QUARTERLY NEWSLETTER

January 16, 2013

Market Commentary:
Global equity markets experienced an overall rally during 2012, with foreign equities generally outperforming those based in the United States. Those that waited on the sidelines due to concerns over Europe and/or the "fiscal cliff" missed some truly impressive gains.

If you've worked with me for any length of time you'll be familiar with the *Table of Investment Returns* that I put together after the end of each year. I've included the most recent table at the end of this letter. I find it interesting that Emerging Market Equities were once again on top after being dead last in 2011, while the broad bond market was the worst performing asset class during 2012 after being very near the top for 2011.

A few things remain clear:

1. Bonds tend to be both the worst performer and least volatile (i.e, risky) asset class; except when equities are "falling apart". During those times bonds tend to be a top performer.
2. Relative equity performance appears quite random, but reversion to the mean causes eventual under and over relative performance over long periods of time.
3. Emerging market equities have been and likely will continue to be the most volatile broad asset class going forward.

Below are the cumulative returns of major market indices for the year ended December 31, 2012:

Benchmark	1 Year
S&P 500 Index[1]	16.18%
MSCI US Small Cap Value Index[1]	18.80%
MSCI EAFE Index[1]	17.32%
MSCI EAFE Small Cap Index[2]	20.00%
MSCI US REIT Index[1]	17.67%
MSCI Emerging Markets Index[1]	18.22%
Barclays Capital US 3-7 Year Treasury Bond Index[2]	2.19%
Barclays Capital US TIPS Index[2]	6.98%
Barclays Capital U.S. MBS Index[2]	2.59%
Barclays Capital U.S. 5-10 Year Corporate Index[1]	11.55%

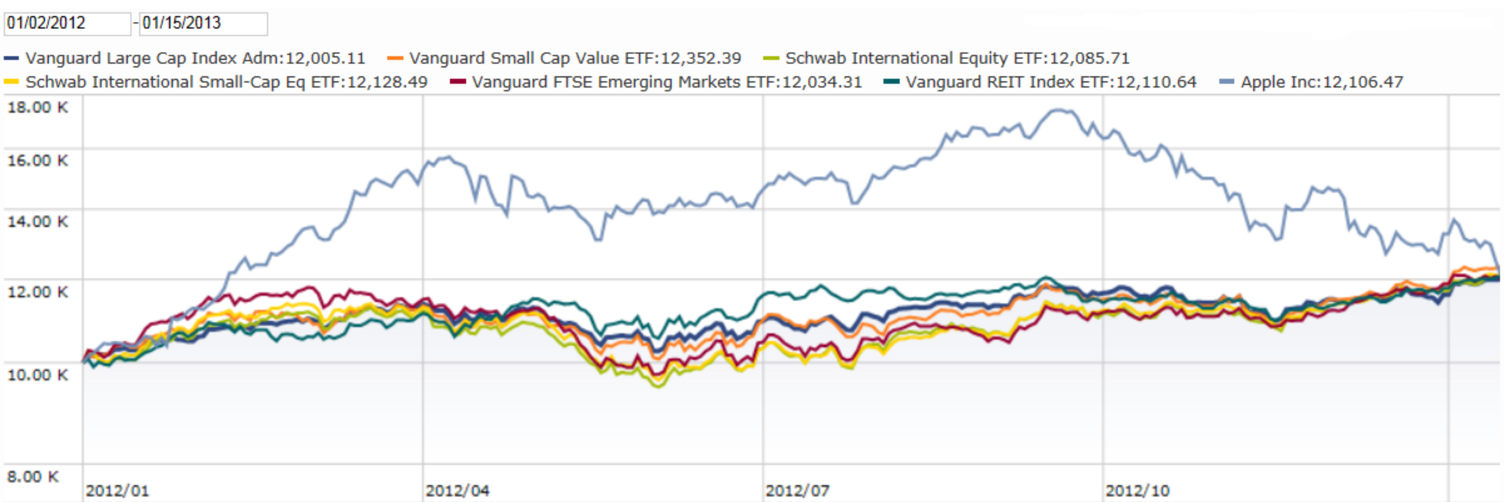
1 Source: Vanguard. Visit **www.vanguard.com** for a description of each index.

