From Left To Right: Joe Kiely, Scott Below, Katie Burr, Brownie Cordell, and Kellie Kiely

BEHIND THE SCENES

Volume 21 | Number 1 | Date April 2011

OPENING THOUGHTS

We hope this newsletter finds you well and enjoying the early days of spring. We love spring because it brings longer days, warmer weather, and a return to gardening. For gardeners, the spring is particularly satisfying since you get to see the end result of your planning and hard work from the previous year. So far, the pay off this year has been spectacular!! Coincidently, the payoff has been just as exciting in the financial markets. Two years ago (this spring) our markets were in chaos; racked by fear and volatility. In response, we put together a strategic plan we believed would be able to capitalize on this opportunity. We expected the full benefits of this plan to be realized over a period of roughly five years. We were wrong. In just two short years, the seeds we planted back then have sprouted, grown, flowered, and born fruit. With the small and mid-cap stock indexes hitting all time highs this year, 2011 has been a spring to remember in more ways than one.

Cautious Optimism

Since the first of the year, we've held a number of client appreciation dinners where the prevailing theme was "Educated Optimism." We think this is worth repeating—we're optimistic about the future of the world economy and, in turn, the global financial markets! That's not to say that we expect things to go straight up. We don't. We recognize there are many issues that still threaten economic growth and cause concern among investors. However, isn't this always the case? For example, we are well aware of the formidable deficit problem we're faced with; the tragic earthquake and tsunami in Japan; the unrest in North Africa; and the rising prices of oil and food. Honestly, how could anyone NOT be aware these things, given the blaring headlines that confront us everywhere we turn. But "the sky is falling" headlines have been running non-stop for more than two years now and in spite of the hysteria the sky hasn't fallen. In fact, the economy has grown its way out of one of the worst recessions in history, the global financial markets have healed, and companies have begun hiring again.

Unfortunately, the headline virus continues to spread, with even CNBC being guilty of blowing things out of proportion and taking short sound bites out of context to build stories around. It makes us wonder what happened to personal responsibility in the news media. In today's world, advertising revenue clearly trumps the need for accuracy, and real news (you know, the informative kind) has gone the way of the dinosaur. What we're left with is little more than tabloid journalism, designed solely to shock and grab market share. How can we forget the doomsday headlines over the past two years, with a series of bold predictions that

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KWAG 2011 PRIVACY POLICY & ANNUAL ADV OFFER

PLEASE TAKE TIME TO READ THE **COMPLIANCE NOTES** SECTION ON THE LAST PAGE.

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have included the "next great depression", unrelenting "hyperinflation", decades-long "deflation", the dreaded "double-dip recession", or the "collapse of the dollar"? Yet none of those things occurred and the economy and financial markets have continued to improve.

In contrast to the headlines of the moment, we base our investment decisions not on short term vicissitudes, but on what we believe are broader long-term trends. These include things like emerging market economies, technological breakthroughs and the ever-changing global economy—which will take decades to play out. So while we recognize there are many issues to sort through, we also understand that overreacting to short-term transitory events (in both good times and bad) is the single biggest reason why most investors fall short of their financial goals.

The Disconnects

For those who missed our client appreciation dinners, we want you to know that we are always available for one-on-one meetings to discuss your needs, the markets, our strategic plan(s) and/or your portfolio. If you were able to attend one of our dinners and would like to meet for a refresher, or to discuss anything more in-depth, please call and make an appointment! In the meantime, we think it's worth repeating our broader message from the client dinners, which revolved around something we've called the "Disconnects." We have also covered these themes in our newsletters over the last few years, but these concepts are so important to successful investing that we think their well worth reiterating again.

Disconnect #1: The Media

Two years ago, the Troubled Asset Relief Program (TARP) set the stage for our economic recovery. Unfortunately, the media presented TARP to the public as a plan to fly large helicopters, loaded with cash, over the homes of wealthy Wall Street tycoons for disbursement. To anyone not familiar with the specifics of the program, this was clearly a cause for concern. And to make matters worse, the media began predicting every sort of economic disaster known to mankind, from the next great depression, hyper-inflation, stagflation, deflation, a double-dip recession, run-away deficits and bankrupt grandchildren. No wonder people were afraid!

