SGL Investment Advisors, Inc.

SGL Investment Advisors, Inc. is a locally owned *Registered Investment Advisory* firm headquartered in Missoula, MT. SGL Investment Advisors, Inc.'s professional money managers, backed by 45+ years of collective experience, personally work with clients to individually structure their portfolios to fit within their risk tolerance profiles. They maintain an open door policy towards personal meetings throughout the money management process. Our in-house research department focuses on constructing portfolios that limit downside risk while maintaining an eye for capturing market upside. Our clients include institutional pension plans, trusts, non-profit endowments, 401K & profit sharing plans and high net worth individuals.

Structural Unemployment in global economies

Authored by Ather Bajwa, C.F.A.

The "great recession", as the last economic downturn has come to be known, ended in June of 2009. The contraction turned out to be the worst since World War II, lasting 18 months in the US and 15 in the Euro-Area. Although most global economies have bounced back significantly since the end of the recession, one aspect of the recovery (particularly in the US) that continues to be of concern is persistently high unemployment. Compared to other recent recessions rate of employment growth has been substantially below historical trends (Fig 1) - since the beginning of the expansion, a net 330,000 jobs have been lost. The pace of hiring can be soft post short recessions, such as the ones after 1991 and 2001, however after long and deep recessions (such as 1982, 1970) the US economy has seen robust jobs recovery. By historical standards over two and a half million jobs should have been created by now. Where then is the disconnect?

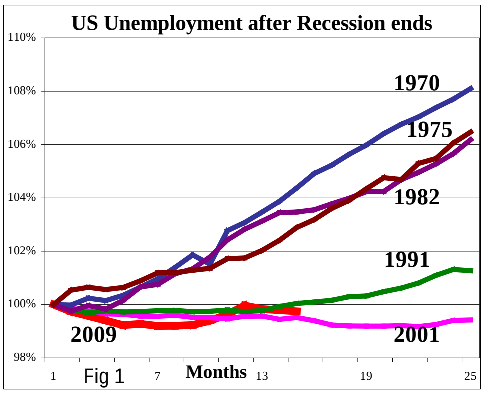


Fig 1

The American economy lost approximately 8 million jobs during the recession; almost half were shed by the construction and manufacturing industry. The skills of these 4 million or so workers are geared towards industries that have seen little positive impact from the recovery (see next article). These workers are ill equipped to find meaningful employment in growing industries such as Information Technology and Health Care. Among the out of work almost half are long-term unemployed (26-weeks or more), pointing to a disconnect between jobs available and skills possessed. Along with dearth of modern skills required, another critical issue is that of their personal housing crisis. Many families are tied to their houses and are unwilling to move, this mobility-drag is causing a significant impact on job miss-match where instead of foreclosing or selling their homes at a loss and moving to a place with better job prospects, many families are staying put. Businesses too are being extremely cautious with regards to the recovery; very few have indicated a desire for expansion or hiring. Citing uncertain business environment, public companies have announced an increase in share buy-back of over a $100 billion compared to 2009 – why invest when one can increase earnings by repurchasing stock.

On a global scale, economies that, like the US, had large real-estate bubbles, financed largely by expanding credit and low inflation, have been the largest laggards in creating employment (Fig 2). Countries like Portugal, Ireland, Iceland, Greece and Spain (so-called PIIGS) are still struggling with large budget deficits, rising borrowing costs and near zero economic growth. Without excess real-estate inventory reduction and further labor reforms, such countries will likely continue to struggle. Emerging markets, which largely sidestepped both the credit crisis and the real-estate bust, continue to perform extremely well – supporting budget surpluses, increasing domestic demand and strong industrial production.

Unemployment Rate	Jun-07	Jun-08	Jun-09	Jun-10
Australia	4.3	4.2	5.8	5.1
Brazil	9.7	7.8	8.1	7
Canada	6	6	8.6	7.9
France	8.4	7.7	9.5	10
Germany	8.4	7.3	7.7	7
Greece	8.4	7.5	9.2	n/a
Ireland	4.6	6	12.1	13.3
Italy	6.1	6.9	7.8	8.5
Japan	3.7	4	5.3	5.3
Netherlands	3.3	2.7	3.4	4.4
Portugal	8.3	7.8	9.7	10.8
Spain	8.1	11	18.1	20
United Kingdom	5.3	5.4	7.8	n/a
United States	4.6	5.5	9.5	9.5

