



DEEP ROOTED THOUGHTS

JANUARY 2011

_____ will win the Super Bowl

_____ will win the Oscar Award for Best Picture

Making predictions is fun and relatively painless if you are wrong when forecasting things like football games and entertainment awards. The stakes are raised when you invest based on financial market predictions. In Oak Wealth Advisors' annual search to find a source of consistently accurate financial forecasts, we have uncovered the following:

1. *Journal of Finance* 18 year study of institutional money managers

This long-term study indicates that investment manager outperformance is not persistent. In fact, many of the worst performing stock-picking firms in one period are the ones that outperform in subsequent periods. While there were a few firms that outperformed in consecutive periods, there were no identifiable factors that would indicate which ones they would be. With a lack of persistence in outperformance, the authors conclude that passive indexed investing strategies are superior to active management approaches that rely on stock picking skills.

2. *Wall Street Journal* 2009 survey of economists

Fifty leading economists were asked around the middle of 2009 for their estimates of the yield (interest rate) of the ten-year U.S. Treasury note a year later. Essentially, the economists were being asked if interest rates would be rising or falling over the next 12 months. At the time of the survey, the yield was 3.52%. Forty three of the fifty economists expected rates to move higher to an average rate of 4.13%. Seven expected rates above 5%. Only two of the fifty predicted rates to be below 3%. On June 30, 2010, the ten-year U.S. Treasury note had a yield of 2.95%. Clearly, not even the market experts have the ability to predict the future.

3. *Burns Advisory Group* 2010 study of Morningstar Star Ratings

Morningstar provides objective mutual fund information and subjective mutual fund ratings. Beginning in 2009, the Burns Advisory Group researched Morningstar's recommendations over the prior decade to determine how accurate their ratings are at predicting the future success of mutual funds. Morningstar applies a star rating to mutual funds, with the highest rated funds receiving five stars and the lowest rated funds receiving one star. Of the 248 funds receiving a five star rating in 1999, only four were still receiving that rating ten years later. 87 of the 248 five-star funds were no longer in existence. Of the funds still in existence, the average rating of the former five-star funds was just below three-stars. The average performance of the funds originally rated as five-stars was less than the average performance of all peer funds. Even highly respected Morningstar is unable to accurately predict which funds will outperform others.

4. *Wall Street Journal* 2011 study of Thompson Reuters stock market analysts recommendations

Reporter Brett Arends recently worked with Thompson Reuters to study stock market analysts' highest conviction recommendations for market outperformance and underperformance. Thompson Reuters collects analyst forecasts from all over the globe. For 2010, their top ten "buy" recommendations returned 24%. The S&P 500 returned just bit over 13%. This sounds great until you learn that the ten stocks they expected to be the worst performers returned 32%. For 2009, the highest rated stocks returned 22%. However, the S&P 500 returned 26% in 2009. The stocks they expected to perform the worst in 2009 returned 70%. Their record was no better in a down market year. In 2008, a year in which the S&P 500 fell 39%, the analysts' top picks fell 48%. Their least favorite stocks fell 51%. In looking over multi-year periods, Arends found similar disturbing results. His conclusion, with which we concur, is to ignore the stock recommendations of investment "experts."

5. *The Hindenburg Omen*

One of the most widely reported financial predictions in 2010 was the Hindenburg Omen which is attributed to Jim Miekka, a blind physics teacher, who started an investment newsletter. His models had great accuracy in predicting *prior* events. The media widely reported his market meltdown prediction at the end of August. Immediately following his forecast of doom, the S&P 500 advanced 8.92% in September. This was the best September stock market result since 1939. In fact, the stock market went on to rise almost another 11% in the final quarter of 2010, leading to a return of 20% in the four months following the market meltdown prediction.

Maybe not surprisingly, objective research continues to suggest that it is not possible to predict the future of the investment markets or which stocks will outperform others. We can use known economic factors and other data to determine if conditions are more or less favorable to different types of investments, but the inability to know what will happen in the future makes it impossible to forecast future investment returns with any certainty.

Investors are much more likely to enhance their results by focusing on elements that they and their advisors can control. These include managing exposure to market risk, diversifying, and minimizing costs and taxes. Working with investment advisors who have disciplined, consistent approaches to investing, and who provide transparency in what they are doing should help you avoid negative surprises in your portfolio. Portfolios managed for tax-efficiency and cost-effectiveness continue to deliver the best net results for investors.