On the other hand, we took the time to explain why the economy had experienced a "heart attack", and how the economy was surgically repaired through a series of innovative moves by the Federal Reserve and the Treasury. In a nutshell, the cash provided through TARP was necessary to avert a credit crisis and was used to provide liquidity to our money and capital markets, thereby averting their collapse. In essence, TARP acted like a stent inserted in a collapsed artery to keep the lifeblood of the economy – money - flowing. Without TARP, money would have ceased flowing, the global financial markets might well have collapsed, and the economic fallout could have been devastating.

Once it was clear TARP was working, we laid out a plan to recoup market losses in our portfolios by taking advantage of assets we believed were significantly underpriced. Since that time, in numerous updates and newsletters, we have provided countless examples showing how the media has no desire to educate you about your finances, or help you make sound investment decisions. Remember, they are in the business of entertainment and are driven by their need for ad revenue. As most media outlets have learned, fear and hyperbole can really help improve their ratings…and revenue.

TARP has since come under criticism on many fronts and we're the first to admit the program is far from perfect. However, what government program is perfect? Problems aside, however, TARP did what it was supposed to do—it helped stabilize the banking system at a time when stability was desperately needed. As of mid-March, the Treasury has reported that $244 billion of the $245 billion in TARP funds that had been disbursed to banks had been repaid (a repayment rate in excess of 99%). They also estimate that taxpayers will ultimately wind up with roughly $20 billion in the black over the life of the program. So in spite of all the problems, the program accomplished its most important goals and didn't wind up costing us (taxpayers) anything. We don't know about you, but those are the types of problems we're willing to live with.

Disconnect #2: The Price

Three months after the liquidity crisis had been averted, the capital markets experienced a panic sell-off that was typical in nearly every respect…except for its magnitude. The size of the selloff was partly the result of the severity of the economic situation we were facing, but it went well beyond that. Maybe the biggest driving factor was the <u>forced selling</u> of assets on the part of financial institutions and hedge funds who had overextended themselves so badly in mortgage derivative products. In this case, the only chance they had to survive, was to liquidate everything they owed and hope that would be enough. All this selling, of course, spread panic, causing even more selling and markets began to spiral down

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into the abyss. Surprisingly, if you go back to that time (Feb 2009), and examine the positive news, underneath the tons of doom-and-gloom headlines, you'll find the following:

1. Warren Buffett, the man famous for saying—"*I like cinches. I like to shoot fish in a barrel. But I like to do it after the water has run out."— was imploring* investors to buy low-priced assets, and then he went out and invested billions.
2. Two of the largest banks that received TARP payments announced that they would be profitable in the coming quarters and requested permission to repay the money immediately.
3. Congress enacted a Stimulus Plan to jumpstart the economy, while the Federal Reserve enacted the first of their quantitative easing policy initiatives.

In essence, we were being told that; A) asset prices were at fire sale levels and too low to ignore; B) TARP was working and banks were returning to profitability; and C) two of the largest stimulus plans in history were being enacted, which would help provide a shot a adrenalin to the struggling economy. So what did the public do?

Unfortunately, most individual investors listened to the media, bought into the panic, and sold out of stocks and bonds heavily for six straight weeks. Conversely, we stayed focused on the long-run, harvested tax losses wherever possible, rebalanced our client portfolios into lower priced assets, and focused on maintaining a diversified basket of stocks and bonds to help diminish the impact of the record volatility we were experiencing. Many of our peers in the advisory community also chose to follow the media-driven herd, by selling out of virtually everything and sitting in cash. We'd like to think advisors knew better, but we'd probably be wrong.

One phrase we used over and over again during that period was, "knowledge is power." This is because understanding how markets (and investors) behave during extreme situations is critical to avoiding the major mistakes that have laid waste to millions of retirement portfolios over the years. Knowledge alone is no guarantee you'll be able to overcome the urge to join the herd and sell. However, without knowledge it's a pretty safe bet you won't.

