ALL STAR QUARTERLY

THIRD QUARTER 2010

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2010 – 3RD QUARTER REVIEW AND PREVIEW

BOB'S CORNER

Create a Path of Less Volatility!

As we have promised many times in the past, reducing volatility in your portfolio creates a better compounding effect on your dollars. This in turn, creates efficiency and you will have more money in your bucket than someone who took on 100% of market risk. The market will continue to gyrate up and down as the economy works its way through the current consolidation phase of the cycle. Please see page 4 for more details on how this reduction of risk has benefited you.

Tax Advice Before It's Too Late!

Just a reminder, Kris Collins our in-house CPA is ready to answer any and all tax questions that you may have. The fourth quarter is an important time to plan from a tax perspective (reduce quarterly estimates, tax harvesting of losses or gains, etc…) The majority of the public use their accountant, after the fact, to do their tax filing but not manage the tax aspect before the year is on the books. A little over 50% of our clients are using Kris and I know that you would benefit tremendously from the seamless money/tax management of your portfolio. Please call and set up a time before year-end to review your tax situation.

Good Bye Recession – Hello To Slow Recovery!

MARKET OVERVIEW

Overview

What we've suspected for some time was finally confirmed by the official scorekeeper of economic cycles – the National Bureau of Economic Research (NBER). They declared in September that the "Great Recession" ended all the way back in June 2009. Most people may not have noticed given the tepid pace of the economy in recent months. Along with this slow growth pattern, consumer sentiment reached its lowest levels in close to a year, mainly because the housing market remains in the doldrums and unemployment is stubbornly high.

While the environment in the closing months of summer and the beginning of fall was full of fear and uncertainty, the stock market managed to climb the walls of worry. Markets generated double-digit gains for the quarter, driven by the best-performing September since 1939. Despite all of the bad news, investors were encouraged by continued strength in corporate profits, thriving bond markets and the surprising trends in interest rates and inflation that remained near all-time lows.

Despite the tortoise pace of economic growth, the risk of a double-dip recession does not appear to be a likely outcome. As investors sort through economic data, these mixed signals will keep the markets in a volatile state at least until we see more sustained improvement in both the housing and job markets.

ECONOMY

THE 3RD QUARTER

Any boost the economy gained from the 2009 American Recovery and Reinvestment Act (also known as the "Stimulus Package") seems to be fading. The nation's economic growth, as measured by Gross Domestic Product, slowed to 1.7% in the 2nd quarter, while the growth rate for the year is projected to fall between 2% and 3%. In spite of the frustratingly slow progress and recent mixed data most economic trends have been moving in the right direction, showing signs of significant improvement from the depth of the recession.

In spite of some job growth, unemployment is at 9.6% and has barely budged since the beginning of the year. Mortgage delinquencies are at 9.9% and with almost 12 months of housing inventory on the market, the real estate market will still take years to heal.

The ISM Manufacturing and Service Indexes are gaining ground, but not at the pace they achieved in the early stages of the economic recovery. Chain store and retail sales remain flat, an indication that consumers continue to focus on paying down existing credit. Construction spending and durable goods orders have also flattened out in recent months. Even though Moody's Risk of Recession indicator rose to 33% in the 3rd quarter, a double-dip recession seems unlikely.

Perhaps the biggest hurdle for the economy today is confidence. Businesses need to feel more assured that hiring will be warranted. Consumers are looking for signs that they can safely increase spending without risking their personal financial security. The Federal Reserve has indicated it hopes to provide more monetary stimulus. But short-term fiscal stimulus seems less likely with Congress likely stuck in gridlock until the mid-term elections are resolved in November.

INSIDE…3RD QUARTER REVIEW AND PREVIEW CONTINUED…PERFORMANCE SUMMARY

LOOKING AHEAD

Given the depth of the recession, the pace of the recovery has been disappointing by historical measures. We expect the economy will continue to make a long, slow, gradual recovery, with slower growth than what we have been used to in the past. There is also a lot of uncertainty coming during the final quarter of 2010. The next three months could bring more or less clarity to our future depending on three issues.

Some of the things we are watching in the coming months include, 1) *Earnings reports*-companies have begun to slightly lower their profit and revenue forecasts in recent weeks, a possible cause for concern; 2) *Mid-term elections*-the results could dramatically change the complexion of fiscal economic policy going forward, and 3) *Holiday sales*-temporary holiday hiring should boost employment, but will the consumer be willing to spend this year? We have maintained some tactical cash and rebalancing flexibility until these events play out at year end.

BOND MARKET

THE 3RD QUARTER

Bond markets enjoyed another quarter of solid performance as investors kept pouring money into fixed income investments, a sign that investors remain risk averse. The Federal Reserve's apparent commitment to low short-term rates in the current economic environment is helping to keep interest rates down across the board.

