TW Advisors

## AUGUST 2012

The stock market has surprised most everyone by rallying of over 11% since bottoming in early June. At that time the market had given up most of its double-digit gain for the year and seemed destined to continue to fall given the poor macro-economic environment . A heavy dose of uncertainty in Europe caused a further exit from investors. Fortunately going into that decline we had accumulated a healthy cash position. After the decline into early June we decided to increase our equity exposure despite the uncertainty for several reasons.

First, the overall conditions seemed conductive to rising prices as we forecasted in our letter that accompanied the first quarter performance reports:

> *"Successful investing is difficult because it is emotionally hard to sell high and buy low. In our opinion stock valuations are at the upper end of their fair value range currently. The time to be aggressive is when stocks are well below fair value. But the natural instinct at those times is to sell.* ***We're reviewing these concepts now because we want our clients to remember how it feels right now after a 25% rally. It feels really good and seems like stocks can only go higher from here. However, because there are so many structural issues with our economy, we believe at some point in the future the current bullishness will turn into fear driving stock prices lower. That will be the time to buy aggressively but it will feel risky.*** *Hopefully, it will be much easier to be comfortable with that decision by remembering the good times and knowing they will return."*

Buying while stocks are declining is hard because only the passage of time will determine if you're buying after a correction, or during a correction, which is why having a discipline is critical to successful investing. Because the stock market is complex and adaptive we use a multi-discipline approach that we believe is more comprehensive. While far from perfect this approach has allowed us to achieve our goals of outperforming our benchmarks over a market cycle with less risk.

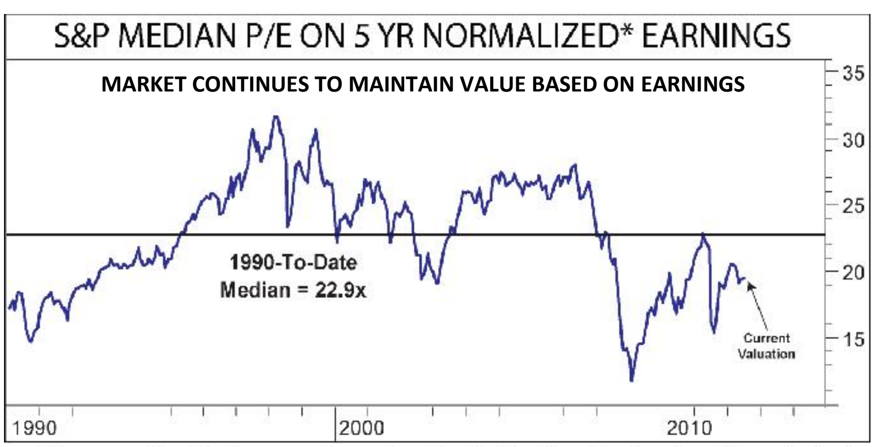
Besides recognizing the conditions were favorable for rising prices three other observations contributed to our decision to buy. **First,** we believed the agreements to allow the eurozone's rescue funds to recapitalize vulnerable banks directly are an important step in solving the euro crisis. **Second**, investor sentiment was extremely bearish, which is usually a good contrary indicator. The American Association of Individual Investor Sentiment Index only registered 22% bulls which matched the figure at the March 2009 lows. **Finally,** and most importantly, we were finding several stocks in various industries that we were willing to own for the long-term, regardless of whether the short-term selling pressure was over.

For example, we sold McDonald's close to $100 in January and were able to buy it back around $86. Caterpillar had declined by over 26% from its high in February, and most recently Cisco was purchased not much higher than its financial crisis low.

The European debt crisis is a long way off from being resolved and a multitude of things can go wrong from here. Plus, the markets have already had a nice rally from recent lows. All of which is to say that our message of the importance of navigating the markets is still paramount. If progress reverses in Europe, if we don't deal with the fiscal cliff in the U.S., or if prices rally too far, too fast, we will not hesitate to raise cash. But, in the meantime, we expect to continue to own a diversified portfolio of high-quality, dividend-paying stocks.

Be sure to call us if you have any questions.

***James Tillar, CFA     Steve Wenstrup***



*Five year arithmetically averaged annual earnings, looking 6 months ahead and 54 months back


Chart source: Leuthold Group