Disconnect #3: The Globe

As we know now, 2009 saw one of the most spectacular rebounds on record - one we all enjoyed immensely. Even so, the media continued its assault of negativity, focusing on domestic unemployment, the federal deficit, and a moribund real estate market, among other things. The investors who had pulled out of the market earlier continued to listen, and remained steadfastly on the sidelines, while even more investors joined them. In fact, according to the Investment Company Institute, domestic equity funds experienced a net outflow of $40 billion in 2009, even though U.S. stocks rose 25%. Incredibly, stock fund outflows continued into 2010, and accelerated in the second half of the year as stocks enjoyed their biggest rally in years.

The fact that individual investors continued withdrawing money from stocks, even as the market, recovered indicates just how pervasive the fear had become. Even though money has now begun flowing into domestic stock funds again, it's still only a trickle.

Fortunately, American companies didn't have time to watch the news. Instead, they were too busy cutting costs, streamlining their business, and improving productivity through the use of technology they've been acquiring over the previous decade. In addition, they were tapping into cheaper labor markets abroad, cheaper capital at home, and using these resources to expand their businesses and position themselves to take advantage of the changing global economic environment.

So, while the media and the public stayed focused on America's woes, corporations focused on building a global presence in emerging markets, which continue to grow at rates significantly above those found in developed nations. Fast forward to today and we find this approach has resulted in record exports, record cash flows, and record profits. In fact, March marked the 22nd consecutive month of growth in the U.S. manufacturing sector—although you'd be hard-pressed to find that stat reported anywhere in the "mainstream" news.

One of the major problems for investors is that many continue to connect the government's deficit problem to the long term health of their portfolios. Although the federal deficit is an extremely important issue—and one which we believe will ultimately be resolved—American companies could really care less. They continue doing what they have to do to succeed, without any real concern for what' happening inside the Washington beltline. So if you are equating the success of your portfolio to what happens in Washington, you're missing the broader message. America no longer drives the world's economic machine. Today, we live, work, and compete in a truly global marketplace that our corporations are well-positioned to compete in. As a result, the future for investors is bright. For those who shut off the TV when the news comes on, it's probably even brighter!

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Disconnect #4: The Stock Market's Present Value

The way to value any investment, whether we're talking about stocks, bonds, real estate, or rare oil paintings, is by first estimating the cash flows the investment will generate in the future. If you want to buy a building, you look at its expected rents. If you want to buy a cable company, you look at its subscribers fees. If you want to buy an insurance company, you look at the premiums they will collect. Beyond some basic accounting knowledge and a little high school algebra it's really pretty simple. One of the undeniable conclusions of asset valuation models is that the value of an investment will increase (or decrease) as the expected future cash flows from the investment increase (or decrease). So, if you examine corporate America's cash flows today - which are near all time highs and growing - it should come as no surprise that stocks are doing well in spite of all the fear and loathing on the part of many investors.

It also follows that as corporate cash flows improve, the value of the companies creating those cash flows will improve—which is exactly what we think is going to happen. There will be bumps along the way and some of these bumps could be quite dramatic. However, unless you're clairvoyant (we're not - and if you hired us to manage your money it's a safe bet you're not either) the bumps are an unavoidable part of the process. On the other hand, they ultimately provide some nice buying opportunities for patient, long-term investors who are able to keep their emotions in check.

That said; let's examine the four current "macroeconomic" trends that we believe will drive corporate cash flows for some time. This is what drives our aforementioned optimism.