The Barclays Aggregate Bond Index rose 2.48%. Long-term government bonds gained 5.26% as they benefited from investors' flight to safety and the Federal Reserve's plan to buy more Treasury securities. Credit related bond sectors were also solid during the quarter. Emerging Market bonds gained 8.33%, High-Yield bonds were up 6.71% and Multi-Sector bonds returned 5.07%. World bonds gained 7.30%, benefiting in part from a weaker dollar during the quarter.

Although local governments were issuing more bonds to deal with budget shortfalls, Municipal bonds still rose 3.40%. Demand for inflation-protected bonds remains high despite a very low level of inflation in the current economic environment. This helped Treasury Inflation Protected Securities (TIPS) to gain 3.26%

LOOKING AHEAD

Even with interest rates at historically low levels, there seems to be little immediate risk that rates will move significantly higher. Investment Grade, Corporate High Yield and Emerging Market bonds are likely to grind out modest gains as interest rate spreads approach historic norms. Our current bond exposure features all three of these sectors.

In addition to the domestic market, Emerging Market bonds appear to offer a uniquely attractive opportunity in the bond market. They should benefit from favorable growth rates, improved credit ratings and lower debt/GDP ratios in many developing countries. Emerging markets, in many ways, are in a better financial condition than developed countries, many of which face significant debt issues.

Currency moves can also have an impact on bond returns, particularly on overseas positions. Japan has intervened to weaken the yen, which helps Japan's exports. At the same time, pressure is growing on China to allow its currency, which has been kept artificially undervalued, to appreciate. Even though we do not subscribe to this thought process, many investors are reacting to currency moves and higher government deficits by moving money into gold as a hedge against broad currency devaluation.

DOMESTIC STOCK MARKET

THE 3RD QUARTER

In an environment of general gloom and uncertainty, the stock market showed a resiliency that produced a very positive quarter which helped it move back into positive territory for the year. Investors were encouraged by strong corporate profits, as many companies are carrying high cash levels and low interest on debt. Merger and acquisition activity is also on the rise, which helps support stock prices.

Gains were broad based, with all industry sectors ending the quarter with positive returns. Leading the pack were Telecom stocks +20%, which appealed to investors looking for attractive dividends, and Materials stocks +19%, benefiting from strong demand from China and other emerging markets. The weakest-performing sectors also did well, as Healthcare stocks rose + 9% and Financial issues gained +5%. Companies in both sectors are still trying to determine the potential impact of recently enacted legislation.

Growth style stocks fared better for the quarter, gaining +13.0% compared to +10.1% for value style stocks. Mid-cap stocks returned +13.3%, outpacing large caps and small caps which returned +11.6% and +11.3% respectively.

Performance Update

Market Index	3rd Qtr	YTD	1 Year	2 Years	3 Years	5 Years
DJ Ind Average	11.15	5.58	14.12	2.77	-5.39	3.11
S& P 500	11.30	3.89	10.13	1.34	-7.18	0.62
Russell 2000	11.29	9.12	13.35	1.25	-4.29	1.60
S&P Mid-Cap 400	13.12	11.57	17.78	6.82	-1.67	3.77
Russell 3000	**11.53**	**4.78**	**10.96**	**1.90**	**-6.59**	**0.92**
MSCI EAFE	16.48	1.07	3.27	3.25	-9.51	1.97
MSCI Em Mrkt USD	18.03	10.75	20.22	19.64	-1.48	12.74
NASDAQ Comp	12.30	3.89	11.60	6.65	-4.29	1.94
Barclays High-Yield	6.71	11.53	18.44	20.37	8.75	8.37
Barclays Agg Bond	2.48	7.94	8.16	9.35	7.42	6.20
Barclays Credit Index	4.07	9.09	10.84	13.97	7.90	6.38
Barclays Gov Bond	2.52	8.05	6.97	6.85	7.20	6.10
Barclays Corp	4.64	10.53	11.67	15.51	8.30	6.48

The above annualized total returns and betas represent All Star Financial models. Your actual beta may differ depending on your portfolio holdings.

LOOKING AHEAD

Even after September's rally, stock valuations remain below historical averages. In addition, the current environment with low inflation and interest rates also typically work in favor of the stock market.

Even though the cyclical growth sectors such as technology, financials, healthcare and materials remain well positioned going forward we believe the profit recovery for most of these areas, particularly financial stocks, will be gradual. We expect small-cap stocks to re-assert their market leadership as the recovery matures.

Wall Street analysts continue to expect double-digit profit growth along with single-digit revenue growth when 3rd quarter earnings reports are released. A potential concern is that earnings estimates have been lowered in recent weeks due to the continued sluggishness of the economy. Many strategists warn that it is difficult to generate 12% equity returns in an economy that is expected to grow by only 2% to 3% in coming years. This should be the kind of environment that rewards dividend-paying stocks.