Source: IMF

Fig 2

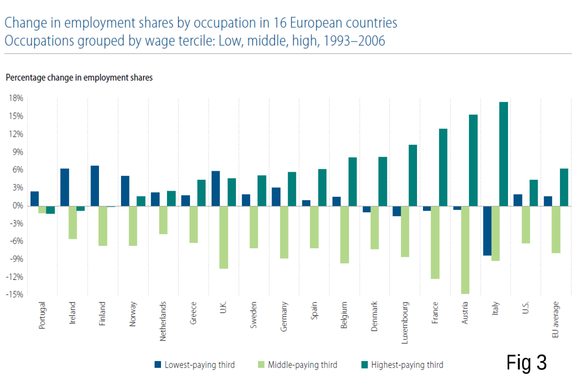


Fig 3

Over the past several years questions regarding skills available, jobs created and real (inflation-adjusted) wage growth have come to the fore. The number of middle-class jobs (e.g. salespeople, secretaries, factory supervisors) available have not only declined, but real-wages have fallen significantly as well. This phenomenon is true in countries with varying levels of unionization, economic competitiveness and welfare systems (Fig 3). Real wages have grown significantly for both low skilled workers (e.g. custodians, bus drivers) and high-skilled ones (e.g. lawyers, engineers, health professionals) largely because their jobs cannot be automated or easily outsourced. Many middle-class skills such payroll specialist (replaced by accounting software), bank tellers (ATM and online access) and machine operators (outsourced) have been significantly impacted both by increased trade (shifting production to Asia or Latin America) and increased IT sophistication. Without significant changes to the way our workforce is educated and tooled with the right skills to deal with a challenging and ever changing economy, we will continue to have significantly high unemployment and large number of under-employed workers. If we include discouraged workers and the underemployed, the US unemployment rate currently stands around 17%.

SGL Investment Advisors, Inc.

Current Portfolio Strategies

Released October 2010

GROWTH + PORTFOLIO

Designed for the risk tolerant investor with a mid to long-term investment time horizon

Targeted Performance in a Market Cycle: greater than 100% of S & P 500 upside performance with 100% market risk

Approximate Average Equity Beta (**β**) > 1

Current Allocations (appx.); 85 % stocks, 7% fixed income, 8% cash

Strategic Outlook; Although generally more growth story focused, the Growth + portfolios have recently taken an incrementally more income orientated approach to equities. As the bond market continues to rally with vigor and banks offer very little in terms of yield on savings, some investors might eventually rush to undervalued equities with attractive dividend yields. Some equities trade at levels that generate dividend yields that exceed their mid to long term borrowing rates. This dynamic is highly atypical, and could cause a rush into these dividend stocks – subsequently pushing up prices.

Recent Purchases; Old Republic Intl (ORI) is an example of that type of strategy. ORI was founded in 1887, and has marketed and underwritten a broad range of insurance products for well over a century. ORI is a very well established company within its business niche, and is unlikely to set the proverbial world on fire from a growth perspective. ORI does however offer investors a dividend yield well north of 5%, and a 10 year dividend growth rate of 13%! In this yield starved environment, ORI looks attractive.

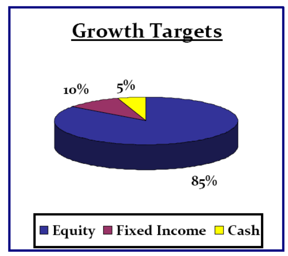
GROWTH PORTFOLIO

Designed for the risk tolerant investor with a mid to long term investment time horizon or a risk neutral investor with a long-term outlook

Targeted Performance in a Market Cycle: 100% of S & P 500 upside performance with 85% downside risk

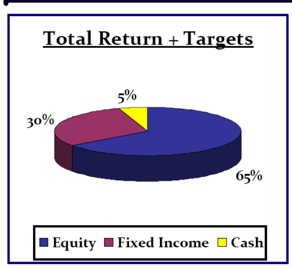
Approximate Average Equity Beta (β) >/= 1

Current Allocations (appx.); 85% stocks (E/W), 10% fixed income (E/W), 5% cash



Strategic Outlook; As the market stayed roughly range bound through the summer, SGL had success in incrementally working that range in the Growth portfolios. By slightly trimming allocations after rallies and lightly raising allocations in pullbacks, we were able to achieve targeted portfolio performance over the interval. Via this ebb and flow strategy, SGL has also been working to increase the dividend income generated by the Growth portfolios.

Recent Purchases; Accentuating our very conservative approach to the American consumer and the consumer discretionary sector in general, SGL recently purchased Aeropostale (ARO) in some accounts. ARO was spun off of Macy's in 1998, and has performed admirably since then. ARO now operates over 900 stores in the United States and Canada. ARO operates with no long-term debt and has generated a 5 year earnings growth rate of over 30%. At the time of intial purchase, ARO was trading around 8X forward earnings – a sharp discount to the market. That sort of growth rate/earnings multiple discrepancy provided an attractive value entry point opportunity for our clients.



