October 2012

About Beacon Financial Advisors Ltd.

Beacon is an independent fee-only advisor with a clear mission statement: To provide our clients long-term value-added financial counsel and investment performance with *exceptional service.* **Beacon** is a Registered Investment Advisor with the US Securities and Exchange Commission.

Beacon's Advisors

MARCEL HEBERT has a B.S. in Finance, an M.B.A., and is a Certified Financial Planner (CFP) licensee and a Chartered Financial Analyst (CFA) charterholder.

JOSH HEBERT has a B.S. in Accounting, an M.B.A., and is a Certified Internal Auditor (CIA) and a Certified Financial Planner (CFP) licensee.

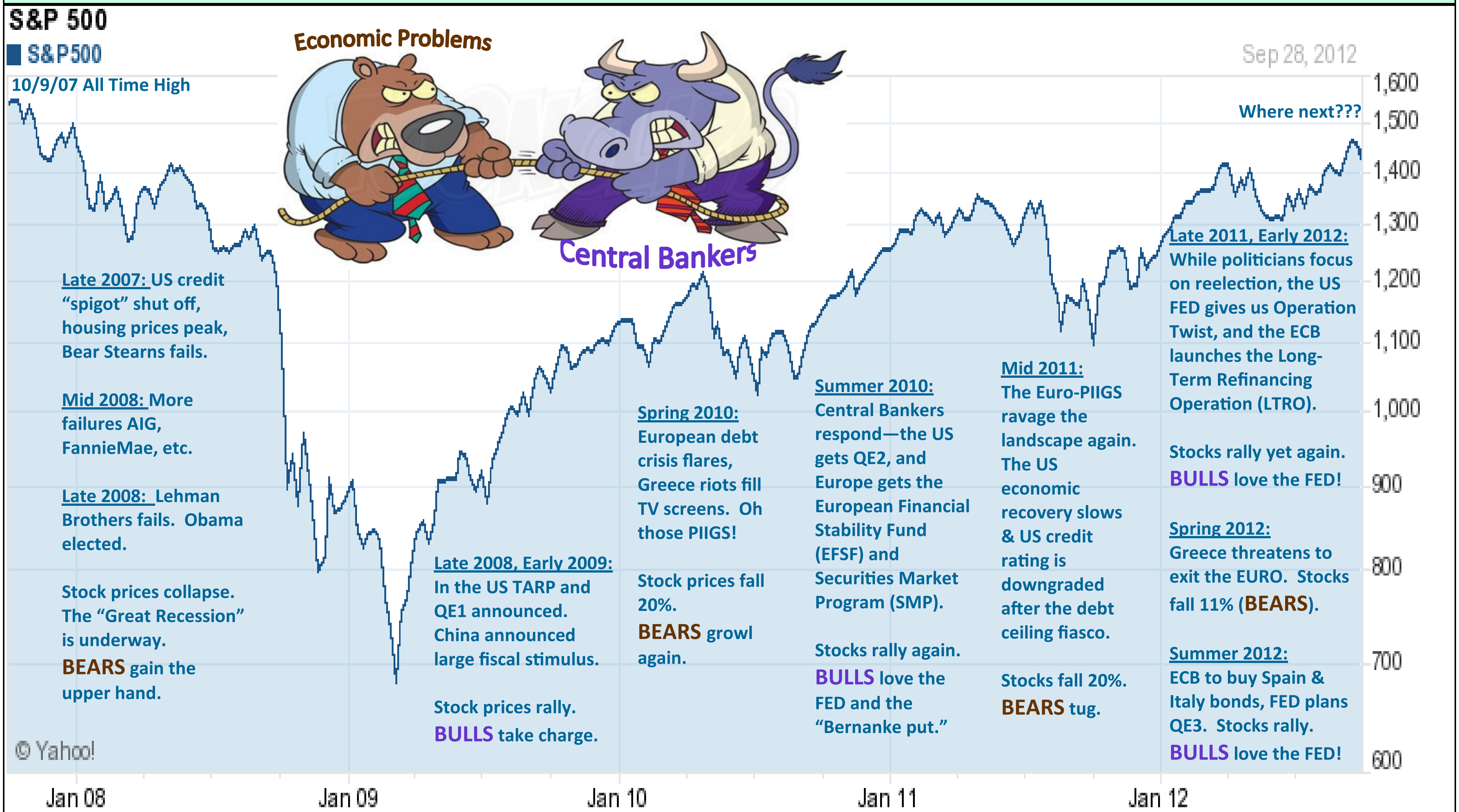
A Tug of War

A Tug of War has been ongoing since 2007 between the stock **bulls** and **bears** (see chart p2). The **bears** call attention to the world's structural economic (& geopolitical) challenges. The US had it's "Great Recession", a substandard recovery, and now faces $16 trillion in debt and the upcoming "fiscal cliff" (see VIEW 2012 Q2 for a discussion of the fiscal cliff). Europe has it's ever evolving debt crisis (remember the PIIGS...Portugal, Ireland, Italy, Greece & Spain)? China is trying to engineer a vast exchange from an export-driven economy to a consumer-driven economy, and has a bank and real estate bubble. And if these issues weren't enough, the so-called "Arab Spring" has been hijacked in Syria, Egypt, Libya etc. Then there is Israel and Iran. Lot's for **bears** to cling to, huh?

