



Tarpley & Underwood

Financial Advisors, LLC

January 15, 2010

Mr. and Mrs. John Smith (Sample Client)
ABC Company, Inc.
123 Peachtree Street, NE
Atlanta, GA 30305

Dear John and Nancy,

Enclosed are your reports for the fourth quarter of 2009.

Quarterly Commentary

When the dust settled on one of the most eventful and upended years in memory, investors had generous gains in stocks and certain segments of the bond market to salve the wounds of a disastrous 2008 and first quarter of 2009. Stocks finished the year strongly, continuing their powerful run that began in early March. Large-cap stocks, based on the Vanguard 500 Index Fund, gained about 6% in the final quarter, and finished 2009 with a 26.5% gain. In both the quarter and the full year, growth sharply outpaced value, but between larger-caps and smaller-caps, returns were pretty similar. Mid-caps were a different story; while the iShares Russell Midcap ETF posted fourth-quarter returns in line with the overall market, full-year returns were just north of 40%.

On the domestic fixed-income side, returns varied widely in 2009. The Vanguard Total Bond Market Index Fund gained 5.9% for the year, but the iShares Barclays 7-10 Year Treasury ETF was down 6.4% and the iShares Barclays Credit Bond ETF gained more than 14%. High-yield bonds, which normally exhibit hybrid characteristics of stocks and bonds, instead crushed both, with Merrill Lynch U.S. High-Yield Cash Pay Index gaining 56% for the year.

Heading overseas, the story was emerging markets. Both equity and debt of emerging-markets countries left their developed-market counterparts in their dust. Vanguard's Emerging Market Stock Index Fund tacked on 8.2% in the fourth quarter to bring its full-year gain to 76%, versus a gain for the predominately developed market Vanguard Total International Stock Index of 3.2% for the quarter and a still impressive 37% for the year. For bonds the pattern was tighter but the same: Emerging-markets bonds (JPMorgan GBI-EM Global Diversified Index) gained 2.8% and 22% for the quarter and year, while developed-nation sovereign bonds (Citigroup World Government Bond Index) lost 1.9% in the fourth quarter and gained only 2.6% for the year.

As we'll note below, we aren't overly enthusiastic about the multiyear return potential from either stocks or bonds at current valuations, but are optimistic that periodic dysfunction in the markets will allow valuation opportunities to appear.

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The incremental value of these opportunities may be much lower than it was this past year, where absolute returns were unusually high, but in a low-return environment they can make a material difference.

As we look ahead over the next several years, we continue to believe that the weight of the evidence makes a strong case for a tough road for the economy and the financial markets, despite the beginnings of an economic recovery -- which at this point have been mostly government supported.

Debt, Debt, and More Debt

We continue to believe that we are in the midst of a major debt-driven transition in the economy that will keep risks elevated, result in continued economic headwinds, and have longer-term consequences due to the acceleration of the buildup of our public (government) debt.

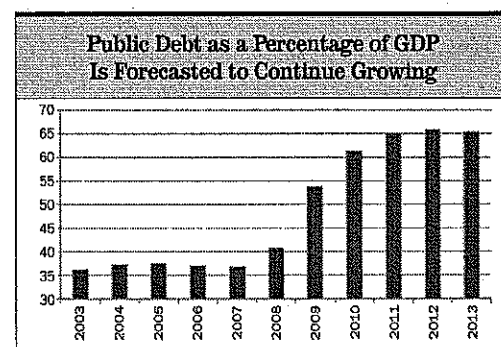
Household Debt: Households have hit a debt wall and are in the process of deleveraging. Despite the huge government stimulus, this process is not close to being over.

Consumer Spending Headwinds: Because consumer spending is 70% of the economy it is hugely important to overall economic growth. The desire among households to rebuild balance sheets, along with high unemployment and low perceived job security, makes it very likely that consumption growth will be subpar compared to what we've been used to.

U.S. Government Debt Explosion: The U.S. Government's actions in aggregate probably saved us from a 1930s-type depression. However, the resulting leap in the government deficit comes at a terrible time. This increase, coupled with a coming explosion of Social Security, Medicare, and Medicaid benefits to retiring baby boomers, means that the U.S. faces extremely challenging times in the coming years.

As debt continues to grow, at some point it will become difficult to get investors to lend to a fiscally challenged U.S. in the amounts needed without paying a significantly higher interest rate. Though some increase in borrowing costs is likely soon, the risk of a sharp increase in rates is not imminent if the recovery is subpar (as seems very likely). But looking out over the next 10 years and beyond, the math is impossible to ignore. There is little question that taxes will have to increase and spending will have to decrease. If this doesn't happen in a significant way, and maybe even if it does, there is a great risk of both a dollar and an interest-rate crisis that could be extremely painful for the U.S. and global economies.