2 Source: BlackRock. Visit **us.ishares.com** for a description of each index.

Apple Inc.: A look back

2012 was an extraordinary year for Apple (AAPL) stock. By the end of the 1st quarter, AAPL had gained a whopping 48% for the year. If that wasn't enough, the year-to-date return was 65.4% by the end of the 3rd quarter! Unfortunately, the next 3½ months weren't so good for AAPL…

Below is a chart for AAPL along with equity funds I recommend. For the period AAPL was outperformed by three of the market index funds, while its outperformance of the other three was very slight. Along the way AAPL owners had a much bumpier ride; an important fact that should not be discounted.



Source: Morningstar®

So what's ahead for AAPL? AAPL has good products and ecosystem, but the high-end mobile market appears saturated and competitors ([especially Samsung]) are collectively squeezing what was once AAPL's competitive advantage. In fact, the iPhone 5 didn't even make it in the top three smartphones of a recent Consumer Reports' [review]. AAPL has a lot of cash and talent, though, so the battle ahead will continue to be fierce.

Where AAPL goes in the future is anyone's guess. Fully diversified investors will be glad if AAPL does well because it makes up approximately 3-4% of their US Large Cap holdings. If AAPL doesn't perform well, they'll be glad that AAPL makes up only 3-4% of their US Large Cap holdings. The point is that investing shouldn't be like gambling. Investing too much in one company generally results in either substantial profits or devastating losses (unfortunately, usually the later). I prefer diversifying across many companies and countries as it affords a better best chance of long term financial stability.

Remember: The market does not compensate investors for risk that can be diversified away, so diversify!

Summary of 2013 tax changes

As you are probably aware, congress and the President have "permanently" fixed tax laws that were set to expire on December 31, 2012. Although the new law does raise certain taxes, at least we now have the clarity necessary to properly arrange our financial affairs. Beginning 2013, the following are some the major changes affecting individual taxpayers.

Personal Exemption: The personal exemption will now begin to be phased-out once adjusted gross income (AGI) exceeds $250,000 for single taxpayers ($300,000 for married filing jointly).

Itemized Deductions: Itemized deductions will once again be subject to phase-down. This phase-down will now begin once a taxpayer's AGI exceeds $250,000 ($300,000 for married filing jointly).

Payroll Taxes: The payroll tax holiday is now over with Social Security taxes increasing back to 6.2% from 4.2% for all taxpayers with earned income. For taxpayers with earned income greater than $200,000 ($250,000 for married filing jointly) an additional 0.9% Medicare tax will also now apply.

Ordinary Income Tax: Tax brackets for ordinary income remain largely unchanged except for taxpayers with taxable income greater than $400,000 ($450,000 for married filing jointly). For those taxpayers the highest tax on ordinary income increased to 39.6% from 35%.

Dividend & Capital Gain Tax: Taxes on qualified dividends and long-term capital gains remain unchanged, except for taxpayers that fall in the new 39.6% tax bracket. For those taxpayers taxes on qualified dividends and long-term capital gains will increase to 20% (versus 15% previously).

Medicare Surtax: A new Medicare surtax will now be levied on the lesser of net investment income or the excess of modified adjusted gross income above $200,000 ($250,000 for married filing jointly). This Medicare surtax rate is 3.8%.

Alternative Minimum Tax (AMT): Before 2013 lawmakers had to update the AMT exclusion each year since it was not automatically adjusted for inflation. This caused taxpayers major planning problems since it was often not known whether the exclusion would be adjusted until the end of the year (for 2012 we didn't know for sure until after the close of the year!). The new law permanently fixes AMT so that annual adjustments are now automatic. For 2013 the AMT exemption is $50,600 ($78,750 for married filing jointly).

Summary of 2013 tax changes (cont'd)

Annual Gift Exclusion: The annual gift exclusion for 2013 is $14,000, up from $13,000 for 2012. This means that a person can gift up to $14,000 each year to any person (or certain trusts for a person's benefit) without incurring gift tax. Married couples can gift up to $28,000/year (twice the single gift exclusion) without incurring gift tax if they elect to "split gifts" and/or if they gift community property. Remember that annual exclusion gifting can be an effective way to reduce estate taxes.

Estate Tax: The federal estate tax exemption equivalent for 2013 is $5.25m, and will be adjusted each year going forward. This credit equivalent also remains portable for 2013 and beyond. The effective federal estate tax rate for estates above $5.25m has been increased to 40% from 35%.

For Washington residents the Washington Estate Tax credit equivalent remains at $2m, is not adjusted for inflation each year, and the credit is not portable to a surviving spouse. This means that even though an estate may not have to pay federal estate taxes, Washington Estate Tax may still be an important planning consideration.