TOTAL RETURN + PORTFOLIO

Designed for the risk tolerant investor with a mid term investment time horizon or a risk neutral investor with a mid to long-term outlook

Targeted Performance in a Market Cycle: 80% of S & P 500 performance with 60% downside risk

Approximate Av**erage Equity Beta (β)** = 1

Current Allocations (appx.); 62% stocks (E/W), 36% fixed income (E/W), 2% cash

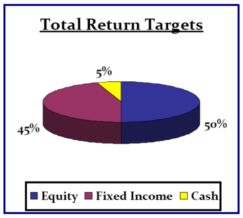
Strategic Outlook; Similar to Growth, we endeavored to 'massage' the Total Return + portfolios through the range bound motions of the summer market. We continue to refocus our efforts on income in both the equity and bond portions of the Total Return + portfolios. In many of our portfolios, the dividend yield of the equity portfolios exceeds the 10 year Treasury yield. This is a rare opportunity. In normalized markets, the S&P 500 dividend yield rarely approaches that so-called 'risk free' Treasury yield. We've attempted to maximize income by incrementally moving more and more into high dividend yield equities.

Recent Purchases; In order to both increase the current yield of the Total Return + portfolios and to provide some short term protection against market rates pushing upwards, SGL recently purchased some Ford Motor Credit bonds that mature in January of 2012. The bonds pay a coupon equal to 3 month LIBOR (3ml) + 2.75%. Purchased at a discount, the bonds offered a total return package equivalent to other Ford bonds that did not carry the same defensive floating rate protection. If, prior to maturity, the Fed makes a move on short term borrowing rates (commonly reflected in LIBOR) or if risk premiums expand dramatically as they did in late 2008 – this bond's floating coupon should absorb some of the impact of those scenarios. Although Ford still carries a heavily leveraged balance sheet, the company survived the credit crisis without needing government funds and has since worked diligently to trim excess inventories, expand it's global sales footprint and to meet the nascent but expanding demand for hybrids.

Current Portfolio Strategies

Released October 2010

Investment Advisors, Inc.



TOTAL RETURN PORTFOLIO

Designed for the risk tolerant investor with a limited investment time horizon, or a risk averse/neutral investor with a mid to long term outlook

Targeted Performance in a Market Cycle: 65% of S & P 500 upside performance with 50% downside risk

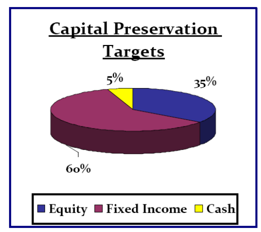
Approximate Average Equity Beta (**β**) </= 1

Current Allocations (appx.); 52% stocks (E/W), 46% fixed income (E/W), 2% cash

Strategic Outlook; Very strong performance from the fixed income component of the Total Return portfolios has helped to protect our clients from some of the volatility in the equity markets. We continue to harvest capital gains in the bond portfolios where appropriate and look to enhance the dividend yield on the equity side of the equation. As is the case with our equity management methodology, SGL is careful not to rush into any bonds that now appear overpriced due to the rallies in Treasuries.

Recent Purchases; JP Morgan recently issued a Certificate of Deposit (CD) that pays annual interest based on the performance of a basket of commodities. Since it is a CD, the return of principle at maturity is insured by the FDIC. It was purchased at a significant discount, adding to both the total return and current yield potential of the strategy. A CD such as this should try to beneficially pass on the effect of inflation, as commodity prices are one of the roots of inflationary tendencies.

CAPITAL PRESERVATION PORTFOLIO



Designed for the risk averse/neutral investor with a limited to mid-term investment time horizon

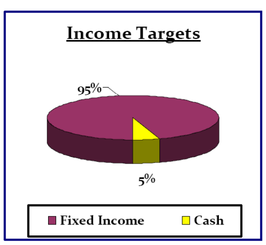
Targeted Performance in a Market Cycle: 50% of S & P 500 performance with 35% downside risk

Approximate Average Equity Beta (β) < 1

Current Allocations (appx.); 31% stocks (E/W), 61% fixed income (E/W), 8% cash

Strategic Outlook; In the Capital Preservation portfolios, SGL has continued to harvest gains on the equity side as we limit our client's exposure to volatility. We also continue to harvest significant gains in the fixed income portfolios – as the bond rally continues with vigor. A variety of high credit quality Build America Bonds (BABs) have recently been brought into the Total Return portfolios. Many of these were purchased very close to their initial offer date – prior to the bonds 'trading into' their normal position on the yield curve. Similar (although much less volatile) to a stock IPO, purchasing bonds as they are issued can benefit our clients.