1. **Labor prices:** Labor prices are generally much lower outside of the United States and this trend will continue for some time. Billions of people in China, India, Brazil and elsewhere want to live the American dream. They are willing to work for it. For generations, most of these people have lived in abject poverty, but that's changing. If you do the math, it's amazing to think about the billions of people who will increase their standards of living over the next few decades. American companies understand this and are tapping into this previously nonexistent pool of consumers, and workers. We hear a lot about all the American jobs being lost overseas, but almost nothing about how overseas economic development impacts the values of the companies we invest in. That's too bad, because it is economic growth <u>outside</u> the U.S. that is largely responsible for this country's rising exports and aforementioned 22 consecutive months of growth in manufacturing jobs.
2. **Capital inputs:** Interest rates are near all time lows and they will likely stay that way for some time. People can argue about QE2 all they want, but the Federal Reserve is going to keep interest rates low as long as unemployment remains high and core inflation remains under control. In March, the U.S. unemployment rate stood at 8.8% and, in spite of rising food and oil prices, the consumer price index posted a smaller-than-forecast gain of 0.1%. In other words, the cost of capital for American businesses is low and will likely remain that way for some time to come. That's important, because if American companies have access to low-cost capital it is less expensive for them to expand their operations and develop new products and services. Low cost capital also has a positive effect on profit margins and makes companies better able to compete overseas, which is precisely what we're seeing reflected in the current economic data. American companies are also taking advantage of current interest rate environment by issuing long term bonds that lock in these low rates for decades to come. So even when interest rates increase in the future, they will still be enjoying the benefits of the low rate bonds they're issuing today. We're not sure we understand why investors would be willing to buy bonds that effectively lock in low interest payments for decades to come, but that's a story for another newsletter.
3. **Technology:** We believe scientific and technological breakthroughs over the next 10 years are going to surprise even the most optimistic of observers. These breakthroughs will likely result in increased productivity which will allow companies to leverage the benefits of inexpensive labor and capital. Think about this for a second. American companies have access to inexpensive labor and capital in combination with an unbelievable technology base, making these inputs more productive. This is a potentially powerful combination. Now all American companies need, is access to markets for their products and services. Thank goodness for the expanding global marketplace…
4. **Trade and Trade Barriers:** Over the last few months, everyone has seen the drama play out in Northern Africa and the Middle East. The catalyst for these uprisings is straightforward—people are seeking more freedom and greater access to global markets, which will ultimately lead to greater prosperity for a

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larger portion of the world's population. What many people seem to forget is that similar dramas have been playing out in various parts of the world for more than 20 years, beginning with the collapse of the Soviet Union. From Russia and Eastern Europe the movement spread to places like Brazil, China, India and other emerging market economies. Today, the focus is on North Africa and the Middle East. However, the desire for greater freedoms and access to capital markets has been going on for decades. No two situations are ever the same and in some cases the transition will be decades in the making, but the net result will ultimately be the same. This is because capitalism is a "good virus" that causes those infected to recognize that greater freedoms and more access to global markets means better lives are within their grasp. As we write this, some countries are in the process of creating a middle class that will make the U.S. middle class look miniscule by comparison. But for American companies that's not a threat—it's a colossal opportunity! Like we said above, America's companies have access to cheap capital, cheap labor, amazing new technologies, and the ability to compete like no other companies on earth. Now all they need is someone to buy their goods and services. So say hello to China, India, Brazil, and the rest of the developing world.

In our view, the next decade could turn out to be one of the most exciting and rewarding in history. Make no mistake; there will be daunting challenges. For many countries, the changes their peoples seek will only be realized grudgingly, and at a tremendous cost in human lives. Ultimately, in our opinion, the will of the people will prevail.

Disconnect #5: Our Stock Portfolio's

For years we have presented raw data demonstrating the amazing strength of long run returns in stocks. We have also discussed a number of rigorous academic studies that show a persistent premium for value stocks and for smaller company stocks. If you examine the table on the next page, you'll see what we're talking about. For every size classification, from large to small, value stocks have outperformed growth stocks by 2% to nearly 5% annually. That's a huge difference on an annual basis, but perhaps even more important is the fact that value stocks have been able to achieve this while exposing their investors to significantly less risk!

In addition, you'll notice that size also matters when it comes to stock returns over time. Although it may come as a surprise that, at least in this case, smaller is clearly better. Specifically, small value stocks have led the way by a wide margin over the last 40 years, while large growth stocks have lagged significantly. What's amazing is that we continually find people (and investment advisors) who have built their portfolios mainly around large growth stocks. We understand how some individuals may fall into this trap. After all, many people have been conditioned to believe that large companies are "blue chip" and that they are somehow safer than the rest of the market. Unfortunately, the data on page 6 does not support this notion.

We have more trouble understanding why advisory firms build large cap growth portfolios. If they are really providing sound advice, then how do they explain 1) building highly concentrated portfolios, 2) investing almost exclusively in what historically has been the worst area of the stock market, and 3) exposing their clients to much more risk than is necessary. If you look at the bottom row of the chart on page 6, you'll notice the Beta (which measures "market risk") associated with small value stocks is significantly lower than the Beta for large growth stocks. What we don't understand is why so many advisors and brokerage firms continue to build portfolios almost exclusively around the category of stocks that is both the riskiest and lowest returning over the last 40+ years?

