April 2, 2009

Dear Client,

Winter is finally over and the market is has recovered somewhat since its low on March 9. Though there is some concern that the market may retest its low we believe the time has come to rebalance.

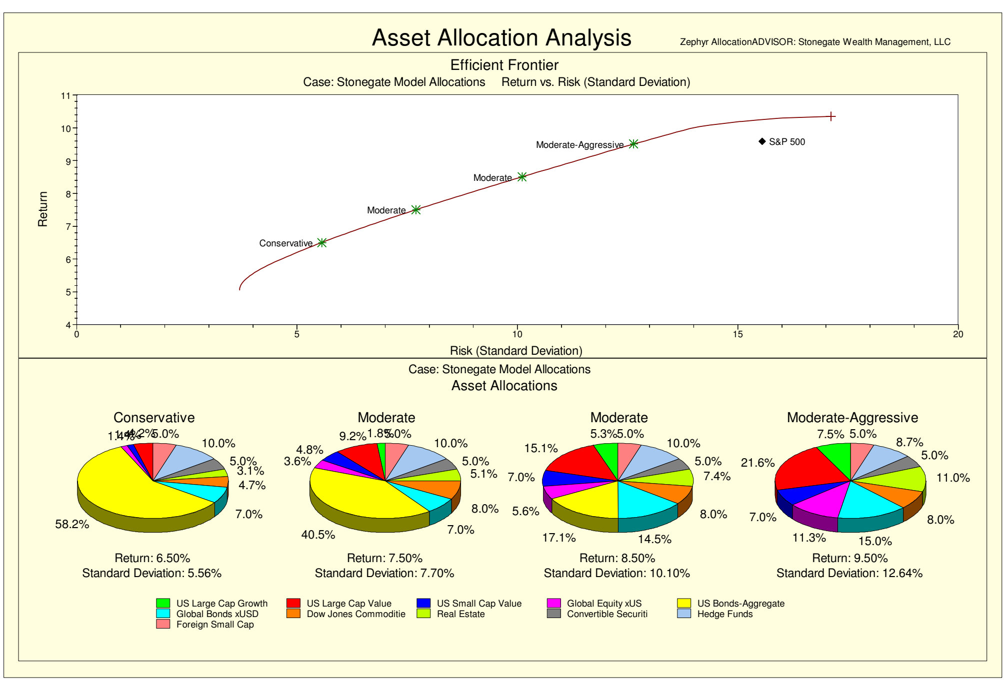
Our allocations and manager selections have been revised and we are prepared to rebalance your account. With that in mind we thought it might be useful to explain in detail what we have been doing to revise our models and manager selections. We hope you find this informative.

New Allocations

Modern Portfolio Theory (MPT) has always been our method of choice for developing investment models since the science behind it was relatively sound. For those not familiar with it, MPT is a method used to devise portfolios that minimize risk for a given level of return. The key result of MPT is a graph that plots the best portfolios (Efficient Frontier) from a return vs. risk standpoint. This graph is created by combining asset classes whose sensitivity to different economic factors; for example interest rates, or commodities prices is dissimilar. Combining assets with price fluctuations that are not synchronized will lead to dampened volatility for a portfolio as a whole.

A new approach to MPT called the Black - Litterman (BL) model has been devised that improves the technique and leads to more stable models. The BL approach is an attempt to come up with reasonable predictions of future returns for asset classes by "reverse engineering" them from their market capitalization in relation to the market portfolio. The market portfolio is a theoretical portfolio that consists of all investable assets worldwide. Studies indicate that this approach results in portfolios that exhibit more stability in their composition.

Here is an efficient frontier which is a sample of the output of the BL software:



You will note that 4 points are plotted on the curve. Those four points are representing mixes of assets that are in our new models.

We spent an enormous amount of time working with this software to create models that we think will exhibit stability over time. All the new models we will be using are shown below:

Model Portfolios									
					Allocation (%)				
Asset Class	***1***	***2***	***3***	***4***	***5***	***6***	***7***	***8***	***9***
Stocks - Large/Mid Cap Value	0.00%	4.15%	7.50%	9.00%	11.50%	15.00%	18.50%	22.00%	25.00%
Stocks - Large Cap Growth	0.00%	0.00%	0.00%	2.00%	3.00%	5.50%	6.25%	7.00%	11.00%
Cash - Money Market Funds	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%	1.25%
Fixed Income	64.00%	57.00%	48.00%	39.00%	30.00%	16.00%	8.00%	0.00%	0.00%
International Bond	7.00%	7.00%	7.00%	7.00%	8.00%	14.00%	15.00%	15.00%	7.00%
Real Estate	2.20%	3.10%	4.00%	5.00%	6.00%	7.50%	8.00%	11.00%	11.00%
Stocks - International Large	9.60%	1.40%	2.30%	3.95%	6.00%	5.75%	8.00%	11.00%	16.00%
Stocks - International Small	0.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	4.75%	5.00%
Bond Convertible	1.30%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	5.00%	2.00%
Stocks - Small Cap Value	1.35%	1.40%	3.25%	4.80%	6.25%	7.00%	7.00%	7.00%	6.75%
Natural Resources	3.30%	4.70%	6.70%	8.00%	8.00%	8.00%	8.00%	8.00%	8.00%
Alternative Investments	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	10.00%	8.00%	7.00%
Total	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%	100.00%
Projected Return	5.99%	6.49%	6.99%	7.51%	7.98%	8.50%	8.91%	9.43%	9.91%
Risk (Standard Deviation)	4.60%	5.60%	7.00%	7.70%	8.90%	10.10%	11.40%	12.60%	14.00%

A few important changes of note in these models vs. our old models;

1. Our allocation to alternative strategies (Market Neutral) has increased dramatically vs. our old models. At present our alternative strategies category only includes the market neutral approach. In the future as more alternative strategies become readily available through mutual funds or ETF's it may include such strategies as managed futures.
2. Our commitment to natural resources has increased.
3. We have merged the large cap value and mid-cap value categories into one.
4. We are also increasing our allocation to foreign bonds

When we rebalance we will maintain your preset ratio of fixed income to growth assets. If you had an initial portfolio allocation of 60% growth to 40% fixed income you will remain with that allocation when we rebalance and you will have allocation #5.

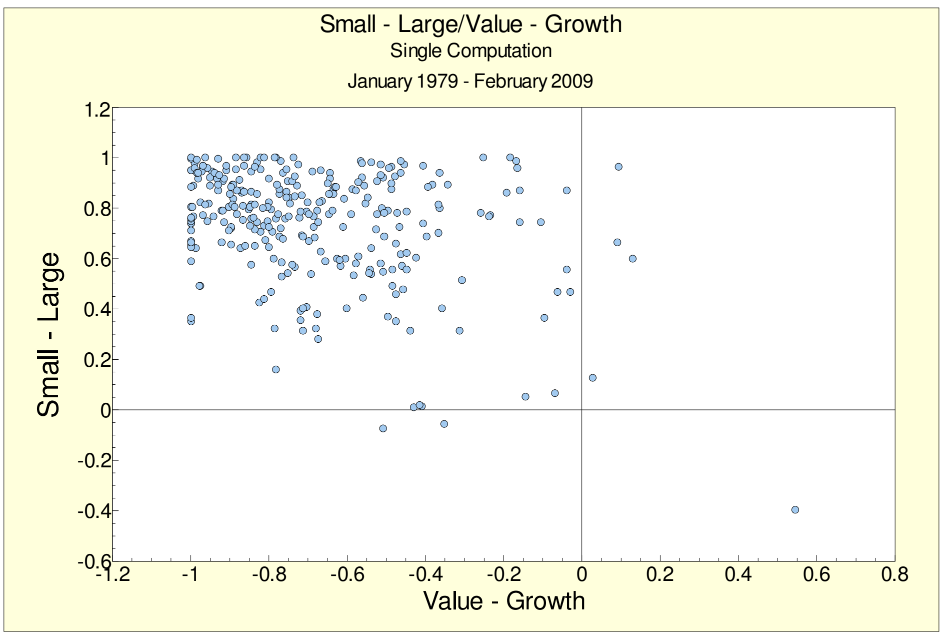
If you'd like to change your allocation from your current policy please let us know as soon as possible.