Recent Purchases; In the midst of the scrutiny paid to Goldman Sachs on Capitol Hill in the spring, SGL was able to find an attractive entry point on some Goldman Sachs 5.625% due in January of 2017. On occasion, bonds will trade dramatically down on news headlines – not unlike a stock. As is true with equities, reaction can at times snowball into overreaction – and that offers our clients potentially attractive opportunities. Since the bad press around Goldman has settled down to some extent, the bonds have appreciated by 7%.



INCOME PORTFOLIO

Designed for the investor in search of current income and/or preservation of principal.

Targeted Performance: Customized income portfolios to meet a variety of income needs.

Approxima**te Average Equity Beta (β)** ~ n/a

Current Allocations (appx.); 76% fixed income, 24% cash

Strategic Outlook; As many types of fixed income continue to get more and more expensive, SGL has been patient in order to not rush into overpriced assets. In other words, we're picking our spots very carefully because of current market conditions. This is especially true of our more conservative Income portfolios as brokered CDs are currently trading with very little spread above Treasuries. As banks and other types of companies continue to refinance at lower and lower rates, the bond landscape continues to get more and more sparse from a yield perspective.

Recent Purchases; SGL has still been finding significant value in the near-high yield market. In addition to the Ford bond mentioned in the TR + section, we were also able to pick up a Morgan Stanley bond with an attractive floating component. Although certainly a high quality credit (A2/A), Morgan brought this bond out at 7% for two years and then 3 month LIBOR (3ml) + 2.00% until maturity. 7% on a credit of that quality is unheard of in any maturity in this market, and the floating component of the bond protects investors from rising rates. In either a scenario where the Fed begins tightening monetary policy (increasing rates) or if the risk trade comes back online in debt markets as in did in late 2008 – the coupon payment should help to pick up some of that slack.

(U/W) – Underweight relative to targets, (O/W) – Overweight relative to targets, (E/W) - Equalweight relative to targets

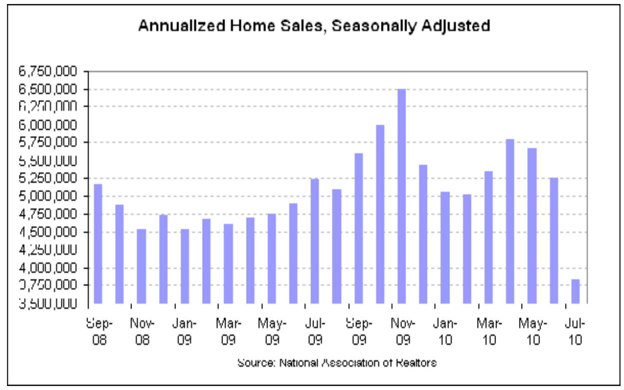
Beta (β) is a quantitative measure of a stock's volatility relative to the market as a whole (eg – a Beta of 1 implies that a stock historically has performed in exactly as volatile a fashion as the entire market)

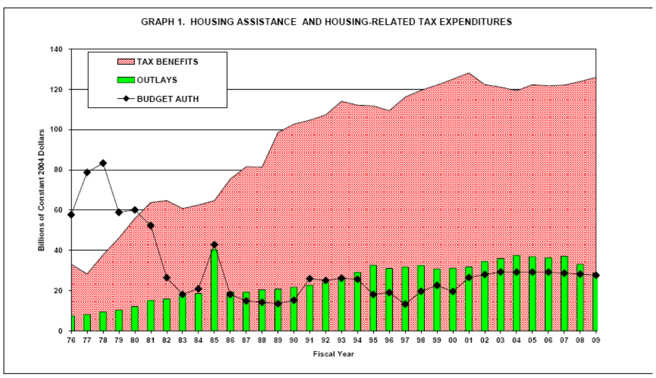
The Public/Private Housing Codependence Dynamic

Authored by Joshua Denney

I have been saying for a while that "this will end where it began" – that being the housing sector of the United States' economy. Multiple interlocking scenarios contributed to the credit crisis but none was more at the root than the US housing market. As the effects of deleveraging spread throughout the global economy, many sectors were impacted internationally but none more directly than domestic home prices. According to the S&P/Case Schiller index, home prices nationwide found a year over year trough at negative 20% in early 2009. The peak to trough fall was over 30%. Frankly, I could fire off frightening statistics until I was blue in the face (or fingers as it were) but we're all familiar with the housing driven devastation caused to personal balance sheets in the last few years.