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APRIL 2011

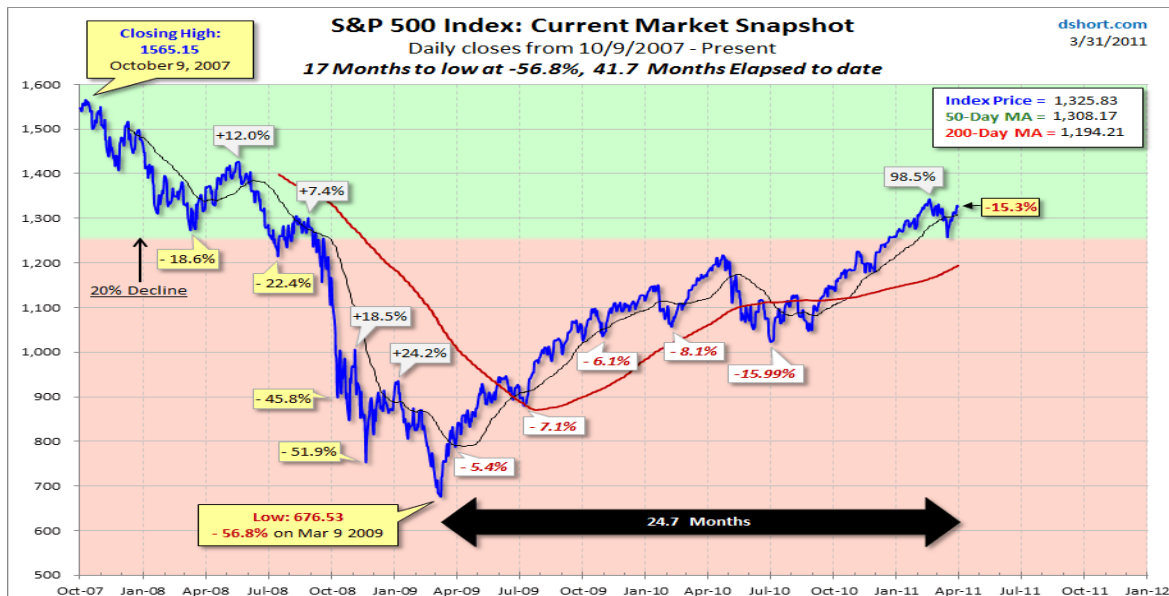
R

isk tolerance or loss tolerance?

When investors hear the term risk, their thoughts turn to losing money. Ironically, the financial services industry and academics define investment risk as the volatility of prices. Volatility measures how far prices move above and below an expected level.

Investors, however, care little about volatility but are passionate about losing money. Oak Wealth Advisors believes we should be implementing strategies to minimize losses, not simply engineering portfolios to have less movement.

As the following chart shows, the stock market declined about 50% from late 2007 through March 9, 2009. It has since rebounded close to 100% from the bottom established in March of 2009.