Limits for Deferred Account Saving: The below chart outlines the maximum deferred account contribution limits in effect for 2013. The amounts shown are absolute maximum dollar amounts that could be allowed, but taxable income levels (earned and unearned), availability of employer plans, and other factors will make each taxpayer's situation unique.

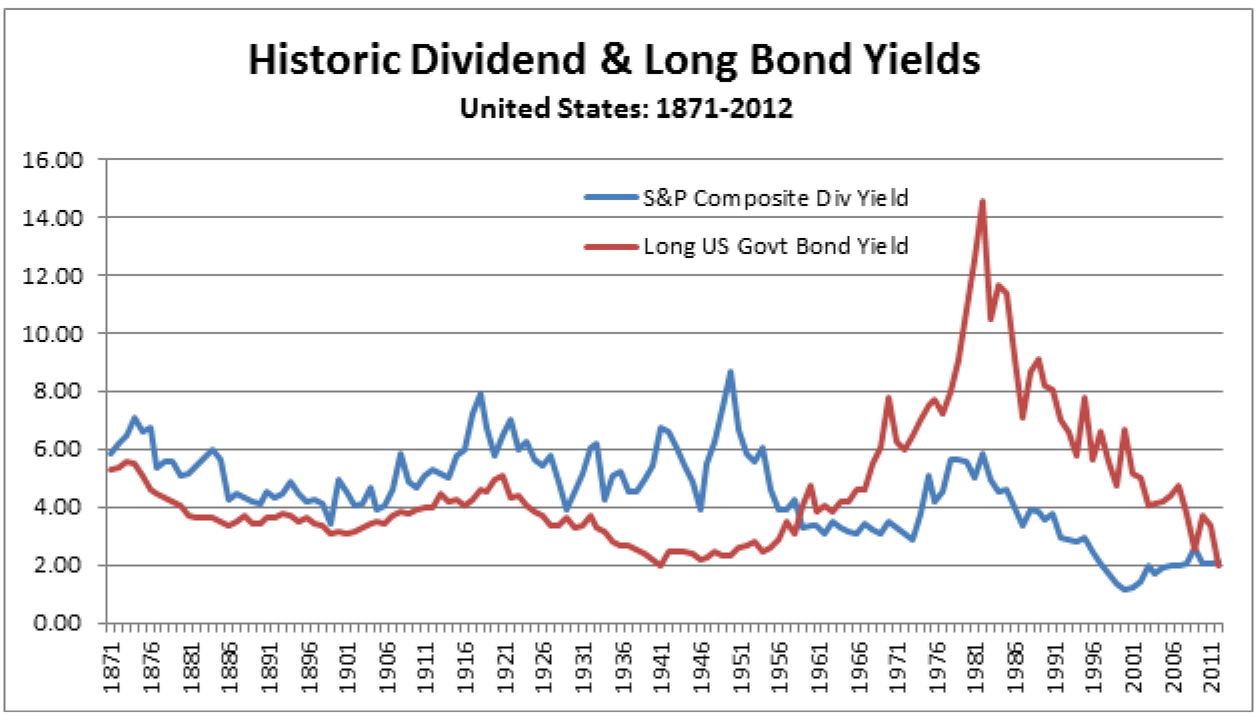
Account type	Annual Max Contribution	Annual catch-up for 50 & over
401(k)/457/403(b)	$ 17,500	$ 5,500
Traditional & Roth IRAs	5,500	1,000
SIMPLE IRA	12,000	2,500
SEP IRA	51,000	n/a

Summary of 2013 tax changes (cont'd)

Conclusion: Tax laws are complex and recent legislation made them more complex than ever. Some recent tax law changes are encouraging while others create both challenges and opportunities. The above summary is provided as a brief overview of changes which became effective for 2013, but you should consult with a qualified tax advisor before implementing any particular tax planning strategy.

In Closing

Although volatility in equity markets has decreased, it will always be more volatile than among high-quality bonds. Bonds yields are currently yielding less than dividends yields across large U.S. corporations, however, a first since the 1950s (see below chart). This current low-interest rate environment is nearly certain to result in negative real rates of return for high quality bonds, but the purpose of bonds should be to bring stability to a portfolio. If higher yielding bonds are introduced, it's critical to remember that higher yields cannot be had without taking on greater risk. In my opinion this risk is not worth taking within a bond allocation. Simply put, a little extra yield now can result in a devastating overall loss in the long run. DO NOT CHASE YIELD!