Our collective hindsight is 20/20, the more interesting (and likely more relevant) questions are 'How bad IS it?" and what should be done, if anything, to spur activity in that part of the economy? Clearly, the homebuyer tax credit was a relative success in terms of utilization. We won't know with certainty until fiscal 2010 taxes are in, but almost 1.5 million credits were claimed as of March 2010. The number of homes sold in July of 2010, immediately after the expiration of the tax credit, generated a measly annualized seasonally adjusted number of 3.8 million home sales (see chart). The July total was the lowest annualized rate generated by the NAR since the creation of the study in 1999. The tax credit stimulated significant activity within a narrow price band, mostly houses that closed for under $250,000. Although that is of little help to beleaguered homeowners in more expensive markets, any and all transactions are welcome in this constrained environment.





Am I calling for more government sponsored housing stimulus? Not necessarily, although I do see it as a potential outcome if the housing market craters significantly again. What I'm primarily trying to point out is that the United States housing sector wouldn't exist in anything resembling its current form without substantial and ongoing government subsidization programs – both explicit and implicit. One could certainly argue that those stimulative programs built the foundation on which the housing bubble initially formed. From the deductibility of mortgage interest and some insurances (see chart) to the now formal commitment to prop up Fannie and Freddie (who collectively own or insure almost half of the outstanding mortgage debt in the US) to secondary support such as FHA and USDA Rural Development loan programs – Washington has clearly been focused on stimulating the housing market for long before the recent crisis began. Post crisis, Fannie and Freddie continue to supply around 75% of the funds flowing into the mortgage market.

It would be an oversimplification to characterize that support as unidirectional. It could be argued that the public sector is just as dependant on housing as housing is on government support. In a very direct sense, property tax revenue makes up a huge portion of most state and municipality's revenue stream. Rising property values directly translate into rising revenue for the non-Federal government system. Some would say the so called 'wealth effect' (central notion being the more wealthy we feel the more we spend) of the voracious American consumer is more dependant on housing wealth than any other individual component of personal net worth. This group would say that one of the single most important variables relative to how much consumer driven money circulates in the economy is linearly tied to housing prices. Therefore, housing price appreciation and domestic economic growth must be highly correlated phenomena.

In having a variety of conversations over the last couple of years as it relates to this public/private symbiosis, I have come to an interesting conclusion. I have noticed repeatedly that Americans (homeowners or not) simply have a difficult time conceiving of a governmental system that doesn't aggressively incentivize home ownership. This is perpetuated constantly via media stories that tout the tax benefits, federally subsidized or insured mortgages and government sponsored assistance programs as reasons why taking on a mortgage makes economic sense. Culturally, we as a country are simply very acclimated to a highly subsidized housing market. In the aforementioned conversations, people are often somewhat surprised to learn that this sort of accommodative public policy isn't necessarily the norm amongst developed nations worldwide.

Canada serves as an interesting example of contrast. For our northern neighbors, there is no federal deduction for mortgage interest - and as such no tax motivation to convert home equity into debt. Canada has no equivalent to Fannie/Freddie to provide funds to the mortgage market nor does it have anything resembling the Community Reinvestment Act to distort the pure economics of its housing sector. Banks largely hold the mortgages they issue on their balance sheets as opposed to selling them to servicers that would package them into CMOs. Canadian homebuyers are required to purchase mortgage insurance if they put less than 25% down at closing. The result of this less expansionary policy tilt? A predictably smoother trendline in prices. Smaller peaks and smaller valleys, a 'boring' chart if you will but perhaps preferable to the experience the US is currently undergoing. Both interestingly and not surprisingly, there is notable public pressure in Canada to make housing more affordable for potential purchasers – which is thinly veiled code for increasing government support for potential homebuyers.

So where does that leave us? Although the somewhat incestuous relationship between government and housing in the US is concerning and likely is partially responsible for the current economic environment, now would be the worst time possible to forcibly disengage from that symbiosis. Assuming we clear this economic 'soft patch' and resume a normal growth trajectory as a nation, those questions will require answers. But for now, government must stand ready to inject vitality into the real estate market as needed. At best, the housing market is limping along weakly despite historically low mortgage rates – traditionally one of the primary catalysts for home price expansion. All data out of the sector varies from luke-warm to downright concerning. As a result of the continued softness in domestic employment and housing, SGL Investment Advisors continues to favor consumer-facing stocks that should benefit from a constrained US consumer. Advanced Auto Parts (AAP) should benefit from Americans being forced to put off new car purchases and Family Dollar Stores Inc. (FDO) should benefit as consumers pursue lower price points for household staples and discretionary purchases. This approach has served our clients well and should continue to do so if current data trends continue.