ROCKBRIDGE INVESTMENT MANAGEMENT, LLC

Financial Common Sense

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Rockbridge Investment Management is a group of like-minded professionals working with a select group of clients with whom we can have a significant impact. Everything we do is focused on building and preserving wealth for our clients. We help remove complexity so clients can focus on the simple but difficult process of successful investing.

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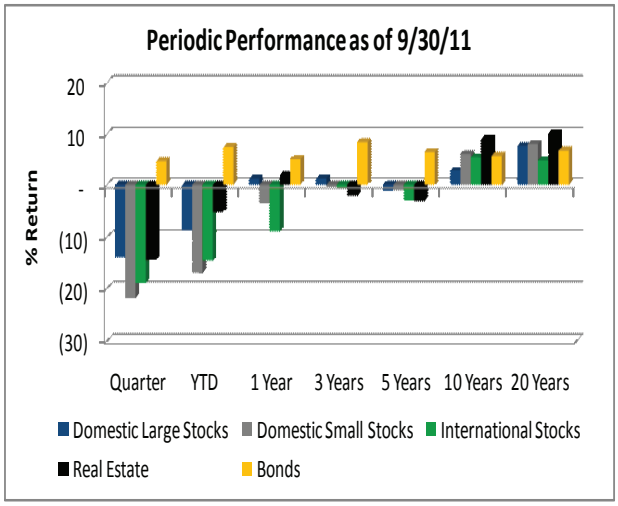
Market Commentary by Craig Buckhout

Renewed fears of a double-dip recession, policy paralysis across the U.S. and Europe, and the looming threat of a financial crisis in the euro zone combined to create very volatile markets and a devastating quarter for equities.



Equity Markets

The third quarter of 2011 saw the value of small stocks and international stocks fall more than 20%, which is generally considered a bear market correction. Large domestic stocks (S&P 500) did a bit better but fell nearly 14% in the quarter, dropping into negative territory for the year at -8.7%.

Fixed Income

Government bonds, on the other hand, had a stellar quarter, defying logic and many experts' expectations, by rising in value after S&P downgraded the U.S. Government debt rating. The broad bond market index, which is dominated by government securities, rose 4.7%. The value of TIPS (Treasury Inflation Protected Securities) rose even more than the general bond market, as hope for economic recovery diminished, and action by the Federal Reserve drove expectations for real interest rates further into negative territory. Based on the pricing of Treasury securities, and TIPS, the market now expects inflation to average less than 1.8% over the next ten years with ten-year government bonds providing a return above inflation of a meager 0.20% on average. Government bonds of shorter maturities are expected to provide returns less than inflation, so investors' purchasing power will diminish.

Return Expectations

We cannot predict future returns, but it can be instructive to examine assumptions built into current market pricing. As mentioned above, the expected return on ten-year government bonds is barely above the expected rate of inflation, driven by dismal expectations for economic recovery, extremely accommodative monetary policy, and fear of another financial crisis coming out of the euro zone. This is well below the long-term average, which is about 2% above inflation.

Stocks on the other hand appear priced to provide future returns more consistent with their long-term risk premium of 6-8% above inflation. The S&P 500 index is at a price level first achieved in 1998, but since that time the Price/Earnings Ratio for the index (price paid per dollar of expected earnings) has fallen dramatically. So today's price reflects a lower, and perhaps more realistic, assumption of growth in dividends and earnings.

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Market Commentary (cont.)

Five Reasons You Should Not Panic in the Face of Market Volatility

1. It is not really "different this time." Vanguard, in a recent study entitled "Stock Market Volatility: Extraordinary or 'Ordinary'?", concludes that recent volatility appears extraordinary compared to the relative calm of the markets in 2010, but is in fact "ordinary" when compared to similar periods characterized by major global macro events – they cite the Asian currency crisis of 1997, the Russian debt default and bailout of Long-term Capital Management in 1998, the tech market bubble (2000-2002), and of course the financial crisis of 2008-2009. Market volatility spiked in similar ways during each of these events as markets tried to re-price risk in the face of startling new information. This time it is political paralysis and the European sovereign debt crisis. So the reason is different, but the market reacts to crisis in similar fashion, over and over again.

2. Diversification provides a remarkable amount of protection from volatility. Information in the charts at right is taken from the same Vanguard study mentioned above.

3. The only way to fully participate in the up days is to be able to withstand the down days. Volatility refers to moves in both directions.

