The Lam Group
Investment Management

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The Big Picture:
After a successful 2009, some would say that the most expensive investment advice given during the global credit crisis was:

This Time Is Different

The last 16 months are an example of how volatile markets can be and the importance of a long-term strategy and investment discipline. Markets are unpredictable; the severe downturn that began in September 2008 was as unexpected as the worldwide rally that began in March 2009.

Table 1: Asset Class Returns for The Crisis, The Recovery and The Aggregate

EQUITY ASSET CLASSES	**The Crisis (6 mo) 8/31/08-2/28/09**	**The Recovery (10 mo) 2/28/09-12/31/09**	***This Time is Different? (16 mo) 8/31/08-12/31/09***
S&P 500 Index - Domestic Large Cap Stocks	-41.82%	+ 54.56%	*-10.08%*
Russell 2000 Index - Domestic Small Cap Stocks	-46.91%	+ 62.88%	*-13.53%*
MSCI EAFE Index - International Large Cap Stocks	-44.58%	+ 62.82%	*- 9.77%*
MSCI EAFE SC Index - International Small Cap Stocks	-45.16%	+ 73.42%	*- 4.89%*
MSCI EM Index - Emerging Markets Stocks	-47.21%	+102.70%	*+ 7.00%*
DJ Wilshire REIT Index - Domestic Real Estate	-61.72%	+100.65%	*-23.19%*
FIXED INCOME ASSET CLASSES	**The Crisis (6 mo) 8/31/08-2/28/09**	**The Recovery (10 mo) 2/28/09-12/31/09**	***This Time is Different? (16 mo) 8/31/08-12/31/09***
BarCap Aggregate Bond Index - US High-Grade Bonds	+ 1.88%	+ 7.28%	*+ 9.29%*
BarCap High-Yield Index	-22.39%	+54.06%	*+19.57%*
BarCap TIPS Index - US TIPS	- 7.47%	+11.76%	*+ 3.41%*
DJ UBS Commodities Index - Commodities	-44.03%	+31.48%	*-26.41%*
Citigroup Non-$ World Bond Index - Non-$ Bonds	- 1.62%	+13.65%	*+11.81%*
JPM EMBI Global Bond Index - Emerging Markets Debt	-12.74%	+28.64%	*+12.25%*

Source: Morningstar, JP Morgan, PIMCO and DFA.

As illustrated in Table 1, despite the 6 month crisis in all asset classes, the cumulative performance of these asset classes over the last 16 months, ***while disappointing, was not the end of the world.*** At the apex of the crisis in February 2009, many of those who predicted that "this time is different", also boldly proclaimed that:

Commercial Real Estate is: a) the next shoe to drop, b) the next nail in the coffin, c) both a & b

It is worth noting the return of the DJ Wilshire REIT Index is up over 100% over the last 10 months.

What the data in Table 1 shows us is that trying to predict market direction, especially with a short-term time horizon is a loser's game. Global diversification, portfolio balance and discipline, combined with low investment expenses and tax-efficiency, are the keys to long-term investment success.

Over the long-term, if you take more risk, your expected return should be higher

While greater risk does not necessarily translate into higher return in the short-run, over longer periods of time, if greater risk did not result in higher return, why would anyone take greater risk? Conversely, if you are not taking very much risk, why do you deserve to make a higher return?

In many ways, the last 10 years of equity asset class returns support this assertion. In late 1999, the US economy was soaring. Unemployment was at record lows, our currency was strong, inflation was low, and our budget was in surplus. With regard to the US stock market, the economy was "new" and it was often heard in the financial media that: *the risk was NOT being in US growth (internet) stocks.*

At the same time, the circumstances in the emerging markets countries were dire. In the late 1990s, there had been an Asian currency crisis (the Asian Contagion), the Russian bond market had defaulted, and the political unrest in many emerging markets countries was constantly in the news. Common problems that many emerging markets countries shared were high unemployment, weak currencies, rampant inflation, and weak sovereign balance sheets.

In 1999-2000, why would anyone invest in the risky emerging markets when the US economy and stock markets were doing so well? The data shown in Table 2 with regard to the US and Emerging Markets equity markets is eye opening. Investors who took risk in the new millennium (2000) were rewarded over the next 10 years and the investors who watched too much CNBC television were not.

Table 2: US vs Emerging Market Equity Returns – 16 mo and 10 yr (annualized and cumulative)

	16 Months	**10 Years**	
EQUITY ASSET CLASSES	**8/31/08-12/31/09**	**Annualized**	**Total Return**
S&P 500 Index - Domestic Large Cap Stocks	**-10.08%**	**- 0.95%**	**- 9.10%**
MSCI EM Index - Emerging Markets Stocks	**+ 7.00%**	**+10.11%**	**+161.96%**

Source: Morningstar, JP Morgan, PIMCO and DFA.

