MITCHELL MCLEOD PUGH & WILLIAMS
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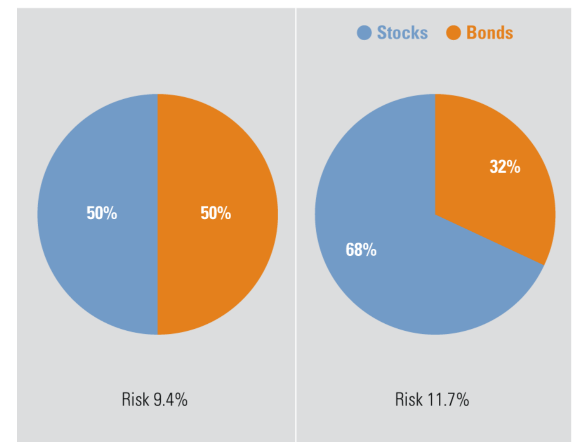
The Importance of Rebalancing

Over time, your asset-allocation policy can veer off track because of market ups and downs. This is illustrated quite clearly in the image below; a strong stock performance can cause a simple 50/50 portfolio mix to become unbalanced over time. After 30 years, what was once a 50% allocation to stocks now sits at 68%—quite a jump. Moreover, not only does the portfolio's allocation change, but the portfolio's risk also changes, rising sharply from 9.4% to 11.7%. If your needs and/or risk tolerance have not changed, your allocation shouldn't either.

But why would anyone want to sell investments that have done great in order to purchase laggards? While rebalancing might seem odd at first, it is all about risk control. If more and more of your total portfolio winds up in one investment, you risk losing a lot should that investment stumble.

Change of Portfolio Allocation: January 1980–December 2009



Keep in mind that an investment cannot be made directly in an index, and past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. The sale of an investment for the purposes of rebalancing may be subject to taxes. Risk is measured by standard deviation. Standard deviation is a statistical measure of the extent to which returns vary from the expected returns. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. Stocks are not guaranteed and have been more volatile than bonds.

Source: Stocks—Standard & Poor's 500®, which is an unmanaged group of securities and is considered to be representative of the stock market in general; Bonds—five-year U.S. Government Bond.

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Doug McLeod is a founding member of the firm and serves as a Managing Director and as a member of the firm's Investment Policy Committee. He has been continuously engaged in the investment management business since 1992.

Doug holds an undergraduate degree in finance from Auburn University and practiced public and financial accounting before obtaining a Master of Business Administration degree from The University of Alabama.

He also holds the Accredited Investment Fiduciary (AIF) desgignation from the Center of Fiduciary Studies in Association with the University of Pittsburgh's Joseph M. Katz Graduate School of Business.

His clients include ERISA (401-(k)/ Profit Sharing) plans, high net worth individuals, trusts and estates.

Doug was born in New Orleans, Louisiana and has lived in Mobile for nearly 40 years. He and his wife Julie have two daughters, Libby and Caroline.

Monthly Market Commentary

Economic news in September helped the market gain back its previous losses. The market moved up about 9% from late August until the end of September. The Dow Jones Industrial Average experienced the best September performance since 1939. Further, the National Bureau of Economic Research announced on September 20th that the U.S. economy reached a trough in June 2009, making the 18-month recession that began in December 2007 the longest in the post-war period.

Manufacturing: Manufacturing news showed mixed signs as the European Purchasing Managers reported a larger-than-expected decline, while the U.S. Census Department's new durable goods order report (excluding transportation) revealed surprisingly robust results. Manufacturing numbers have showed slow but steady growth. A closer look at the ISM manufacturing index revealed a jump in the number of firms reporting inventory growth, which resulted in a 26-year high.

Income: The personal income report for August was relatively stable in both income growth and spending growth. Both personal consumption expenditures and real disposable income grew by 0.2% (adjusted for inflation), which translated to 2.4% annualized. However, a notable part of the increase came from the rise in government unemployment benefits. Interest income declined $12 billion while employee compensation income was up about $25 billion in aggregate.

Housing data: Housing data showed a second consecutive month of improvement with an increase of 10.9% to 598,000 units in August in a seasonally-adjusted annual rate basis compared with July data. Existing home sales were better than anticipated, growing 7% sequentially to 4.1 million units on a seasonally-adjusted annual rate basis.

Employment: The latest employment report revealed a decline of 95,000 in payroll employment. This decline was mainly attributed to Census Bureau layoffs of temporary workers. The private sector added 86,000 jobs in the month of September with a large number of these jobs in the leisure and hospitality area. After accounting for the losses of temporary census workers, it appears that the recovery continues at a slow pace.

Quarter-end insights: The latest GDP report included a second-quarter GDP revision while the consensus GDP forecast for the third quarter increased to 1.8%. According to Morningstar economists, GDP growth is likely to accelerate in the 3rd and 4th quarter of 2010 with a total growth estimated at 2.5% to 3% for the year 2010. Further, relatively stable consumption growth along with improvements in net exports and slow growth in business investment spending may be the key driver of GDP growth in the months ahead.

According to Morningstar's industrials team, businesses substantially underinvested during the recession compared to normal levels and are now making up for lost time. The health-care team's outlook details a slowing in the health-care spending with a per-capita decline of 0.2% in health-care spending during the first half of 2010.