4. Remember that you are investing and not trading. "Sitting out" the current volatility is an appealing notion, but timing the market is something better left to speculators and traders. Trying to benefit from correct predictions of short-term moves in the market is not a long-term investment strategy.

5. "The market has been volatile and just dropped dramatically – what do I do now?" This is a bad question and bad questions do not lead to good investment decisions. A better question would be, "Am I still taking an appropriate amount of risk considering my goals and time horizon?"

Sticking to your disciplined investment strategy is a better response than panic. When stock prices tumble and bond prices soar, it provides an opportunity to rebalance your portfolio by taking some profits from the bonds and buying stocks at reduced prices. ◆

Volatility of U.S. stocks versus balanced portfolios 2006-2011

Number of days up or down per return threshold

S&P 500 Index			
	1%	3%	5%
All	443	67	18
2006	30	0	0
2007	63	1	0
2008	129	39	14
2009	108	14	3
2010	67	6	0
2011	46	7	1

40% S&P 500/60% Barclays Capital U.S. Aggregate Bond Index			
	1%	3%	5%
All	104	2	0
2006	1	0	0
2007	12	0	0
2008	44	2	0
2009	27	0	0
2010	12	0	0
2011	8	0	0

Note: This hypothetical illustration does not represent returns on any particular investment, as you cannot invest directly in an index. Portfolios are rebalanced on an annual basis. Data for 2011 are through August 30.

Sources: Vanguard calculations, using data provided by Thomson Reuters Datastream and Barclays Capital.

Patrick E. Rohe
CRPC®

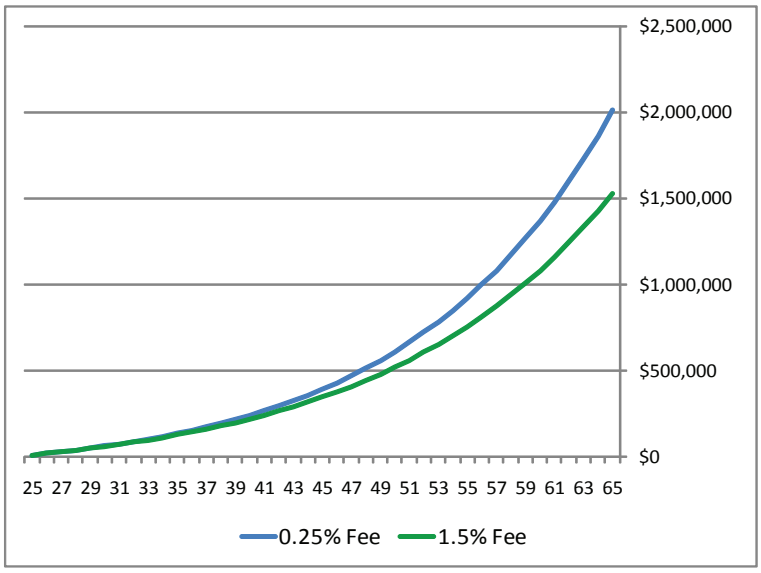
Don't Sweat the Small Stuff . . . Well Maybe Sometimes by Patrick Rohe

In the world we live in today, we are constantly reminded not to sweat the small stuff. We are told to not let the little things get in the way of living our lives and pursuing our dreams! That is so true and why we shouldn't worry about the gossip being spread around at work, what our neighbor might think if we can't get to mowing our lawn today, those stubborn few pounds we just can't seem to lose, and what outfit we should wear to the company's holiday party this year. All of these things clutter our mind on a daily basis and keep us from focusing on what's truly important. What about the costs associated with your investment portfolio? Your advisor may try to categorize these as "small stuff" as well, but should they?

Rockbridge Investment Management is a firm that prides itself on controlling the controllable when it comes to investing, thus addressing the issue of investment costs is something we don't take lightly. The average cost to invest in mutual funds with the typical brokerage firm is 1.5%, while here at Rockbridge the typical client pays around 0.25%. Are we just sweating the small stuff? Let's find out!

Let's take a look at an American family with a combined income of $75,000 who is saving 10% a year for forty years and is getting a fixed rate of return. Can an extra 1.25% in expenses make that much difference in their standard of living during retirement? The graph below shows the impact that fees can have on a portfolio – the results are staggering! The family with the low cost portfolio retired with over $2,000,000, which should allow them to comfortably draw around $100,000 from their portfolio each year during retirement! On the other hand, the couple who had higher portfolio expenses only accumulated $1,500,000 at retirement, giving them only a $55,000 draw from their account on an annual basis, after taking into account the lower balance and the higher continuing expenses.