Today, rare is the pundit who believes the US economy, Federal Government and corporate America are in anything but trouble, and at the same time it is often heard in the financial media that *the risk is NOT being in emerging market stocks*.

It is fair to say that the US economy is on uncertain footing; unemployment is high, our currency is weak, inflation is pending and our political direction is anything but certain. At the same time, circumstances in the emerging markets have never been better; employment is robust resulting in a growing middle class, currencies are strengthening, and they enjoy large budget and trade surpluses.

Is it possible that emerging markets equities are the next new thing? Or is it possible that being up over 160% over the last 10 years (vs. US equities being down over 9%) the markets have already recognized the promise of the emerging markets and compensated the investors who took the risk when they were risky?

If the US is more risky than it was 10 years ago, and the emerging markets are less risky than they were 10 year ago, where should the future expected return be higher?

Table 3: Asset Class Returns for 16 month period (8/31/08-12/31/09) and 10 years thru 12/31/09

	16 Months	10 Years	
EQUITY ASSET CLASSES	**8/31/08-12/31/09**	**Annualized**	**Total Return**
S&P 500 Index - Domestic Large Cap Stocks	-10.08%	- 0.95%	- 9.10%
Russell 2000 Index - Domestic Small Cap Stocks	-13.53%	+ 3.51%	+ 41.23%
MSCI EAFE Index - International Large Cap Stocks	- 9.77%	+ 1.17%	+ 12.38%
MSCI EAFE SC Index - International Small Cap Stocks	- 4.89%	+ 6.87%	+ 94.29%
MSCI EM Index - Emerging Markets Stocks	+ 7.00%	+10.11%	+161.96%
DJ Wilshire REIT Index - Domestic Real Estate	-23.19%	+10.67%	+175.59%
	16 Months	**10 Years**	
FIXED INCOME ASSET CLASSES	**8/31/08-12/31/09**	**Annualized**	**Total Return**
BarCap Aggregate Bond Index - US High-Grade Bonds	+ 9.29%	+ 6.33%	+ 84.75%
BarCap High-Yield Index	+19.57%	+ 6.72%	+ 91.57%
BarCap TIPS Index - US TIPS	+ 3.41%	+ 7.70%	+110.02%
DJ UBS Commodities Index - Commodities	-26.41%	+ 7.13%	+ 99.15%
Citigroup Non-$ World Bond Index - Non-$ Bonds	+11.81%	+ 6.62%	+ 89.88%
JPM EMBI Global Bond Index - Emerging Markets Debt	+12.25%	+10.52%	+171.98%

Source: Morningstar, JP Morgan, PIMCO and DFA.

This question is not meant to suggest that the prospects of the US are better or worse than the emerging markets or that one asset class should be eliminated in favor of another. As markets are unpredictable, both asset classes are important contributors to a diversified portfolio strategy.

In practice, buying low and selling high is never easy or obvious; as a consequence, the framework of a disciplined multi-asset class investment strategy has never been more important.

In retrospect, the asset class results for the past 16 months and the last 10 years were unexpected, surprising and in many ways shocking. What will the next decade bring?

We are sure of only one thing:

The future will continue to be unpredictable

2010 Investment Outlook
We continue to believe that portfolio balance, global diversification and the acknowledgement of risk in the context of a long-term investment horizon are important and critical to the proper management of investment portfolios.

The New Year is off to a strong start. Here are The Lam Group's 2010 strategies, ideas and biases:

General:
With short-term US Treasury rates so close to zero, the landscape of risk and return has never been clearer: investors must take risk in order to earn return.

- Risk can be taken in many forms: credit, interest rate/duration and capital structure (equity) and each of these forms has different return profiles.
- By keeping short-term interest rates so low, the Fed is trying to force capital back into the equity and capital markets by making it too expensive (no return) to stay in the safest investments.
- While there are those who seek the safety of cash to avoid the *explicit risk of capital loss*, the holders of zero-yielding cash/money market funds have the *implicit risk of losing future purchasing power to the ravages of inflation*.

With a weakened global economy, some are arguing that return expectations should be moderated or lowered due to lower earnings expectations. However, at the same time, as a consequence of the credit crisis, the global cost of private capital is higher, not lower, than before the crisis.

- The cost-of-capital is highly correlated to expected return. If the long-term cost-of-capital is higher, so should the long-term expected return.