Source: *Online Data for Robert Shiller*: http://www.econ.yale.edu/~shiller/data.htm

For the past 30 years or so we have lived through a great bull bond market, but interest rates have experienced a general decline over that time period. Given the incredibly low current interest rates, it would seem this decades long run is near its end (recall that when interest rates rise, bond valuations fall). From the early 1950s through the early 1980s holders of long-bonds realized terrific losses. It would seem that such a bear bond era is likely to occur in the future.

On a fundamental basis US equities currently appear fully priced, while foreign equities (especially Europe) continue to trade at attractive levels. Additionally, the broad base dividend yield on foreign equities continues at a level approximately 50% higher than that of US equities. Based on these facts, international investing continues to be attractive.

Between now and my next newsletter you'll likely hear all sorts of noise about the US government hitting the authorized borrowing limit and the expiration of the stop-gap budget; both of which will happen in March. This is not something that the investment community does not know. News channels are paid according to the audience they attract, however, and the more sensational the story, the larger the audience. Do not let this noise distract you from adhering to a well-reasoned investment policy.

Remember: *Develop a financial plan according to your unique situation and manage your assets according to a well thought out and documented investment policy. Doing so will greatly increase the probability you will actually meet your financial goals.*

This letter is intended to address broadly defined financial planning issues. If you need assistance developing a wealth management program tailored to your unique situation, then seek the assistance of a fee-only NAPFA registered financial advisor who is also a CERTIFIED FINANCIAL PLANNER™ professional having the proper education and experience. Additionally, consult with your tax advisor before implementing a particular tax strategy.

Troy

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Table of Investment Returns

Annual Returns (1993-2012) of Major Market Indices Ranked by Performance

1993	1994	1995	1996	1997	1998	1999	2000	2001	2002
MSCI Emerging Markets 74.84%	MSCI EAFE 7.78%	S&P 500 37.56%	NAREIT Equity 35.27%	S&P 500 33.36%	S&P 500 28.58%	MSCI Emerging Markets 66.42%	NAREIT Equity 26.37%	Russell 2000 Value 14.02%	BC Aggregate Bond 10.26%
MSCI EAFE 32.57%	NAREIT Equity 3.17%	Russell 2000 Growth 31.04%	S&P 500 22.96%	Russell 2000 Value 31.78%	MSCI EAFE 20.00%	Russell 2000 Growth 43.09%	Russell 2000 Value 22.83%	NAREIT Equity 13.93%	NAREIT Equity 3.82%
Russell 2000 Value 23.77%	S&P 500 1.32%	Russell 2000 Value 25.75%	Russell 2000 Value 21.37%	NAREIT Equity 20.26%	BC Aggregate Bond 8.70%	MSCI EAFE 26.96%	BC Aggregate Bond 11.63%	BC Aggregate Bond 8.43%	MSCI Emerging Markets -6.00%
NAREIT Equity 19.65%	Russell 2000 Value -1.54%	BC Aggregate Bond 18.46%	Russell 2000 Growth 11.26%	Russell 2000 Growth 12.95%	Russell 2000 Growth 1.23%	S&P 500 21.04%	S&P 500 -9.11%	MSCI Emerging Markets -2.37%	Russell 2000 Value -11.43%
Russell 2000 Growth 13.37%	Russell 2000 Growth -2.43%	NAREIT Equity 15.27%	MSCI EAFE 6.05%	BC Aggregate Bond 9.64%	Russell 2000 Value -6.45%	BC Aggregate Bond -0.82%	MSCI EAFE -14.17%	Russell 2000 Growth -9.23%	MSCI EAFE -15.94%
S&P 500 10.08%	BC Aggregate Bond -2.92%	MSCI EAFE 11.21%	MSCI Emerging Markets 6.03%	MSCI EAFE 1.78%	NAREIT Equity -17.50%	Russell 2000 Value -1.49%	Russell 2000 Growth -22.43%	S&P 500 -11.89%	S&P 500 -22.10%
BC Aggregate Bond 9.75%	MSCI Emerging Markets -7.32%	MSCI Emerging Markets -5.21%	BC Aggregate Bond 3.64%	MSCI Emerging Markets -11.59%	MSCI Emerging Markets -25.34%	NAREIT Equity -4.62%	MSCI Emerging Markets -30.61%	MSCI EAFE -21.44%	Russell 2000 Growth -30.26%