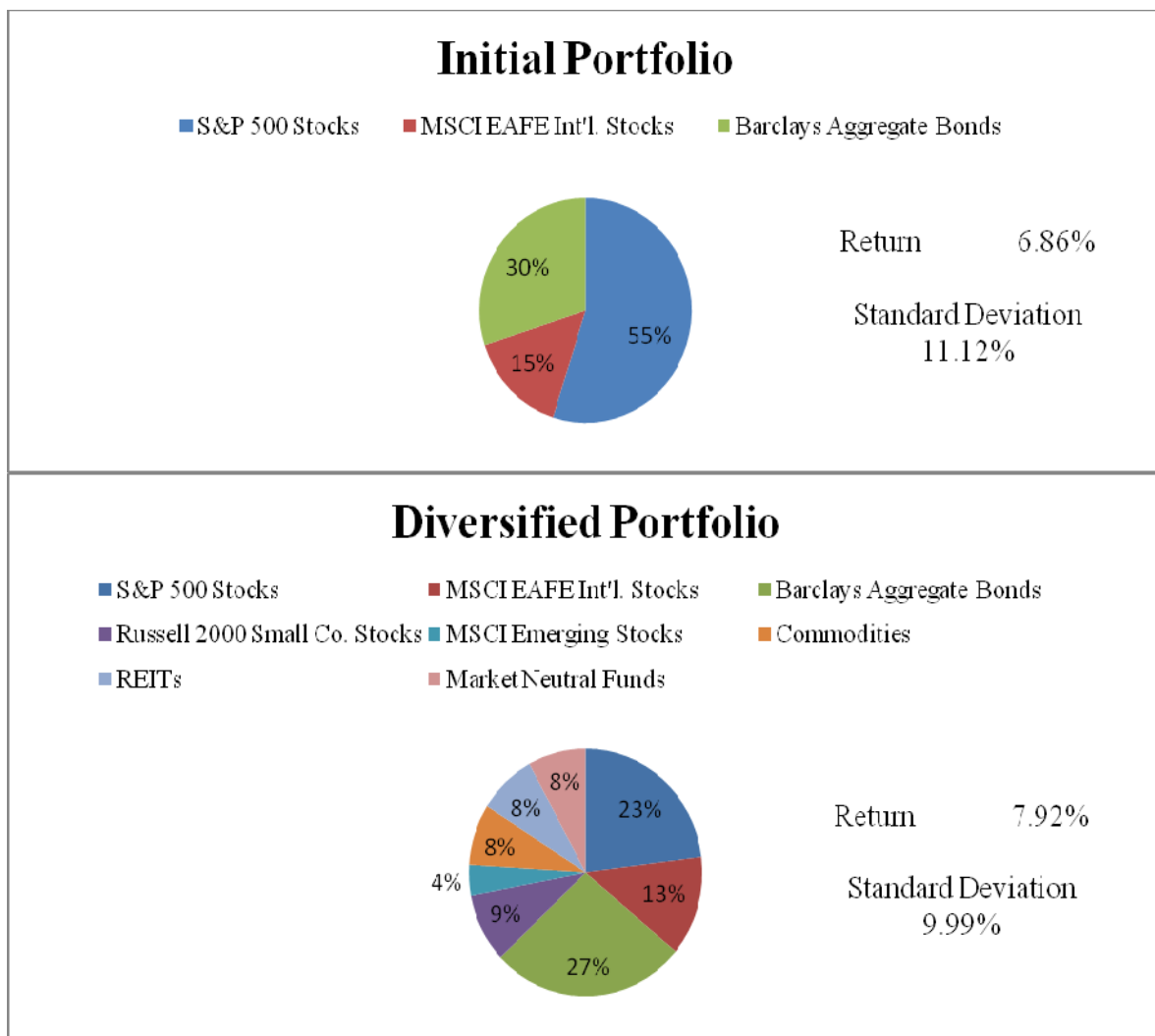
In terms of volatility, 2009-2011 has been every bit as volatile as 2007-2009 was. According to the financial service industry's definition, risk-averse investors should have been just as uncomfortable during 2009-2011 as they were from 2007-2009. The reality is that people grew terrified of the investment markets during the 2007-2009 recession, and have been pleasantly surprised by the rise in the markets since early 2009. Unfortunately, the financial services industry has accepted a non-useful model for the assessment of investment risk.

During the recent recession, additional attention was given to financial risks. Nassim Taleb wrote the book *The Black Swan* in which he illustrates the significant impacts of highly improbable events. While his commonly cited work has led to a greater awareness of the impacts of the unpredictable, neither he nor anyone else has developed a model to more accurately forecast catastrophic events.

Oak Wealth believes that investment advisors should focus on minimizing the risks that can lead to catastrophic losses for investors. While it is impossible to eliminate the risks, there are strategies that can minimize the damage they can inflict.

DIVERSIFICATION

Modern portfolio theory provides the greatest financial “free lunch” available. It is as simple as increasing diversification in an investment portfolio. By adding investments that are not perfectly correlated with the other holdings in the the portfolio, we can achieve greater returns with less risk. Increasing diversification is one risk minimization strategy available to all investors.



Diversification does not eliminate the risk of loss, but it does allow an investor to optimize how much return can be expected from each unit of risk (standard deviation) the investor is willing to accept. The example on the prior page illustrates that adding five additional asset classes to an existing portfolio of stocks and bonds will generate a higher expected return, (7.92% vs. 6.86%), and less portfolio volatility or risk, (9.99 vs. 11.12).