Interest Rates and Currencies:
We don't think that the Fed will act to raise interest rates until domestic employment improves, however, it is possible that market forces cause US interest rates in the longer maturities to rise. We think any increase in interest rates will be led by a steepening US yield curve.

- A steep and/or steepening US yield curve improves the health of our still weakened financial institutions.
- Accommodative monetary policy is ultimately inflationary.

The risk in US interest rates is a sudden global crisis in the US dollar.

- This could lead to dramatic increases in short-term rates similar to the policies then Fed Chairman Paul Volcker initiated in the late 1970s/early 1980s.

Equities:
Absent of any sudden crisis in the US dollar, short-term interest rates are likely to stay low until explicit signs of domestic economic recovery. Combined with a steepening US yield curve, this is favorable for the global financial system and equity risk in general.

The Lam Group: 2010 - The Year of the Roth Conversion
As a consequence of the Tax Increase Prevention and Reconciliation Act of 2005 (TIPRA), beginning in tax year 2010, the income limitation on conversions to Roth IRAs has been removed**.** *This means that in 2010 individuals can convert their Traditional IRAs to a Roth IRA format regardless of their income; for many individuals, a Roth conversion can have favorable long-term tax and investment consequences.* The tax liability resulting from 2010 Roth conversions can be deferred over the 2011 and 2012 tax years.

You should consult your tax advisor to discuss whether converting your Traditional IRA assets to a Roth IRA makes sense for you.

As you may know, with a *Roth IRA, contributions are made with after-tax dollars*. Any earnings in a Roth IRA grow tax-free as long as they remain in the account. Withdrawals of earnings from Roth IRAs are free of federal income tax if a 5-year aging period has been met and the account owner is 59 ½ years old or over. Additionally, Roth IRAs are not subject to Required Minimum Distribution (RMD) rules during the lifetime of the original owner (or spouse), so you can leave your assets in the Roth IRA longer than you can with a Traditional IRA.

With a *Traditional IRA, contributions are generally made on a pre-tax (tax-deductible) basis*. Any earnings in the Traditional IRA are tax-deferred as long as they remain in the account. Withdrawals of pre-tax monies are subject to ordinary income tax when withdrawn. After the owner of a Traditional IRA reaches the age of 70 ½, RMD (which are taxable) are required.

In a Roth IRA conversion, you pay federal income taxes <u>in the current year</u> on the conversion amount, but none on any future earnings as long as when withdrawals are taken after the 5-year aging period has been met and you are age 59 ½ or over.

The decision to convert to a Roth IRA is not a simple one, and you should consult your tax advisor to assist in making this complex decision. Obviously, one of the biggest considerations is your ability/willingness to pay the taxes up front. Other important considerations include your investment time horizon (the longer the better) and whether you think federal and state tax rates will be the same or higher than the current rates when you withdraw your money.

The Roth conversion decision has ramifications on asset location in the context of the aggregate portfolio. While we have always tried to keep tax inefficient assets (such as bonds, real estate and commodities) in tax-deferred accounts, and riskier assets (equities) in taxable accounts (to take advantage of lower capital gains rates in times of appreciation and tax-loss harvest/carry forward to take advantage of capital loss); the attributes of a Roth IRA (with its tax-free gains, but no benefits for capital loss format) presents unique asset location challenges.

The Lam Group continues to focus on designing and managing balanced and globally-diversified investment portfolios. Our asset allocation approach employs a highly-analytical process to determine the appropriate combination of asset classes to build investment portfolios and strategies that realistically and optimally reflect the needs, risk tolerances, and investment horizons of our clients.

The Lam Group
Investment Management

The Lam Group is an independent, fee-only, SEC-registered investment advisory firm with clients in Oregon, Washington State, California, Connecticut, New York, and New Jersey. We offer both investment management and portfolio consulting services for taxable investors, family offices, and foundations.

Our Firm has been structured to provide our clients with an investment management relationship that enjoys the highest degree of transparency and avoids any conflicts of interest. This transparency, combined with the intellectual honesty of using passively-managed asset classes in our asset allocation strategy, is the foundation of our overall investment philosophy and approach.

As our Managing Director and Chief Operating Officer, Tina Lee's efforts at the firm in 2009 have allowed us greater efficiencies and as a result we have the capacity to accept a limited number of new clients in 2010. We will continue our policy of considering new clients on a referral-basis only.

