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Style: Growth and Income Balanced (Diversified Core)

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Balanced portfolios offer the combined benefit of fixed-income security of returns and equity-driven capital growth. Tillar-Wenstrup Advisors provides its Diversified Core Balanced Portfolios to investors looking to generate stable returns amidst market volatility.

Q: Would you give us a very brief overview of the company?

A: Tillar-Wenstrup Advisors, LLC is a registered portfolio management advisory firm located in Dayton, Ohio. We do not have a broker's license and the majority of our business is generated from brokers and consultants' referrals. While we do some long-range planning for our clients we do not provide what a full service brokerage firm offers. Our clients benefit from our demonstrated record of after-tax returns through portfolios of selected securities.

> **"We start with the top down approach and we look for opportunities in various sectors and industries where future earnings are expected to rise."**

The firm has two investment committee partners James Tillar and Stephen Wenstrup with both of us having more than 20 years of experience in this field. The initial idea of the Core Strategy was formed by us at a firm called C.H. Dean Inc., and we still manage money for them today.

Q: What is the investment strategy of your Diversified Core balanced portfolio?

A: The portfolio in balanced accounts is partly in equity where we manage allocation and partly in fixed income securities. In our allocation model between equity and fixed income, the fixed income portion generally remains fully invested following the strategy of interest rate anticipation through ownership of high quality bonds. At present, in the fixed income portion we are holding high quality corporate and agency individual securities and ETFs. In the bond portfolio we use a laddered approach and set our duration in the portfolio based on our anticipation of interest rates.

The equity portion is targeted to be fully invested but at times when the risks are higher we look for cash allocation using short/intermediate term fixed income instruments

While on the fixed income side we look at the quality of the company, on the equity side we follow a multi-disciplined approach that focuses on economic and fundamental research supplemented by other disciplines to assist us in understanding the investment environment. Our core portfolio is designed to give investors the gains from the appreciation of the equities and stable returns from the bond market.

Q: Can you describe an environment when you may find yourself thinking outside the box?

A: Right now from an economic analysis standpoint one may say this is not a good time to invest because we are seeing rising unemployment, capital projects are put on hold, earnings at companies are declining and new product launches are delayed. But history tells us that the markets looks ahead and current valuations reflect weak earnings environment for a long time to come. While stocks are presently undervalued, they are reasonably priced assuming the economic recovery continues.

Tillar-Wenstrup Core Balanced Portfolio

Company	Tillar-Wenstrup Advisors, LLC
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Source: Company Documents

JAMES G. TILLAR

JAMES G. TILLAR, CFA, began his investment career with a West coast money management firm in 1986. He was recruited to Dean Investment Associates (DIA) in 1987, where he moved to the Research Department and was promoted to Assistant Vice President and Equity Strategist in 1994.

Tillar received his Chartered Financial Analyst designation in 1989 and is a member of the Dayton Chapter of Financial Analysts. He received a BA from the University of Notre Dame.

STEPHEN A. WENSTRUP

STEPHEN A. WENSTRUP has been active in the investment business since 1982 when he began his investment career assisting small business owners and buyers. Since 1983 Wenstrup has been a member of Salomon Smith Barney; Hatteras Capital Management; and James Investment Research.

Wenstrup received his BSBA in Finance from Xavier University in 1981. He has passed and participated in numerous industry education programs, including the NASD Series 7, 24 and 65.

Q: Would you walk us through the analytical steps and your buy discipline?

A: We start with the top down approach and we look for opportunities in various sectors and industries where future earnings are expected to rise.

This has led us to believe that the major focus should be participation in global growth which affects companies in many countries and sectors. This means we are going to be buying into much larger companies with presence in Asia, China and other emerging markets. That being the main focus we also would like to look at the U.S economy which is consumer-driven. Our portfolio is spread across companies with market capitalization from small to large.

In a nutshell, we look at the big picture of the economic drivers, expectations of interest rate, inflation, growth and drivers of the global economy and what impact it will have on different sectors and industries. We then evaluate growth characteristics of various companies and decide on the valuations of the businesses.

We separate the analysis of the business from the analysis of the stock. In the business analysis we ask ourselves, is that business growing and do they have a competitive advantage that is stable of growing stronger. We also look at the future prospects of that business,

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namely the growth prospects. We look at the return on capital and the sustainable competitive advantage, future earnings growth catalyst and the balance sheet and free cash flow of the business.