Manager Selection Strategy

The second piece of this process is the review of all of our existing managers and the replacement of those managers that were not performing well in relation to their best fit benchmark. We recently purchased a costly program called Zephyr that enhances our manager selection strategy by providing us with detailed style and trend analysis. The process we developed to select managers is described below:

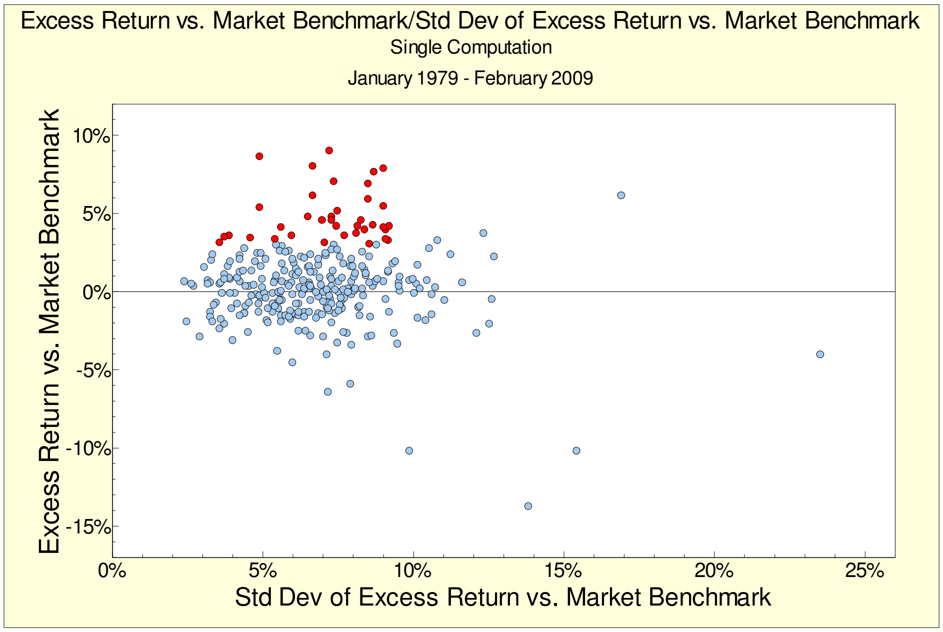
1. Choose only those managers that are style pure. We plot for example all large cap value managers on a graph that shows their style (value vs. growth and large company stocks vs. small company stocks) as shown below:

(Each point in the chart represents a different mutual fund manager)



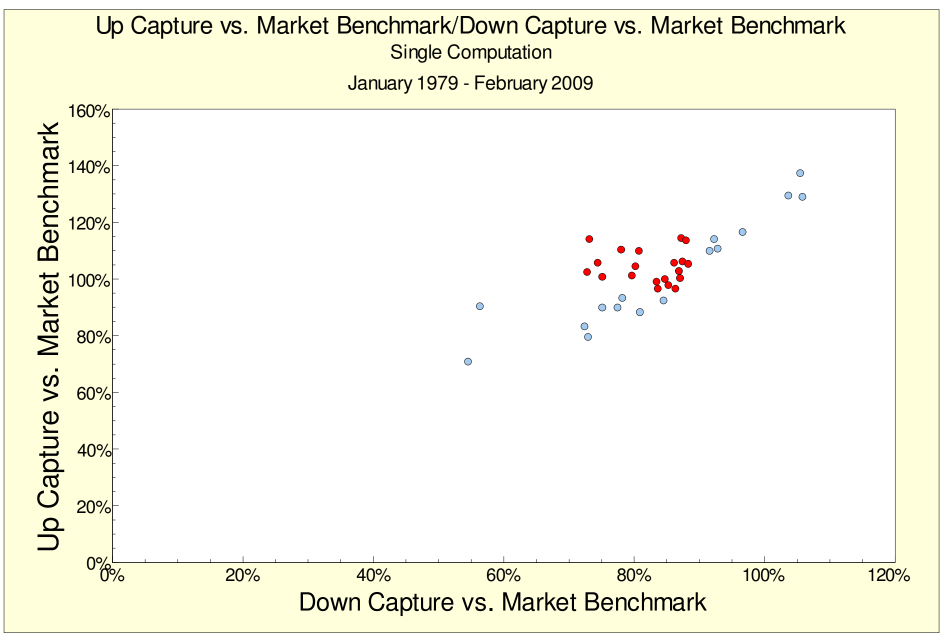
Since we lean towards value we choose those managers that are in the upper left hand quadrant of the graph.

2. Next we select those managers that seem to provide consistent (excess) return above their benchmark. To see if this excess return is less likely to be accidental, how much it varies over time is plotted on the x axis. If it varies less and is more consistent over time it probably represents manager ability.