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Asset Class Investment Results:
All portfolios constructed and managed by The Lam Group are designed for an individual client's specific risk tolerances, income requirements and investment horizon. Our investment management approach includes the design of a customized asset allocation plan, the research and selection of the most appropriate and cost-effective asset class investments for the client's specific investment policy, and the on-going monitoring and disciplined rebalancing of the aggregate portfolio to optimize return, manage risk and minimize taxes.

As different clients have different goals, risk profiles and investment horizons, it is not useful to publish a track record of specifically-managed portfolios. The investment performance data below illustrate the returns of some of the actual mutual funds utilized by The Lam Group for specific asset class allocations in the construction of investment portfolios we manage.

All data is as of 12/31/09

Equity Asset Class Category	**4Q2009**	**2009**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Total Equity Market				
-Wilshire 5000 Index (Total US Eq. Market)	*+5.87%*	*+29.35%*	*- 5.01%*	*+1.00*
US Total Market Fund	+5.41%	+29.84%	- 5.38%	+1.00
Domestic Large Cap Stocks				
-S&P 500 Index	*+6.04%*	*+26.46%*	*- 5.63%*	*+1.00*
Domestic Large Cap Value Fund	+3.82%	+30.19%	- 9.17%	+0.97
Domestic Small Cap Stocks				
-Russell 2000 Index	*+3.88%*	*+27.17%*	*- 6.07%*	*+0.92*
Domestic Small Cap Value Fund	+2.90%	+33.62%	- 8.99%	+0.91
Real Estate Investment Trusts (REITs)				
-Wilshire REIT Index	*+9.18%*	*+28.46%*	*-13.65%*	*+0.80*
REIT Fund	+9.00%	+28.17%	-13.25%	+0.80
International Real Estate	+0.65%	+37.01%	N/A	N/A
International Large Cap Stocks				
-MSCI EAFE Index	*+2.18%*	*+31.78%*	*- 6.04%*	*+0.90*
International Large Cap Value Fund	-0.07%	+39.45%	- 6.21%	+0.92
International Small Cap Stocks				
-MSCI Small Cap EAFE Index	*-1.03%*	*+46.78%*	*- 7.59%*	*+0.83*
International Small Cap Value Fund	-1.97%	+39.51%	- 5.74%	+0.85
Emerging Markets Equity				
-MSCI Emerging Markets Free Index	*+8.25%*	*+74.50%*	*+ 2.73%*	*+0.82*
Emerging Markets Value Fund	+9.00%	+92.28%	+ 8.85%	+0.86

Source: Morningstar, JP Morgan, PIMCO and DFA.

* 5 yr correlation using monthly data

All data is as of 12/31/09

Fixed Income Asset Class Category	**4Q2009**	**2009**	**3 Year Annualized**	**Correlation w/ S&P 500***
Domestic Investment Grade Bonds				
-Barclays 1-3 year Govt Bond Index	*+ 0.09%*	*+ 1.41%*	*+ 5.03%*	*-0.26*
Short Duration Domestic Inv. Gr. Bond Fund	+ 0.15%	+ 2.08%	+ 3.80%	+0.04
Short Duration Domestic Muni Bond Fund	+ 0.64%	+ 3.69%	+ 3.39%	+0.14
-Barclays Aggregate Bond Index	*+ 0.20%*	*+ 5.93%*	*+ 6.04%*	*+0.25*
Domestic Investment Grade Bond Fund	+ 0.99%	+13.83%	+ 9.18%	+0.29
Domestic High Yield Bonds				
-Barclays High Yield Bond Index	*+6.19%*	*+58.21%*	*+ 5.98%*	*+0.76*
High Yield Bond Fund	+5.09%	+39.09%	+ 3.76%	+0.73
Inflation-Linked Bonds				
-Barclays TIPS Index	*+1.76%*	*+11.41%*	*+ 6.69%*	*+0.30*
- Dow Jones UBS Commodities Index	*+9.03%*	*+18.91%*	*- 3.83%*	*+0.45*
TIPS Fund	+2.16%	+11.02%	+ 6.97%	+0.36
Commodities-Linked Fund	+11.64%	+39.92%	- 0.62%	+0.48
International (non-US $) Bonds				
-Citigroup Non-$ World Govt Index	*-2.15%*	*+4.39%*	*+ 8.61%*	*+0.20*
Non-$ Bond Fund	-1.83%	+6.72%	+ 6.30%	+0.32
Emerging Markets Debt				
-JP Morgan EMBI+ Index	*+1.53%*	*+28.19%*	*+ 6.67 %*	*+0.69*
Emerging Markets Debt Fund	+2.36%	+30.54%	+ 5.85%	+0.68

Source: Morningstar, JP Morgan, PIMCO and DFA.

* 5 yr correlation using monthly data

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