2003	2004	2005	2006	2007	2008	2009	2010	2011	2012
MSCI Emerging Markets 56.28%	NAREIT Equity 31.58%	MSCI Emerging Markets 34.54%	NAREIT Equity 35.06%	MSCI Emerging Markets 39.78%	BC Aggregate Bond 5.24%	MSCI Emerging Markets 79.02%	Russell 2000 Growth 29.09%	NAREIT Equity 8.28%	MSCI Emerging Markets 18.22%
Russell 2000 Growth 48.54%	MSCI Emerging Markets 25.95%	MSCI EAFE 13.54%	MSCI Emerging Markets 32.59%	MSCI EAFE 11.17%	Russell 2000 Value -28.92%	Russell 2000 Growth 34.47%	NAREIT Equity 27.95%	BC Aggregate Bond 7.92%	Russell 2000 Value 18.05%
Russell 2000 Value 46.03%	Russell 2000 Value 22.25%	NAREIT Equity 12.15%	MSCI EAFE 26.34%	Russell 2000 Growth 7.05%	S&P 500 -37.00%	MSCI EAFE 31.78%	Russell 2000 Value 24.50%	S&P 500 2.11%	NAREIT Equity 17.67%
MSCI EAFE 38.59%	MSCI EAFE 20.25%	S&P 500 4.91%	Russell 2000 Value 23.48%	BC Aggregate Bond 6.97%	NAREIT Equity -37.73%	NAREIT Equity 27.99%	MSCI Emerging Markets 19.20%	Russell 2000 Growth -2.91%	MSCI EAFE 17.32%
NAREIT Equity 37.13%	Russell 2000 Growth 14.31%	Russell 2000 Value 4.71%	S&P 500 15.79%	S&P 500 5.49%	Russell 2000 Growth -38.54%	S&P 500 26.47%	S&P 500 15.06%	Russell 2000 Value -5.50%	S&P 500 16.18%
S&P 500 28.68%	S&P 500 10.88%	Russell 2000 Growth 4.15%	Russell 2000 Growth 13.35%	Russell 2000 Value -9.78%	MSCI EAFE -43.38%	Russell 2000 Value 20.58%	MSCI EAFE 7.75%	MSCI EAFE -12.14%	Russell 2000 Growth 14.59%
BC Aggregate Bond 4.10%	BC Aggregate Bond 4.34%	BC Aggregate Bond 2.43%	BC Aggregate Bond 4.33%	NAREIT Equity -15.69%	MSCI Emerging Markets -53.18%	BC Aggregate Bond 5.93%	BC Aggregate Bond 6.58%	MSCI Emerging Markets -18.17%	BC Aggregate Bond 4.32%

S&P 500	The S&P 500 Index is a market capitalization weighted index designed to measure the performance of large capitalization U.S. stocks that are traded on the NYSE, AMEX and NASDAQ.
Russell 2000 Value	The Russell 2000 Value Index is a market capitalization weighted index designed to measure the performance of U.S. small cap value stocks. The index is constructed by dividing the market capitalization of the Russell 2000 Index into Growth and Value indices. The Value index contains those Russell 2000 securities with a greater-than-average value orientation; and generally have lower price-to-book and price-earnings ratios than those in the Growth index.
Russell 2000 Growth	The Russell 2000 Growth Index is a market capitalization weighted index designed to measure the performance of U.S. small cap growth stocks. The index is constructed by dividing the market capitalization of the Russell 2000 Index into Growth and Value indices. The Growth index contains those Russell 2000 securities with a greater-than-average growth orientation; and generally have higher price-to-book and price-earnings ratios than those in the Value index.
MSCI EAFE	The MSCI EAFE Index is a market capitalization weighted index designed to measure the equity performance of the developed stock markets of Europe, Australasia and the Far East.
MSCI Emerging Markets	The MSCI Emerging Markets Index is a market capitalization weighted index designed to measure the equity performance of global emerging markets.
NAREIT Equity	The NAREIT Equity Index measures the performance of Real Estate Investment Trust (REIT) stocks traded on the NYSE, AMEX and NASDAQ. The composition of the index changed significantly in 1994, thus comparisons between pre- and post-1994 results are problematic.
BC Aggregate Bond	The Barclays Capital (BC) Aggregate Bond Index (formerly the Lehman Brothers Aggregate Bond Index) through Dec. 31, 2009; Barclays US Aggregate Float Adjusted Index thereafter. Includes U.S. government, corporate and mortgage-backed securities with maturities of intermediate duration.

Prepared by: Troy Sapp CFP®; January 10, 2013