As part of the analysis of the stock we calculate a price range for all the companies that we monitor. Sometimes we develop a range of estimate of discounted cash flow to get a better idea of the future value of the companies that we review.

We look at the price to earnings ratio, book value of the stock, dividend yield, and also keep track of the insider activity.

Q: Can you give us a few examples of stocks that you have acquired?

A: EMC Corporation, a leader in the computer information storage had suffered in the last several years as completion in the sector exploded and prices collapsed. However, with the advent of digitized video content the demand for storage is growing again. EMC is likely to benefit from the demand growth more than anyone else in the industry in our opinion.

American Family Life Assurance Company (AFLAC) is another company that we like. This firm provides supplementary insurance to health insurance and disability insurance in the U.S. In Japan they are the primary supplemental insurer for people. The insurer is diversified and is not that reliant on payment from the government. However, with the recent weakness in healthcare insurance sectors all stocks suffered and AFLAC was no exception. Our research indicated that the company has a stable long term potential and was not likely to be affected from the possible healthcare reform in the U.S.

We acquired the stock as low as $13 this year but it has rebounded since it lows in the first quarter to $40. We have been trimming the stock and lowered our holding down to 2% allocation.

Q: What is your sell discipline?

A: When the stock price nears our average discounted cash flow to price ratio value, we sell the stock and invest in some other position that offers better risk reward opportunity.

Q: How do you divide between equities and bonds while constructing your portfolio and how do you benchmark?

A: We typically use a 70-30 benchmark for construction of the portfolio, 70% for equity and 30% for bonds. We benchmark our equity holdings against the S&P index and bonds with The iShares Barclays Intermediate Government/Credit Bond Index. We offer custom ranges for investors to suit their income needs and tolerance for risk.

Q: How many positions do you typically have in the portfolio?

A: We hold about 40 names in the portfolio now and that is higher than our long term average as markets volatility is abnormally high so we decided to have more positions and spread the risk a little wider. In situations like this we consciously depart from the benchmark index.

We make our sector weighting decisions based on our assumption of the economic drivers and either underweight or overweight sectors to spread the risk. We presently hold positions in material stocks due to the weak dollar economic climate and we are overweight consumer staples stocks that we feel offer better price to value opportunities in light of likely economic volatility.. In the past several years, before the collapse we had lowered exposure in the financial sector when we saw the rising risks and leverage on the balance sheets. We continue to have concerns about bank stocks and have recently exited our bank stock positions.

Q: What is your portfolio turnover?

A: It tends to be around 30% but may be higher in more volatile periods where we are trying to maximize our tax efficiency or take advantage of market swings.

Q: Would you explain the rationale for having the terms core and balanced in the portfolio name?

A: Core comes from our desire to be not constrained by the style box mentality that is so pervasive in the advisory community. Not to be locked in such limited and fixed investment styles gives us the desired flexibility to be either underweight or overweight various sectors as the need arises. It really gives us flexibility to straddle between growth and value. There are times in the marketplace where because of the valuations of the assets you need to overweight value stocks and there are times to overweight growth stocks to achieve the right balance in the fund.

Q: Are you always fully invested in the equity portion too?

A: We like to be fully invested. When the risk levels are at market extremes we would like to allocate some portion to cash. Because money market yields are virtually non-existent we are using fixed income instruments with higher yields. We prefer the money to be always earning something at all times whether it is dividend or cash yields or whatever. And, generally we stay fully invested.

Q: How high do you go in cash?

A: We only allocate capital from our equity portion in cash and generally do not exceed 20 percentage points of the 70% of the equity allocation limit.

Q: How do you perceive risk and what do you do to control it?

A: We monitor spreads between the risk free returns earned on government bonds and from various fixed income instruments. We also look at money creation, new liquidity in the financial system and funds flows in the mutual funds and other risky assets.

Presently the measured inflation is subdued but the government is issuing record level of debt to stimulate the economy. We are constantly looking monitoring how the government debt auctions are received in the market. At one point market will demand higher interest rate.

One unique addition to our research is our work in understanding Behavioral aspects of the marketplace. While we believe the pricing in the market is independent and efficient there are times when emotion may cause investors to lose independence and blindly follow trends that push valuations to extremes (both over and under). In our research we attempt to recognize these patterns and to capitalize on them.

From a technical angle we look at the stocks that are over bought or over sold over a 200 day moving average, over a 50 day moving average and less. These trends help us to decide whether we should stay in stocks or move into cash and acts as our dial to control risk.