The notion of not sweating the small stuff is very important; it helps cancel out the everyday noise in our lives, allowing us to focus on living and pursuing our dreams. However, most of our dreams include a comfortable and fulfilling retirement, and a nearly fifty percent reduction in retirement spending may be a factor in that dream being reached. But I will let you be the judge of that!◆



(Assumptions: A couple saving $7,500 annually for 40 years with an 8% fixed rate of return. To make withdrawal rates equal in retirement, I used a 5% withdrawal rate for the low cost portfolio and reduced the other portfolio's rate by the difference in fees.)

Social Security and Medicare Decisions on the Horizon for Baby Boomers by Anthony Farella

Two of the biggest concerns for aging baby boomers are longevity risk (i.e., not outliving your money) and rising healthcare costs. Social Security and Medicare are programs that we all pay into and expect to partially address these concerns. Social Security is often a cornerstone of a well thought-out retirement plan. It is adjusted for inflation, is tax-advantaged, will continue as long as you live and is backed by a government promise.

Social Security

Deciding when to start Social Security benefits is one of the most important decisions aging baby boomers will make. The Social Security Administration (www.ssa.gov) has a wealth of resources available online. And the local office representatives can provide the facts given your own personal circumstances. However, they will not give you advice on when to start taking Social Security. Our firm took a look at the options and summarized the information in a recent blog post on our website (www.rockbridgeinvest.com).

While we are not experts on all aspects of Social Security, we can help evaluate your options and provide excellent resources to assist you with making this very important decision.

Medicare

Retiree healthcare costs are also a major growing concern for baby boomers. Many will delay retiring to age 65 when they become eligible for Medicare health benefits. Our resident expert, Dick Schlote, has been navigating the Medicare maze for the past few years and has agreed to write a series of blog posts on the subject. You can find his first Medicare blog post on our website (www.rockbridgeinvest.com).

Our main job at Rockbridge is to prudently manage our clients' investment portfolios. We also strive to expand our knowledge in other important areas of financial planning, such as Social Security and Medicare. We continue to develop our website into an excellent resource for our clients and friends of the firm.◆

Returns from Various Markets

The following table shows the returns from various markets over periods ending September 30, 2011:

Market/Asset Class	Quarter	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
Money Market	0.0%	0.1%	0.1%	0.2%	1.7%	2.0%	3.5%
Bond Market	4.7%	7.5%	5.1%	8.4%	6.5%	5.7%	6.8%
Large-Cap Stock Market	-13.9%	-8.7%	1.1%	1.2%	-1.2%	2.8%	7.6%
Small-Cap Stock Market	-21.9%	-17.0%	-3.5%	-0.4%	-1.0%	6.1%	8.0%
International Equity Market	-19.0%	-14.6%	-8.9%	-0.7%	-3.0%	5.5%	4.9%
Real Estate	-14.5%	-5.2%	1.9%	-2.2%	-3.2%	9.1%	10.2%
Inflation	0.3%	3.4%	3.8%	1.1%	2.1%	2.5%	2.6%

Market Benchmark Portfolios

The following table shows returns from our market benchmarks over periods ending September 30, 2011:

Benchmark	Quarter	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
Capital Preservation	0.6%	2.4%	2.3%	4.2%	3.7%	4.0%	5.2%
Conservative	-3.0%	-0.1%	1.9%	4.8%	3.4%	4.6%	6.4%
Moderate	-6.6%	-2.8%	1.2%	4.9%	2.7%	5.2%	7.2%
Aggressive	-11.2%	-6.9%	-0.7%	3.0%	1.0%	4.8%	7.2%
All Equity	-17.3%	-12.7%	-4.0%	-0.3%	-1.8%	4.3%	6.8%

Note: These results were developed by simulating past returns in the various markets included in each benchmark, assuming the reinvestment of dividends and other earnings and deductions of costs totaling 0.20%. The money market is represented by 90-Day Treasury Bills; the bond market by the Barclays Capital Government/Credit Bond Index; the domestic large cap market by the S&P 500; the domestic small cap market by the Russell 2000 Index; and the international equity market by the EAFE Index. This data is presented to show the long-term relationship between returns at various levels of investment risk. It is not intended to present performance results experienced by clients of Rockbridge Investment Management, but is intended to provide a benchmark against which actual performance might be judged. Also, readers should recognize that future investments would be made under different economic conditions. It should not be assumed that future investors would experience returns, if any, comparable to those shown above. The information given is historic and should not be taken as any indication of future investment results.