carefully wade INTO THE stage 2 waters

June 16, 2009

Dear Valued Investor:

Living in Boston, the spot where city folk flock to recharge their batteries is "down the Cape". The Cape's formal name is of course Cape Cod, which is famous for its many beautiful beaches, scenic ports, nostalgic lighthouses, rolling sand dunes, and clam shacks. My family has been going to Cape Cod for many years now and enjoys the atmosphere to reconnect and relax. However, if there is one tip that a seasoned Cape Codder can impart, it is, don't rush to jump into the water. Even on those hot summer days, the water at times seems more like a melting glacier than a summer retreat. If you close your eyes, you can imagine wading in a Rocky Mountain stream or an icy Norwegian lake rather than one of the most popular "hot" spots on the East Coast. If you jump in too fast, the frigid water might turn you into a frozen block of ice, but the "slow walk", just an inch or two at a time, allows you to reintroduce yourself to the water that quickly progresses from shockingly frigid to refreshingly cool to pleasantly rewarding.

The same strategy is also prudent for investors switching from a risk adverse stance during recessionary markets to a more opportunistic one, in hopes of participating in the economy's path to recovery. While we believe that it is now the time to don the bathing suit and begin to wade into the markets' opportunistic waters once again, we urge a cautious and deliberate reintroduction of risk into investor portfolios.

Learning the "slow walk" is important given that we believe the market has shifted from an environment requiring risk aversion to a period that warrants a reintroduction of opportunistic risk taking. While the last year has rewarded a focus on risk minimization in the face of menacing markets and a severe global recession, the recently improving economic conditions point to a backdrop that may provide opportunistic investors the potential to reposition from a protective to reward-seeking posture.

But for many investors, the concept of adding portfolio risk, especially after such a difficult market period, can be a scary proposition. However, risk is not always a bad thing. In fact, the word risk has two broad synonyms: danger and opportunity. While most investors equate the word risk with danger, LPL Financial Research would argue that risk taking at the right time can bring great possibility, or better phrased, a great opportunity. Almost nothing is for certain in investing, but something that is for sure is: an optimal portfolio strategy employs risk aversion around danger and opportunistic risk taking when the horizon begins to clear up.

If we use one of the most common measures of investment risk, the statistical calculation of standard deviation, which measures the volatility of an investment, it is interesting to note that when risk is highest, the market does not necessarily return its lowest rates of return. In fact, risk can be elevated in both rewarding and disappointing return environments. Why would this be the case if danger was not always present, as during some periods of elevated risk, the market was actually rewarding investors with strong relative performance?

The answer is that when risk spikes in non-danger periods in the market, it is just a signal of the other definition of risk: opportunity. Taking risk is not a bad thing, it is just important to take the right risk at the right time in the right manner. Just as swimming in the waters of Cape Cod is not a bad idea, it is just important to pick the right time to do it—winter would be a very bad idea—or how to do it—ease into the water, don't jump in. The same can be said for investing. Risk is simply a knob that can turn from danger to opportunity. When the knob faces danger, risk aversion is the strategy, but when the knob starts to turn towards opportunity, portfolios should also migrate from a protective to risk taking stance.

But just because the market seems to be favoring a more opportunistic portfolio posture, it does not mean danger is no longer present in the markets. Despite sunnier weather, the economic waters still remain cool and a head first dive is not the best way for most investors to enter. In fact, many elements of the economy still remain sluggish or even worsening, albeit at a slower rate. But what it does indicate is that the risks are now, for the first time since late 2007, tilted towards opportunity versus danger. Nonetheless, prudent portfolio management techniques are still required to assure a balanced portfolio aimed at healthy risk taking in areas that provide the best risk/reward prospects. Remain broadly diversified*, dollar cost average** into positions, and remember, only take on the amount of risk that still permits a sound night's sleep consistent with your long-term financial goals. This is not the time to dive head first into risk, but rather wade slowly into the sea of opportunity.

Adding to risk in such uncertain times can feel like an uncomfortable strategy. But always remember that while it is the prudent strategy to employ risk aversion around danger, it is equally important to long-term success to undertake risk taking when the environment changes from danger to opportunity. While tough days remain for the economy, the backdrop has improved and the forward looking market appears poised to begin its long Road to Recovery to retrace its 2008 losses. By following your financial advisor's roadmap to re-engage risk, the "slow walk" from risk aversion to risk taking can help your portfolio benefit from the transition from frigid waters to refreshing opportunities.

Enjoy the summer "down the Cape."

Best Regards,

Burt White
Chief Investment Officer
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