Morningstar economists also suggest a peak in the savings rate. With the economy showing some signs of improvement, it is projected that consumers may be more likely to spend a little more of their income and move the savings rate a little lower going forward. The personal savings rate has increased from under 2% to about 6% over the last three years. Typically, savings rates peak shortly after the conclusion of a recession.

Finally, the large increase in the number of companies reporting growing inventories, combined with slower growth in new orders and fallings backlogs, points to a less robust manufacturing sector over the next couple of months.

Questions to Ask Your Retirement Plan Sponsor

Many employers provide a 401(k) retirement plan to their employees; however, not all plans are alike. Retirement plans usually differ in the number and type of investment choices available to plan participants. Contributing to a 401(k) retirement plan can increase your savings through both a matched contribution and a reduction in your current tax liability. If you're wondering where to start, here are a few questions you should ask your retirement plan sponsor that will help you with your contribution and investment selection decision.

Q. What is my company match? Several employers match employee contributions toward a 401(k) retirement plan. Matched contributions typically range from 25 cents (25% match) to one dollar (100% match) per dollar contributed by the employee, up to a predetermined limit (6% of pay). For example, if your annual salary is $100,000 and your employer provides a 50% match on a maximum contribution of 6%, then you receive an additional $3,000 in matched employer contributions for your $6,000 contribution.

Q. What are my investment options? A good plan should offer a variety of investment options that allow plan participants to build a diversified portfolio and select investments that best fit their risk profile. Options may include investments across different stock market capitalizations, market sectors, domestic and international investments, bonds, and cash. Be sure to read the investment prospectus and ask questions about items that you are unsure about before investing.

Q. What fees are associated with investments available to me? Funds within a 401(k) retirement plan vary not only by investment objective but also by fees. The expense ratio (annual fee) shows the actual amount that a fund takes out of its assets each year to cover its expenses. Investors should note not only the current expense-ratio figure, but also the trend in these expenses; it could prove useful to know whether a fund is becoming cheaper or more costly over time. When considering high expenses versus low expenses, investors must also consider the fund's objective and its size. Certain objectives, such as foreign-equity funds, have higher costs and therefore, higher expense ratios. As for size, smaller funds are normally costlier than larger funds, as they do not have the benefits of economies of scale. Pay attention to expense ratios that are greater than 1%. Expense ratios for many funds exceed 1.5%. The average fund investing in large-cap stocks carries an expense ratio of 1.26% of the investor's holdings as of December 2009. In addition to expense ratios, some funds may also charge sales loads i.e. initial (front-end) and deferred (back-end) sales charges imposed by a fund. Some charges are triggered when an investor transfers assets out of a fund within a specified time frame.

If your plan provides a number of investment options, make sure to evaluate all your choices. Be careful not to only select funds that have the best return in the past year or past few years. Take into account your investment goals, risk profile, asset allocation needs and expenses before you invest. There is no limit to the number of 401(k) plans you can have at any given time, however, you can only contribute new money to the plan at your current employer. Make sure you check your account statements regularly. Employers are required to provide participants with annual statements, but a vast majority of plans provide statements quarterly as well. If you have questions, be sure to consult with human resources at your company. By asking the right questions about your retirement plan, you can make an informed decision based on the options that are available to you.

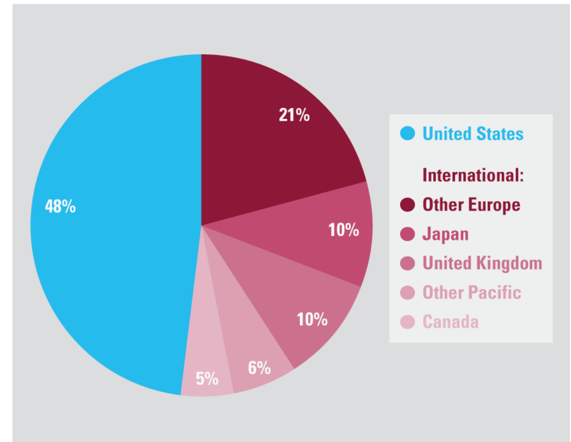
Source: Expense ratio data is from Morningstar's open-end database. This is for illustrative purposes only and not indicative of any investment. The opinions herein are those of Morningstar, Inc. and should not be viewed as providing investment advice. Please consult with your financial professional regarding such services.

A World of Opportunity

As trade barriers continue to break down, the world economy has become a small neighborhood. Should investors seek to participate in this wave of globalization, or are they getting all they need here at home?

Historically, foreign investments have acted in a significantly different way from domestic investments. When the U.S. market slumped, various opportunities abroad have prospered. An American investor who put some money into foreign markets may have reduced risk while still attaining attractive returns. With the spread of globalization, this benefit decreases as companies across the globe are acting more like each other. However, as the image illustrates, an investor who doesn't take advantage of options outside of the United States is missing out on roughly half of the investable developed stock market opportunities in the world.

World Stock Market Capitalization
Year-End 2009



International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

Source: World Market Capitalization by Country is from the Morgan Stanley Capital International Blue Booksm. The data is expressed in U.S. dollars.

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