INTERNATIONAL MARKETS

THE 3RD QUARTER

Overseas markets outpaced the U.S. stock market in the 3rd quarter as both developed and emerging markets rallied. The MSCI World Ex-U.S. Index gained 15.47% for the period while the Developed Market EAFE Index was up 16.48% and the Emerging Markets Index gained 18.03%.

European stocks rebounded strongly in the quarter due to strong export growth and booming business confidence centered in Germany that boosted the rest of the region. Economic growth also picked up in France and Italy while other parts of Europe continue to struggle with sovereign debt issues and union strikes also had a negative impact.

China, India and Brazil were among the best performing nations among emerging markets. Latin American stocks were particularly strong, rising 21.0%, thanks to Brazil's stable finances and record low unemployment. Asian stocks (ex-Japan) gained 16.4% as China, India and other Asian economies enjoyed continued to benefit from dynamic growth. Japan's market lagged, with a return of 5.8% as issues about the country's aging population and strong currency continued to create headwinds.

LOOKING AHEAD

Eight months ago, we tactically added more Emerging Market stocks as part of our foreign market allocations. This is paying off as China and Brazil remain the leading players in the emerging markets, with South Korea also demonstrating strong growth. We will also look to add small cap positions as a complement to our core Emerging Market holdings in the near future.

The economies of Europe and Japan remain important on a global scale, but both face similar deficit and demographic issues that could limit future growth. We've modestly trimmed exposures to both of these areas to reflect the structural challenges that await them. The European debt crisis showed signs of fading, as Spain, Ireland and other troubled nations were able to successfully access bond markets during the quarter. The Euro region should benefit from German export strength and improving conditions in the United Kingdom.

SUMMARY

It is no surprise that the biggest issue as 2010 winds down is the state of the economy. The headwinds are significant as challenges related to the large inventory of housing foreclosures and high unemployment still exist. The inability of our economy to create new jobs for the 8 million who are unemployed is very unsettling.

The 4th quarter begins with notable uncertainty regarding the political landscape, future tax and regulatory policies, and concerns about the ability of consumers to spend sufficiently to avoid a disappointing holiday sales season. Meanwhile, the Federal Reserve seems to have limited options to spur economic growth and the federal government is trying to balance tax and budget policies in a way that avoids a policy error that could hasten another economic downturn.

We have maintained a tactical cash position that will allow us to rebalance when these events play out. Despite the potential obstacles, there are a number of factors that give investors encouragement. Regarding the election, the stock market doesn't care which political party is in power. Historically it has rallied after mid-term elections. More important, stocks appear relatively cheap, and with bond yields moving lower, equities are rather attractive in the months ahead. Keeping their risk tolerance in mind, long-term investors should stay invested and consider the themes that are playing out in our global markets.

Does The All Star Discipline Payoff?

While contemplating on what to write for the fourth page of our 3rd quarter newsletter, I thought it would be interesting to review our back page topics over the past 3+ years. During this time, we have witnessed more volatility in the global equity markets than ever before. **So, what did we say and did it help?** Here are the themes in order:

All Star Newsletters Fourth Page Topics

Q1-07	"It's not how much you make, its how much you keep!"
Q2-07	Why use more international stocks in your portfolio?
Q3-07	Don't fight the Fed. Lowering interest rates is always good!
Q4-07	Volatility in daily markets more than ever before?
Q1-08	How much did you keep since the market peaked?
Q2-08	Is today a good time to buy?
Q3-08	What is happening and has this happened before?
Q4-08	Why stay invested?
Q1-09	What type of investor are you – stay the course!
Q2-09	Can history help forecast our future?
Q3-09	Does strategic and tactical asset allocation work?
Q4-09	Going global for the next decade!
Q1-10	Economic cycle shows hope ahead!
Q2-10	Are investors buying high and selling low?

As you can see, the common themes have been focused on a proactive, global, and value-driven asset allocation discipline to reduce volatility. We are proud to point out that our aggregate portfolio has outperformed the market with less volatility so far in 2010. Looking at the last three years, we have produced an annualized alpha (the difference between a portfolio's actual returns and its expected performance, given its beta) of 4.30% for the income portfolio, 2.70% for the balanced portfolio, 2.13% for the conservative growth portfolio, and 1.58% for the growth portfolio. Over a three year time period, that means we have produced somewhere between 4.7% and 12.9% excess return for the risk that you took. **This is having your cake and eating it too!**

So what does this mean in terms of your dollars? The less volatile path that our clients have experienced has lead to higher balances in their accounts than they would have accrued if they held a Russell 3000 Index fund. These higher balances are all after fees as well. We will continue to use our proactive, global, and value-driven asset allocation discipline to help bring more alpha to the table.

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