LIQUIDITY

Liquidity is another component of risk management that received significant attention during the recession. As a general rule, most people should keep three to six months of living expenses in a savings or money market account. The goal is to eliminate the risk that you will have to sell an investment at an inopportune time to pay for a current financial obligation. For some people who had the majority of their wealth tied up in illiquid investments like real estate, hedge funds, or private businesses, the recession was even more painful as they did not have the ability to escape from falling prices without incurring a significant cost to liquidate their holdings. Investments in mutual funds, exchange traded funds, and individual stocks are examples of liquid investments because they can quickly and efficiently be sold for cash.

HUMAN CAPITAL

Risks associated with human capital also should be evaluated. For a young family with two employed parents, the value of their human capital relative to their investment capital is high. For a couple in this position, or even a single person with a high paying job, their careers and their savings will have the largest impacts on their future wealth. In general, they can afford to take more investment risk with their financial assets. If their future wealth is linked to their company's stock price, special consideration needs to be given to decrease exposure to the company and the industry in the financial investments held by the individual. Examples of this type of human capital risk include executives with large stock option grants and employees whose 401(k) accounts hold significant shares of the company's stock.

At the other end of the human capital spectrum are retired individuals and couples who have expended their human capital during their working years. Many may only have government programs like Social Security to supplement the cash flows from their portfolio. For them, the level of investment risk should be lower since they do not have the ability to compensate for market losses with new savings from earnings. The one caveat to these general recommendations is that some retirees must accept more investment risk due to the need to earn higher returns from their investment portfolio to cover their living expenses in retirement.

LEVERAGE

Leverage is another component of financial risk management. While leverage has taken on a far more negative connotation in recent years, it has been one of the biggest enablers of wealth creation throughout history. Sadly, it has also been responsible for the destruction of a significant amount of wealth. The most commonly used form of leverage is the home mortgage. Very few people can afford to pay cash for their homes at the time of purchase and will typically put down 20% of the value and borrow the other 80%. While it allows you to enjoy a much nicer home than you could have purchased using only your available cash, it also creates the risk that if you fail to make your mortgage payments (or tax payments) you can lose the entire investment you have in your home.

Sometimes greed leads investors to over-indulge in the use of leverage. Through leverage, you can multiply your investment returns or drive yourself quickly into bankruptcy. As we have seen in the recent mortgage crisis in the United States, people took advantage of easy financing and employed far more leverage than they should have. The results are ugly. Just as we would not recommend 20 times leverage on a mortgage, as would be the case with a 5% down payment, we also feel it is imprudent to leverage financial investments. While there is an opportunity for greater earnings, significant leverage exposes you to catastrophic losses.

INSURANCE

The most obvious form of risk protection is insurance. Homes, cars and other valuables should be covered from losses. In reviewing coverages, the need to purchase policy riders at an additional cost to cover flooding, earthquakes, or other natural disasters is often discovered. Every homeowner needs to consider the likelihood and ramifications of a loss versus the cost of covering the loss.

Portfolio insurance can also be evaluated. In its simplest form, portfolio insurance is created by purchasing stock options that will provide a payoff if the market declines enough in value. The concept is very similar to insuring physical property. You pay a premium in the form of the option purchase price and you only receive a payoff if the negative market movement occurs. Due to the costs involved, the purchase of stock options for portfolio insurance is usually done only in circumstances when investors are highly loss averse and want to mitigate their risk for a specified period of time. Option prices are correlated with the volatility of the stock market and the consensus sentiment about the direction of the market. This correlation means that options are most expensive at the times when investors are most likely to be seeking protection.

One of the best uses of stock options as portfolio insurance is to offset the risk in a portfolio from a large single stock position. Unfortunately, in many cases, significant stock concentrations are held by corporate executives who are prohibited from purchasing options to offset their risk.

CONCLUSIONS

Risk is unavoidable. Most significant losses, however, are preventable.

Everyone should take a holistic view at their risks and reduce or eliminate the ones that have the greatest likelihoods of delivering large financial setbacks. Prudent portfolio management is one step in this process. Additional steps are required to implement a comprehensive reduction in risk and greater financial security.



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DEEP ROOTED THOUGHTS

JUNE 2011

Inflation is just around the corner... ...or not.

