July 20, 2012

We must be aware of trying to build a society in which nobody counts except a politician or an official, a society where enterprise gains no reward and thrift no privileges. ~Winston Churchill

Dear Friends:

I am very happy to welcome a guest author to our monthly communication. John Harrell serves as our Director: Portfolio Services and Research. John has applied his efforts on behalf of our clients for about eight years and leads the group that spends its time buried in the details of our portfolios. We are very pleased that John has come up out of the trenches to give us a Mid-Year Review of the investment world and our portfolio work.

We really want our clients and friends to be informed. Consistency and discipline are extremely important characteristics of successful long-term investing and portfolio management. Comfort is enhanced by knowing and understanding what's going on. That's why we try so hard to get communications in your hands and heads as often as our workload (and creative juices) can support.

We are really proud of John and his work. John began working with us while still in college. We have been happy to participate as John completed his undergraduate Finance degree; earned his Masters of Business Administration degree; studied and successfully completed requirements for designation as Accredited Asset Management Specialist (AAMS); and received his CERTIFIED FINANCIAL PLANNER™ certification in 2009. John is a member of the Financial Planning Association.

John's Mid-Year Review notes that in spite of very notable volatility, the first half of 2012 was really pretty good. The U.S. markets fared a little better than foreign markets, but the volatility was prevalent worldwide. Bonds, on the other hand have remained fairly steady, but interest rates (yields) remain quite low. Further, John discusses four important metrics that guide us in the allocation of our Dynamic Strategy and why it currently favors equities. Finally, he nicely summarizes some of the principles that guide our work.

I hope all is well with you and yours and invite you to come see us soon.

God Bless,

Doug

Douglas Smith, cpa/pfs
Managing Director:
Portfolio Strategies and Financial Integration

Clark Tower · 5100 Poplar Avenue, Suite 2904 · Memphis, TN 38137 · Phone (901) 681-0021 · Fax (901) 842-2824
www.tdcapitalmanagement.com
a Registered Investment Advisor

July 20, 2012

Mid-Year Review: Where Do We Go From Here?
Portfolio Services and Research

As we enter the third quarter of 2012, we would like to provide some perspective on what has happened over the first half of the year and discuss how we are positioning our portfolios for the months ahead.

The first six months of the year certainly provided benefit to those with equity exposure; however, the difference between the two quarters was quite drastic. With stronger economic data reported in the U.S. and a reduction of fears about Europe, the U.S. stock market rose 13% for the first quarter, representing the strongest start since 1998, and Japan generated it's best first quarter gains in 24 years.

The second quarter gave back some of those gains. Stock markets were driven by escalating concerns about the future of the European currency union and slowing global growth. This was accompanied by discouraging data on unemployment and by renewed focuses on the capitalization of Europe and some American banks. The slowdown in China and India has put downward pressure on the prices of oil and other commodities, as well as stocks in general. However, as we neared the end of the second quarter, there were signs of the European situation stabilizing; after markets around the world dropped almost 9% in May, they bounced back with a 5% gain in June.

Below is a summary of global market performance for the first half of 2012, all in U.S. dollars. Of note, the global "flight to safety" over the past year has led to a stronger dollar, depressing returns outside the U.S. when denominated in the dollar.

2012	S&P 500	MSCI EAFE	Emerging Markets	Global Returns
Q1	13%	11%	14%	12%
Q2	-3%	-7%	-9%	-5%
Year to Date	9%	3%	4%	6%
12 Months	5%	-14%	-16%	-5%

Source: Morningstar; returns include reinvestment of dividends; all returns are in US dollars

The dilemma investors face today is whether or not to expose their funds to the volatility of the stock market or subject their funds to unattractive bond yields. There is considerable debate about whether stocks are expensive, cheap, or fairly valued. Some observers express doubts about the sustainability of today's record corporate profit margins, the enduring impact of debt problems, and slow growth around the world. US stocks also show up on the slightly pricey side when using longer-term valuation models, such as Robert Shiller's Cyclically Adjusted Price Earnings ratio (CAPE) and Tobin's Q ratio.

On the other side, a fair number of reputable analysts view stocks as historically cheap, pointing to the attractive ratios of stock prices to book values and measures like multiples of earnings and cash flows. Indeed, using longer-term valuation models, Europe and Emerging Markets do appear to be inexpensive by historical standards.

Bonds currently offer low interest rates by historical standards, as banks around the world are keeping rates down to encourage economic growth. Given current inflation of ~ 2%, we would generally see interest rates about 2% higher than today – but these are not normal times.

And sure, holding cash eliminates risks from both stocks and bonds but guarantees depreciation of purchasing power, as cash is yielding ~ 0% (versus ~ 2% inflation).

Clearly, every client's portfolio is different, but even in the short-term, the investment strategies that TD Capital implements on behalf of our clients currently favors exposure to equities. That decision is supported by a multitude of factors but dominated by the following four themes (a paper describing these themes and how to apply them to a dynamic investment approach will be released later in the year for those interested in the inner workings of these strategies):

- Volatility (particularly the VIX)
- Valuation (CAPE and Tobin's Q)
- Market Momentum (50-day vs. 200-day Moving Averages)
- Inflation (currently low, which supports equity investment on a historical basis)

So, what does this mean for your portfolio?

1. For clients with cash-flow needs – We believe in maintaining less volatile, liquid funds to cover these expectations over the next 5 years. Having this buffer means that we reduce the risk of having to sell more volatile holdings at depressed levels, and lessens the stress and anxiety that market volatility can place on investors. These liquid funds are currently allocated more to the credit asset class to gain a little extra yield over treasuries, and are shorter in duration to reduce the potential decrease in price if interest rates rise.
2. Maintaining a diversified traditional equity portfolio has helped many investors during the 2000s but has not added much value in the last year or so. Going forward, we have no idea whether the U.S. dollar and market will do better or worse than global markets, but we do know that the U.S. represents less than half of the investing opportunities around the world. Therefore, we will remain geographically diversified.
3. Where opportunities in the future look more favorable we have added a little extra exposure or "overweighting". Currently we have extra exposures to "high quality" companies paying higher than average dividends, emerging markets, and the European area.
4. Our Dynamic Strategy (managed in-house) is currently favoring equities, allocating ~ 75% of this sub-allocation to the global stock market as of 7/1/12.
5. Finally, regardless of what happens to the markets in the short term, we should adhere to the investment portfolio model in place for you (as described in the first quarter 'client of the day' letter), barring significant changes in your circumstances. Remember that your portfolios are structured in a way that we feel is most appropriate for you and your situation.

Should you have any questions on anything covered here or on any other issue, please feel free to contact us. As always, we thank you for the opportunity to serve your financial needs.

John Harrell, CFP®, AAMS
Director: Portfolio Services and Research