the future is by definition not knowable, then you need a strategy to cope rationally with that intrinsic uncertainty. We believe that our systematic, disciplined, and diversified approach is a wiser long-term bet than a highly-concentrated stock portfolio. This is particularly true of the technology sector, which over most twenty-year periods has delivered returns below the returns of the broad market.

I want to earn the higher returns of stocks while the market is going up, but I don't want to lose money if the market goes down. How can I be sure that you will get me out of the stock market before a big decline?

You can't and we won't.

Most attempts to time the market lead to higher taxes, lower returns, and general frustration. We are great

believers in observing what successful rich people do. We observe that most successful investors do not avoid bad markets; they suffer through them with discipline, and take advantage of the opportunities they present. Every few years, investors must suffer through a nasty bear market, which takes a significant bite out of portfolio values. We never know what that bear market will arrive, so we can't get out before the decline.

Our job is to help our clients stay the course – to avoid panic, and to stay on track with their long-term plan during even the most frightening bear market decline.

My situation is unique, and I'm not sure that I am comfortable with a one-size-fits-all approach. How will your approach address my specific circumstances?

Each of our financial and investment plans is designed to address the specific goals and concerns of one unique client. We design individual strategies for each client to implement our portfolio strategy appropriately given that clients unique circumstances, while maintaining the integrity of our asset allocation process. For example, if a client plans a large house purchase in six months, we will allocate a larger portion of assets to short-term fixed-income or money market assets, to cover the anticipated cost of the new home. A client with access to

certain specific funds within a 401k plan at work would receive direction on which funds to choose and when to change them, designed to complement the investments in the accounts we manage directly on a discretionary basis. Each client's specific situation, including spending plans, tax structure, retirement needs, and risk tolerance, is reflected in that client's portfolio.

What are your charges for an initial meeting?

There is no charge for an initial consultation. We treat our first meeting as a mutual interview, at which we will jointly determine whether a potential advisory relationship makes sense. You will be evaluating our investment approach and our responsiveness to your concerns. We will evaluate whether your expectations seem realistic and if it appears, you will be comfortable delegating investment decisions to our firm. If we both decide to proceed, the next step will be for us to prepare a written proposal for you, making specific suggestions about how we would manage your assets. The cost of an *Investment Analysis & Review*TM is \$2,500. A *Lifetime Wealth Plan*TM (which includes all elements of the *Investment Analysis & Review*TM, plus analysis of tax-reduction strategies, education funding, insurance planning, retirement planning, and estate planning) is \$5,000.

Do you have a minimum account size?

Yes. Our minimum new advisory relationship is \$2,000,000 (for David Burd and Jim Hemphill), or \$500,000 (for financial advisor Vincent Barbera). We believe that this minimum account size allows us to more fully implement all aspects of our investment strategy. In a limited number of cases, we will accept a smaller initial relationship, for example, for a family member of an existing client.

How will you manage my assets? Will you, or the managers you select, call me before buying or selling specific securities?

We manage all client assets on a discretionary basis. We prefer to have the ability to implement our systematic investment strategy fully and efficiently, on a discretionary basis, and to be held accountable for our results over a realistic evaluation period.

How will I know how I am doing, and how my portfolio is performing? How long will it take to know whether your approach is working for me?

For each client, we identify a specific custom benchmark appropriate to his risk level against which we believe that client's portfolio should be evaluated. The Annual Progress Re-

port™ we provide to each client compares his portfolio's performance against that benchmark for one-year and longer periods. Since it is mathematically very difficult to evaluate any investment approach over any period less than three years, we advise every new client to be willing to commit to our approach for at least three years, and ideally for five years.

Can you provide examples of your allocations to assets classes, so that I can better understand your approach, and know what my portfolio might look like?

The *Investment Analysis & Review™* or the *Lifetime Wealth Plan™* documents our asset allocation strategy for your specific situation, together with the investments (mutual funds, ETFs, separately-managed accounts) we recommend to implement that asset allocation.

Can I obtain a copy of your portfolio allocation software, so I can evaluate it for myself?

Our portfolio system and the spreadsheet tools we use to implement it are proprietary, and are never provided to any investor. We will provide illustrations showing the recommended allocations to asset classes as part of each investment or financial plan, but we choose not to make available the underlying databases and the algorithms used to calculate allocations.

Don't most financial advisers operate more flexibly, letting clients make the final decision about what to buy? I don't want to second-guess your investment ideas, I just want to be part of the decision-making process, as I am with my current stockbroker.

Giving up control over investment decisions can be very difficult, especially if you have already achieved meaningful financial success. Yet we believe delegating these decisions is a vital part of a successful wealth-building strategy, because our experience convinces us that the traditional broker/client relationship (broker proposes and client disposes) is a strategy designed to systematically under-perform the markets.

In the late 1990's, none of our investment accounts were managed on a discretionary basis. Every client had to either accept or reject each of our investment recommendations. Some clients accepted most or all of our ideas. Others accepted some, but rejected others. In 1999, we made a systematic examination of the implementation of our investment strategy, focusing on the relatively small number of recommendations that were rejected by clients. We determined that the most likely recommendations to be rejected turned out to be our most profitable trades. Those rejected recommendations were almost always made

when markets were disordered and frightening.

By giving clients the final say on every investment decision, we empowered them to systematically reduce their investment returns. This wasn't a good outcome for anyone. Not only did the traditional broker-client model reduce returns, it was also massively time-consuming and inefficient. Often the time frame to capitalize on genuine market opportunities is short. We were spending that time on the phone, persuading (or failing to persuade) individual clients to make individual purchases or sales, instead of making trades for as many clients as possible.

Since 2000, we have managed assets on a discretionary basis. This allows us to implement our investment ideas consistently, efficiently and quickly, and to be held accountable for the results.

TGS Financial Advisors is a fee-based, discretionary wealth management practice located in Radnor, PA. Since 1990, we have helped successful families to build, maintain and preserve lifetime wealth. We accept new clients primarily by referral. If you or a friend, relative or colleague would like more information about TGS Financial Advisors please e-mail us at questions@tgsfinancial.com or call us at (610) 892-9900 or (800) 525-4075.

Please remember to contact TGS Financial Advisors if there are any changes in your personal or financial situation, or investment objectives for the purpose of reviewing, evaluating and revising our previous recommendations and/or services. Please also advise us if you would like to impose, add, or to modify any reasonable restrictions to our investment advisory services. A copy of our current written disclosure statement discussing our advisory services and fees continues to remain available for your review upon request.