We will probably not see any meaningful increase in inflation in 2011 or 2012. Despite polls of consumers who collectively are certain inflation is just around the corner, and numerous market commentators who believe that the governmental stimulus efforts make inflation inevitable, the more likely scenario is that inflation will not be rising anytime soon.

In this article, I will explain the rationale for inflation remaining benign despite the common thinking that it is inevitable and the evidence in our daily lives that prices are rising. There is no question that we have all experienced higher gasoline and food prices over the last several months. The price of crude oil has risen over \$100 a barrel, up 40% from last year. The prices of corn and wheat have risen even more, increasing by over 100% over the past year. Even industrial metals, such as aluminum and copper, have increased significantly.

However, as Boston Federal Reserve Bank researcher Geoffrey Tootell wrote recently "evidence from recent decades supports the notion that commodity price changes do not affect the long run inflation rate." While the higher prices for gasoline and food can lead to inflation, it is more likely that these prices will stabilize, albeit at higher levels, and consumers will make substitutions in other areas of their lives to offset the increased costs of food and gas. In order for inflation to take hold, price increases would need to be sustained across all goods and services.

The most accurate predictor of future inflation increases in our economy is wages. Respected economist David Rosenberg has commented recently that "unit labor costs have historically had an 80% correlation with inflation, and those costs are declining." When wages begin rising and are sustained at higher levels, then inflation can take hold. Wages, however, do not rise when unemployment levels are high. The sad news for the US economy is that through May of 2011, the official unemployment rate continues to hover around 9%. More depressing is that the broader measure of unemployment, which includes people who stopped looking for work and those who settled for part-time jobs, has recently been as high as 16%! New York Federal Reserve Bank President William Dudley estimates that the unemployment rate would have to fall to 6% to 7% in order for inflationary pressures to build.

Unemployment levels are unlikely to fall quickly given the rate of growth of the U. S. Economy. On June 7, 2011, Federal Reserve Chairman Ben Bernanke spoke at a conference in Atlanta, Georgia, where he indicated that US economic growth so far this year was somewhat slower than expected. The economy will need to start growing at a much more rapid rate than it is currently in order to reduce the unemployment levels.

Bernanke went on to say that there are two major factors that will limit inflation in the near-term. First, the substantial slack in U.S. labor and product markets will have a moderating effect on inflationary pressures. The second factor restraining inflation is the stability of longer-term inflation expectations. Despite the recent run-up in many commodity prices, there is little concern that long-term prices will be sustained at higher levels. In addition to these fundamental reasons why inflation will remain benign, the Federal Reserve is on record as being prepared to “take whatever actions are necessary to keep inflation well-controlled.” Therefore, inflation should not be a near-term concern.

Assuming we are in a sustained low-inflation environment for the next 18-24 months, what are the investment implications? We need to start by reducing our expectations and accepting that lower investment returns will likely be the norm for the next couple of years. PIMCO, the large bond management firm, has deemed this lower-return investment environment “the new normal.”

An environment with little risk of sustained inflation makes bonds more attractive on a relative basis. Low inflation periods limit the upside for commodities. Cash, as we have experienced recently, provides almost no investment return when inflation is very low. Stocks, which benefit from lower inflation and low interest rates, are hindered by a slower growing economy. In summary, there are no asset classes that are poised to outperform in the current environment which makes diversification even more important.

Despite the fact that we may have to accept lower returns, there are several portfolio modifications that can be made to better position portfolios in this economic environment. One involves pursuing higher yields on bonds without incurring significant additional risk. PIMCO has been repositioning its mutual funds to do this. In addition, we are looking to add new investments in portfolios that will increase bond diversification to help mitigate risk. Another portfolio adjustment is increasing the exposure to the rapidly-growing emerging economies in the international equity markets (e.g. Brazil, India, and China) relative to the slower-growing, more fiscally challenged developed country markets (e.g. Japan and the United Kingdom). The final change is to add non-correlated investments to the portfolio. By increasing portfolio diversification with non-correlated investments, we minimize the likelihood of a major decrease in wealth if one or more investment markets suffer a near-term decline.

While we wait for stronger economic growth domestically and globally, Oak Wealth Advisors wants to capture as much return as possible given each investor’s tolerance for investment risk.

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DEEP ROOTED THOUGHTS

AUGUST 2011

Is it okay to panic now? No!