There are still many variables in play that relate to these concerns, including a slower than anticipated recovery for the labor market; the wave of upcoming foreclosures and continued high unemployment; small businesses suffering from weak demand and a larger decline in



Stimulus spending and falling tax receipts have caused a spike in public debt. The debt burden is forecast to worsen significantly due to the increasing cost of entitlement programs like Medicare and Social Security, and of servicing the



profits than bigger firms; states and municipalities suffering from the steepest decline in tax revenue on record; and loan delinquency rates continuing to increase.

Given the challenges, there is risk of policy mistakes as the Fed and the Treasury attempt to maneuver through the next few years. Unwinding of the stimulus at the right time and in the right way will be one of the big challenges. At what point the economy can stand on its own remains an open question, not just in the United States but in most of Europe and Japan as well.

There are some positives, however. This is the largest global stimulus ever to occur in peacetime. Strong emerging-markets economies are feeding back into the global economy, which is a positive for exports and manufacturing. Corporate balance sheets, outside of financials, are in good shape with the best liquidity in 50 years. Inventories are low and a rebuilding cycle is beginning, which will support growth. And, the severity of the economic contraction and corporate cost cutting may mean that businesses overreacted and will need to aggressively increase investment and hiring.

Return Expectations

The analysis we review assesses return potential via scenario analysis that incorporates an assessment of asset-class pricing and fundamentals and how they are likely to be impacted under various economic possibilities over the next five years.

The following conclusions are drawn from this analysis. With the run-up in prices of global equities, many valuation metrics suggest stocks are somewhat overvalued based on history, and more overvalued if subpar growth becomes a reality. Corporate and high-yield bonds are not overvalued but they are no longer cheap. U.S. government bonds are priced to deliver poor returns over five years, barring a severe deflationary world. With historically low dividend yields of less than 4%, REITs are also overvalued. Only emerging-markets local-currency (non-dollar) bonds look reasonably attractive but even they are subject to a fairly high level of short-term risk stemming from currency fluctuations. In short, no asset class appears priced to generate fabulous returns—though some asset classes will do better than others and there are specific investments that look somewhat attractive.

Bad Odds and Not Much of a Payoff

Investing requires one to make decisions with incomplete information and therefore uncertain outcomes. For this reason we believe we must have an understanding of the odds and the payoffs. We use analysis to help understand the upside we gain in exchange for taking risk. Ultimately we want the odds heavily in favor of the decisions we make. But having the odds in our favor does not mean that we will be right immediately or even at all, especially in the short run. But over the long run our discipline, which implicitly requires us to be willing to be wrong in the short run, has added value by putting us in a position to be right far more than we have been wrong.

Given this view, we continue to maintain a conservative bias in our equity allocations. As we move into the New Year, we may continue to move more conservative by reducing our



emerging market equity positions if the fundamentals in that asset class turn negative. We are likely to reduce our high-yield bond exposure in the near future following that asset class's run-up in 2009.

Getting Paid to Wait

As discussed above, we don't believe stocks are cheap. Moreover, we are headed into a period of increased regulation and taxation which will add to growth headwinds. With respect to bonds, while it is true that rates are low and this will limit returns, much of the non-government bond market (corporate and agency mortgages), while no longer cheap, is priced to deliver mid-single-digit returns over the next few years with far less risk than equities.

So, we have built sizable bond positions while we wait for better opportunities. It is extremely unlikely that we will need to maintain these large bond allocations for most of our five-year horizon, but for now we are quite comfortable holding these positions. We should note that we are cognizant of inflation risk, which would be bad news for bonds, though we don't see that risk as imminent.

For appropriate taxable clients, we are maintaining our tax-exempt bond holdings with slightly longer maturity exposure because yields there are somewhat elevated compared to taxable bonds. Though these bonds are at risk if rates rise, yields are high enough to provide some protection.

Looking forward over the next five years we believe higher returns can be captured by patiently waiting for compelling opportunities and then making appropriate tactical moves when they appear. We will attempt to position portfolios to take advantage of these opportunities as they appear.

As always, we encourage you to let us know if there is anything we can do to address any specific questions or concerns you have about your portfolio. We also encourage you to continue to review the information and education materials we continually post at www.tufaviews.com and through Twitter (@TufaViews).

We wish you the best for the coming year.

Best Regards,

Tarpley & Underwood Financial Advisors, LLC

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