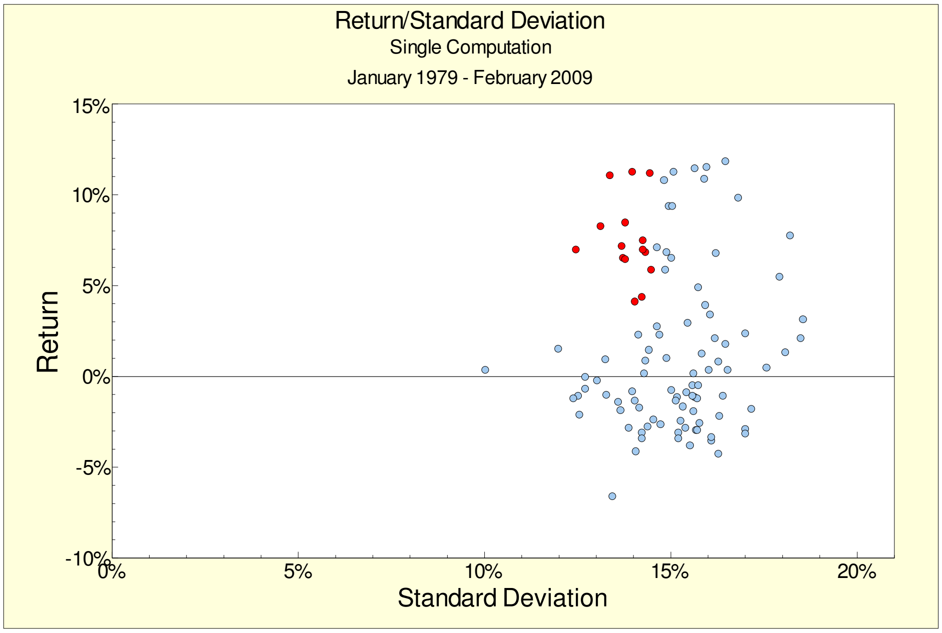
The managers highlighted in red provide excess return above the best fit benchmark and have also provided that return on a statistically significant basis that would lead us to believe that their performance was not luck.

3. The third step is to choose the managers that have a good record of capturing the markets upside without capturing it's downside:



Everyone loves a manager that can go up at least as much as the market when it rises. No one wants a manager that gives it back when the market drops.
The managers that are highlighted have a good upside/downside ratio.

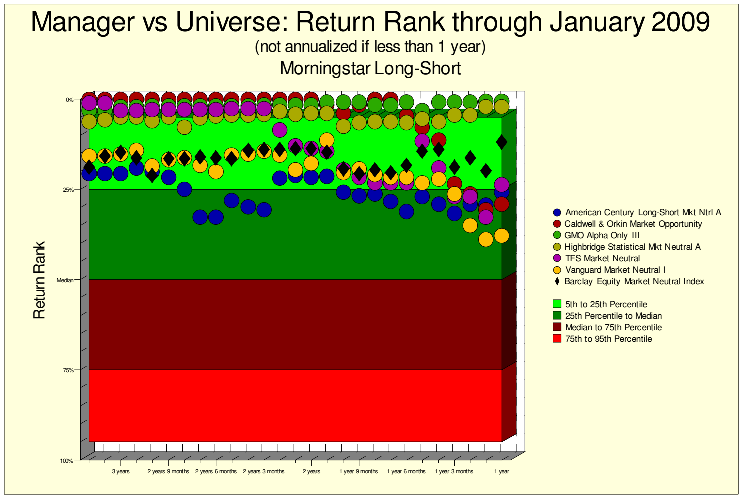
4. The next step is to select the managers (who passed the first three tests) that provide the best return with the lowest amount of risk:



5. The last step in the process is to examine in more detail the 8-10 managers that pass the four tests. We review several factors including but not limited to:

    - Expense ratio
    - Manager tenure
    - Morningstar rating and analysis
    - Style purity over time
    - Turnover ratio

    We also plot the managers against their peer groups and directly compare them in tables with a small sampling shown below:



Performance Table

December 2005 - January 2009. Single Computation

	Portfolio Performance			vs. Style Benchmark						vs. Barclay Equity Market Neutral Index					
	Annualized Return (%)	Cumulative Return (%)	Std Dev (%)	Annualized Excess Return (%)	Cumulative Excess Return (%)	Info Ratio	Significance Level (%)	Explained Variance (%)	Tracking Error (%)	Annualized Excess Return (%)	Cumulative Excess Return (%)	Info Ratio	Significance Level (%)	Explained Variance (%)	Tracking Error (%)
American Century Long-Short Mkt Ntrl A	2.73	8.90	7.29	-0.94	-3.17	-0.13	58.39	2.41	7.24	-0.29	-0.98	-0.05	53.13	29.32	6.13
Caldwell & Orkin Market Opportunity	10.11	35.67	8.78	6.45	23.60	0.74	86.36	8.48	8.66	7.09	25.79	0.82	88.20	6.63	8.65
GMO Alpha Only III	7.85	27.03	3.49	4.18	14.96	1.15	93.62	5.96	3.63	4.83	17.15	0.85	88.93	2.57	5.65
Highbridge Statistical Mkt Neutral A	5.33	17.89	3.83	1.67	5.82	0.42	74.83	4.30	3.95	2.31	8.00	0.56	80.67	19.26	4.11
TFS Market Neutral	9.07	31.66	10.77	10.08	34.81	1.11	93.10	28.91	9.09	6.05	21.77	0.76	86.72	64.32	7.98
Vanguard Market Neutral I	3.59	11.81	6.30	1.42	4.80	0.25	65.71	17.83	5.71	0.57	1.93	0.09	56.14	14.28	6.03

The investment vehicles that pass this filter are the only ones we use.

The results of this selection process have led us to identify new managers in the following categories:

- Large Cap Value
- Small Cap Value
- Convertible Bonds
- Real Estate
- Market Neutral

It also provided confirmation that most of the managers that we were using are fine. When we rebalance we will be replacing the failing managers with the new ones we identified.

As a result of our research we are “firing” the managers listed below:

To Be Fired	Replacement
Davis Appreciation	Nicholas Applegate
Columbia Value and Restructuring	Blackrock Dividend Equity
JP Morgan US Real Estate	First American Real Estate Securities
UMB Scout	Paradigm
Diamond Hill Market Neutral	Caldwell and Orkin Market Neutral

Fixed Income

We will continue to predominately use individual bonds for domestic fixed income and stick to those that have the highest degree of safety. Most of our fixed income will be either government agency bonds or either general obligation municipal bonds or revenue bonds—bonds whose coupon payments are backed by the taxing power of a municipality or by the revenue generated by a significant entity such as a highway. We will lean towards municipal bonds that are also pre-refunded by another asset such as treasuries.

Because interest rates are so low and the expectation is that they will rise we are laddering the bonds and keeping the ladders relatively short. We prefer to avoid locking in low rates for long periods of time.

Economy/Markets

Some evidence is appearing that indicates the economy might have bottomed and stabilized. Home sales have actually increased in February and two troubled banks (Citigroup and Bank of America) reported positive earnings for January and February. Consumer spending rose slightly in February as did consumer sentiment. Since consumer spending is 70% of the economy, both are critical to a recovery. Most leading indicators seem to have leveled off and are no longer in free-fall. Since the stock market tends to precede an economic recovery by 6-9 months perhaps that is what the markets are signaling. Earnings reporting season begins in a couple of weeks and we expect it to be ugly again, hopefully though this is already priced into the market.

We have noted of late that some asset classes have stabilized unlike the last three months of 2008 where nearly every one went down. In particular Convertible Bonds are up nearly 4% for the year through March 27th and commodities are starting to rise. Diversification by asset class is starting to work again.

Stonegate News

If you received this newsletter by mail it means we do not have a valid e-mail address for you. To save a few trees and speed up the delivery of important communications, please provide us with your current e-mail address or let us know if you prefer to receive these newsletters by mail.

Tom traveled to Pittsburgh in mid-March to attend a week of training and qualify for the ***Accredited Investment Fiduciary Analyst*** designation. That designation will enable him to conduct fiduciary assessments of advisor firm’s adherence to the Global Fiduciary Standard of Excellence.

Our web site is in the process of being revised. The new web site should be completed within a couple of weeks. We invite you to take a look at it and provide us with comments.

Please provide us with a copy of your 2008 tax return when it is completed.

Again we will be rebalancing in days, if you want us to change your model allocation please let us know.

Rebalancing will involve:

1. The sale of the ETF's which were purchased in taxable accounts last year as part of the loss harvesting process.
2. The sale of some managers we are firing.
3. The possible sale of fixed income if we do not have enough free cash available to rebalance.
4. The purchase of new managers.
5. Adjustments in your allocation to match the new models.

As always please call us with any questions.

Regards,

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