In the wake of the Standard & Poor's (S&P) credit downgrade of the United States debt obligations (our bonds, bills, and notes that are owed to investors both domestically and globally), there is an abundance of interest, debate, and concern about what should be done. The media once again is filled with stories of impending doom. While we are all pondering what actions we should take, the media provides us with a simple answer – panic. Oak Wealth Advisors believes otherwise and wants to provide you with a more balanced approach to this unsettling time in the investment markets.

In order to evaluate appropriate actions to be taken, we must first understand the problem. The ballooning federal deficit and increasing expenditures are not being adequately supported by the tax revenues being collected by the federal government. The result of this financial imbalance is that the government needed to approve raising the debt ceiling in order to pay all of our bills and make the payments on our debt obligations.

There are a small number of rating agencies, including S&P, which were properly criticized for their lack of due diligence in rating the securities that led to the 2008 recession. Working to restore their credibility, S&P and other firms alerted the government that they wanted to see increased fiscal responsibility including a plan to lower the deficit. When the government passed the Budget Control Act of 2011, S&P determined that the U.S. had not done enough to justify maintaining their AAA credit rating.

Politics played a key role in getting us into this mess. In S&P's explanation for their downgrade, it is clear upon whom they are putting the blame. "Our lowering of the rating was prompted by our view on the rising public debt burden and our perception of greater policy making uncertainty... Our opinion is that elected officials remain wary of tackling the structural issues required to effectively address the rising U.S. public debt burden in a manner consistent with a 'AAA' rating."

This problem will not be resolved by throwing more capital into the system as we did in 2008 to turn the tide against the recession triggered by the meltdown in the financial services sector of the market. Politicians need to make hard decisions that will make it more challenging for them to be re-elected. Only time will tell if they will put the interests of their country ahead of their personal agendas and those of the supporters who line their pockets. I do not have a high level of confidence that the politicians will act soon to both cut entitlement spending and raise taxes. Most credible economists agree that both actions must be taken to improve the financial stability of the country and restore confidence in the promises made by our government.

Working from the assumption that the credit downgrade is unlikely to be reversed in the next six to twelve months, our attention turns to responses to the situation. It is always difficult to be precise about the timing and size of market movements and we know that the penalties for trying to time the market as well as sitting on cash are harsh. PIMCO, the world's largest bond manager, eloquently states, "these are markets where you do not want to be forced to transact unless there is a changed view of fundamentals or emergency cash needs to be raised. Instead the key is to have the ability to react to exceptional opportunities."

In practice, Oak Wealth Advisors will continue to invest portfolios according to the individual investment policy statements that you developed with us and we agreed were in your best long-term interest. We will not be in a hurry to invest new cash as falling security prices are normally a good time to demonstrate patience. While the falling prices are creating more attractive valuations at which to invest new cash, we are keeping the analogy of the falling knife in mind at all times. That is, the safest way to catch a falling knife is to wait for it to hit the floor and then pick it up. We may not buy new securities at the absolute bottom of this current market sell-off, but we expect to be able to make some portfolio additions in most accounts at attractive levels in the coming days and weeks.

While it may be hard to envision a time when better investment returns will reappear, they may be arriving in the near future. Canada lost its AAA debt rating in April 1993 (it has since regained its AAA status). The Canadian stock market rose more than 15% in the twelve months that followed the downgrade. In Japan, the Tokyo stock market rose more than 25% after their downgrade was issued in November 1998. As you ponder the United States' credit worthiness relative to its peers, the following chart from S&P may give you some comfort that we are still among the most financially secure nations in the world.

AAA	AA+	AA	AA-	A+	A	BBB+	BBB	BBB-
Canada	Belgium	Abu Dhabi	China	Czech Republic	Estonia	Brazil	Bahrain	Barbados
France	New Zealand	Chile	Japan	Italy	Mexico	Ireland	Bulgaria	Croatia
Germany	U.S.	Kuwait	Israel	Korea	Poland	Peru	Lithuania	Iceland
U.K.		Spain	Saudi Arabia	Slovak Republic	South Africa	Russia	Morocco	India

Sources: Standard & Poor's, J.P. Morgan Asset Management

As of 8/7/2011

I encourage you to visit our website www.oakwealth.com and read the Deep Rooted Thoughts article from March of 2009 which illustrates the tremendous performance of the stock market following the worst economic news. After the stock markets bottomed in March of 2009, they rebounded significantly over the next twenty-four months. While we cannot know what the stock markets will do over the next twelve to twenty four months following the U.S. debt downgrade, we should assume that the markets will remain volatile and investors who do not panic will be rewarded.