The **bulls** look to policy measures taken (with promise of more) by the world's monetary policy architects—central bankers—including the US Federal Reserve ("Fed"), the European Central Bank ("ECB"), the Bank of England, the German Bundesbank, the Swiss National Bank, the Bank of Japan, and the People's Bank of China. Each has become increasingly bold in their willingness to use conventional and unconventional policy measures to fight the structural problems. In the US, the Fed has just announced a 3rd round of quantitative easing (so-called QE1, QE2 and QE3). As the chart on p2 depicts, the past few years the S&P 500 Index has reflected this **tug-of-war** as investors the world over have driven stock index levels with RORO or "risk on, risk off"—reacting to this **bull** v. **bear** struggle. Greeks or Spaniards pour into the streets in mob-like fashion, and investors go "risk off" and stock indexes decline. Central bankers seek to preempt developments with policy measures to fight economic malaise, and investors go "risk on" and stock indexes rise. In the US, this latter dynamic has become known as the "Bernanke put."

The central bankers can be seen urging politicians to use fiscal policy measures to combat economic problems. The US Fed is using monetary policy to buy time for the "plow horse" economic recovery to take hold and fiscal policy to become clearer (cue the November 7 elections). The Fed et al is warning the US will enter another recession if we fall off the "fiscal cliff". So, a big question is which side will win this **tug-of-war**? And, what are the investment implications? Nobody knows the answer, of course. But one thing is clear to **Beacon** anyway—portfolio diversification among asset classes is still the best option going.

RORO—Risk On (Bulls), Risk Off (Bears)
The Tug-of-War between Economic Problems & Central Banks



Our STOCK and BOND Fund Partners 2012 Q3

STOCKS rose sharply in Q3 as the S&P 500 Index advanced 9%. Corporate profitability was strong and the US "plow horse" economy trudged on. As financial stocks gained favor, Third Avenue Value (TAVFX) and Dodge & Cox Stock (DODGX) outperformed. Thru nine months TAVFX and DODGX returned over 21% and 18% respectively.

During Q3 **Beacon** met with several of our mutual fund partners on the stock and bond side. Talking stocks, here are some highlights of our meetings.

In the US

DODGX's financial stocks (banks, brokerages, insurance etc.) had a strong period led by Bank of America, Capital One and Wells Fargo. Dodge & Cox opined to **Beacon** DODGX'S portfolio characteristics bode well for long-term returns as the 75-stock portfolio now trades at only 11X earnings compared to an average P/E of about 16X. Jensen Quality Growth (JENIX) has 29 stocks like PepsiCo and 3M they believe are well positioned for the current global economic slowdown and our US "plow horse" economy. As US housing rebounds, Jensen likes Equifax as it supplies credit reports used by mortgage lenders. Gabelli Asset (GABAX) lead manager Mario Gabelli observes the global slowdown has lessened merger & acquisition activity (M&A) due to uncertainty about the US elections, the "fiscal cliff", etc. He believes policymakers and politicians recognize the need to generate global growth as the primary means of dealing with the US and European debt situation/crisis, and that will lead to an increase in corporate M&A activity. Much of GABAX's bottom-up stock selection is informed by that theme.

Outside the US

Portfolio characteristics of our foreign stock managers Dodge & Cox (DODFX) and Tweedy, Browne (TBGVX) are even better than US profiles, probably due to fears about Europe. There are compelling investment opportunities emerging from the crisis in Europe, much like those in the US in early 2009. With nearly 22% in financial stocks, DODFX's 91 stock portfolio trades at under 10X earnings versus nearly 19X long-term average P/E. And, let's not forget Beacon's "alternative" holding in AllianceBernstein Real Asset (AMTYX). Despite low inflation pressure, this real asset holding still has returned 9% YTD.

BONDS experienced stock-like returns in Q3 and YTD. In fact, the bond total returns from our fund partners has exceeded **Beacon's** start of the year expectations.

In **Beacon's** balanced, global portfolios bonds are the "anchor to windward"—income producers in all times while most often generating positive total returns when stocks slump (i.e. correlation). Bond investors in 2012 benefited from the same RORO ("Risk On, Risk Off") dynamic that has helped stocks the past twelve-month. This year bond investors have enjoyed price appreciation in addition to income payments, resulting in exceptional total returns.

Municipal bonds have been among the very best performing fixed income sectors for over two years now, and 2012 to date has been especially good for intermediate-duration high yield municipal credits. AllianceBernstein High Income Muni (ABTYX) has returned 14% YTD, and their shorter-duration, higher quality sibling AllianceBernstein National Muni (ALTVX) has returned 8% YTD. At the start of 2011, Beacon rebalanced our clients taxable accounts more heavily into these two funds and that has paid off handsomely. Challenges remain in the municipal market and extensive research is a mandate. Prior to 2008, insured bonds constituted more than 50% of issuance. Today insured bonds are less than 4% so investors can no longer rely on the "crutch" of bond insurance. And as for bond ratings, today more than 30% of new bonds are rated just above "junk" compared to only 14% of issued bonds in early 2007. So ratings are not as reliable. Research is essential.

On the taxable side of the bond world, today's low yields are the rule of the day. Recall the US Treasury 10-year note pays less than 2% (the 5-year under 1%), and the average corporate 10-year investment grade bond yields about 4%. But, research can still add value to low yields. MetWest Total Return (MWTIX) has returned nearly 10% YTD by substantially underweighting US Treasury securities and overweighting mortgage-backed securities (agency and non-agency MBS's). Dodge & Cox Income (DODIX) has returned nearly 7% YTD with an overweight to MBS's and also the corporate sector.