Patience and discipline with respect to your investments are recommendations that you will rarely hear espoused in the media, despite the fact that they are key elements to long-term wealth creation and preservation. Oak Wealth Advisors acknowledges that we have no control over the markets nor do we possess a crystal ball with which to forecast the future. However, we are constantly evaluating ways to protect principal and invest in securities that offer attractive risk-adjusted return opportunities.

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DEEP ROOTED THOUGHTS

NOVEMBER 2011

Seeing our future through the eyes of the Federal Reserve...

In early November, I had the pleasure of having lunch with Bill Strauss, the Senior Economist and Economic Advisor at the Federal Reserve Bank of Chicago. As the lead economist in Chicago, Bill shares research with the other 11 Federal Reserve Banks which collectively comprise our Federal Reserve System (the Fed). Their consensus thinking drives policy creation.

While I place little importance on predictions from “experts” given their track record of being inaccurate as often as they are on target, I am paying attention to Bill’s comments. The difference between the “experts” and the Fed is that the former tries to influence actions while the latter takes action to implement their beliefs. All of their data leads the Fed to the following conclusions:

- 1. Our expansion out of the 2007-2009 recession will continue to be slow.**
- 2. Employment is expected to rise moderately in 2012.**
- 3. Slack in the economy will keep the inflation rate low for the near future.**
- 4. Vehicle sales are a bright spot and are anticipated to rise at a good pace.**
- 5. Growth in all manufacturing should be solid in 2012.**

The summation of his views is that a double-dip recession or other similar significant economic decline in the next 12-24 months is highly unlikely. However, the Fed is seeing enough headwinds to temper its expectations and shape its views that the recovery will be modest and prolonged.

The Fed’s views are aligned with Oak Wealth Advisors’ approach of staying broadly diversified, not taking excess risk, and tempering return expectations. Generating positive returns in portfolios should be feasible but they will likely be single digit returns for at least the next year or two. Investment market volatility will surely persist as uncertainty will not be eliminated from the world economy anytime soon.

More details of the Fed’s research and forecasts are found on the following page for those who are interested.

- Banks are holding historically high levels of excess cash.
 - Economic growth has been slowed by the decrease in lending.
 - Business owners have not been aggressive in borrowing or investing to expand as they are not inclined to take risks in periods of heightened uncertainty.

- Consumers seem to be in a better place financially than they have been for many years.
 - Personal savings rates have stabilized around 4% of income after being close to zero prior to the recession and spiking to 8% during the recession.
 - Consumer debt levels have declined from 24% to 21% of income. The decline has occurred over the past two years after the rate held at 24% from 2001 through 2009.

- Gross Domestic Product (GDP) growth is forecast to be significantly lower than it has been coming out of prior recessions when it averaged 5.2% to 5.5%.
 - 1.6% - 1.7% for 2011
 - 2.5% - 2.9% for 2012
 - 3.0% - 3.5% for 2013
 - 3.0% - 3.9% for 2014
 - 2.4% - 2.7% thereafter for the long-term

- Unemployment has only fallen from a high of 10.1% in October of 2009 to 9.1% two years later. It is anticipated to remain between 8.5% - 9.0% over the next 18 months.
 - Historically, “full employment” has been accepted as an unemployment level of 5% to 6%.
 - Between 2008 and 2009, the unemployment rate jumped from just below 5% to 10%.

- Core inflation (which excludes food and energy) is expected to stay between 1.5% - 2.0% for the near future. While it is understood that we are all affected by energy and food costs, they are highly volatile indicators over short periods of time and have not grown much in inflation adjusted terms over the last thirty years.

- New home construction is anticipated to continue to rise modestly.

- The Federal Funds rate, which is the interest rate at which the banks can borrow short-term funds from each other, is expected to stay between 0.0% and 0.25% through 2012.
 - The continuation of these historically low Federal Funds rates suggests both a lack of demand for the cash and a lack of inflation pressure.

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