This may be the greatest "disconnect" of all—advisors giving poor advice and being completely oblivious to the fact that they're doing so

* *(For reference, the Beta of the overall market is 1.0, so anything with a Beta above 1.0 is riskier than the overall market and anything with a Beta below 1.0 is less risky than the overall market.)*

Disconnect #6: Our Bond Portfolio's

Last quarter we spent a good portion of the newsletter examining why all bonds are NOT created equal. However, it's worth briefly repeating our message again. All bonds are NOT created equal!! Thanks for humoring us.

Bonds actually make up about 2/3's of the world's capital markets, with stocks representing only about 1/3, so there is actually a much greater diversity in bonds than there is in stocks. This acts as a double-edged sword. On one hand, the diversity creates complexity and increases the amount of time and effort that must be devoted to bond research. On the other hand, investors tend to shy away from investments that require a lot of effort, which

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Annual Style Index and S&P 500 Returns

Year	SCG	SCV	MCG	MCV	LCG	LCV	S&P 500
1970	-10.90%	-0.10%	-4.20%	8.00%	-4.80%	14.30%	12.20%
1971	32.40%	16.00%	20.80%	10.30%	20.10%	7.50%	14.30%
1972	4.90%	8.70%	22.10%	8.70%	24.00%	18.90%	18.99%
1973	-35.30%	-23.20%	-25.60%	-17.60%	-17.40%	-7.00%	-14.69%
1974	-31.00%	-18.00%	-30.80%	-19.70%	-35.10%	-20.50%	-26.47%
1975	58.70%	61.10%	43.90%	52.20%	31.50%	35.50%	37.23%
1976	41.10%	52.20%	26.60%	43.40%	10.00%	30.80%	23.93%
1977	22.90%	22.70%	0.20%	2.10%	-12.60%	-5.30%	-7.16%
1978	19.80%	21.30%	8.80%	7.20%	7.00%	5.70%	6.57%
1979	48.20%	39.00%	36.30%	28.20%	11.90%	19.90%	18.61%
1980	53.50%	31.00%	43.20%	25.40%	20.80%	36.70%	32.50%
1981	-8.10%	15.90%	-3.30%	8.20%	-9.60%	-2.60%	-4.92%
1982	26.40%	36.00%	21.50%	30.80%	17.70%	19.80%	21.55%
1983	26.20%	42.90%	19.80%	28.10%	17.60%	26.60%	22.56%
1984	-14.00%	6.00%	-3.60%	7.20%	5.20%	11.30%	6.27%
1985	29.30%	37.50%	30.30%	32.60%	34.80%	29.60%	31.73%
1986	3.58%	7.41%	17.55%	17.87%	13.99%	21.44%	18.67%
1987	-10.48%	-7.11%	2.76%	-2.19%	6.45%	2.20%	5.25%
1988	20.37%	29.47%	12.92%	24.61%	10.88%	22.02%	16.61%
1989	20.17%	12.43%	31.48%	22.70%	37.68%	26.66%	31.69%
1990	-17.41%	-21.77%	-5.13%	-16.08%	1.37%	-3.67%	-3.11%
1991	51.19%	41.70%	47.03%	37.92%	39.41%	18.16%	30.47%
1992	7.77%	29.14%	8.71%	21.68%	3.89%	9.07%	7.62%
1993	13.37%	23.77%	11.19%	15.62%	-0.07%	19.76%	10.08%
1994	-2.43%	-1.54%	-2.16%	-2.13%	4.85%	-1.90%	1.32%
1995	31.04%	25.75%	33.98%	34.93%	38.65%	40.03%	37.58%
1996	11.26%	21.37%	17.48%	20.26%	25.57%	22.31%	22.96%
1997	12.95%	31.78%	22.54%	34.37%	33.73%	35.48%	33.36%
1998	1.23%	-6.45%	17.86%	5.08%	45.09%	21.24%	28.58%
1999	43.09%	-1.49%	51.29%	-0.11%	29.68%	10.95%	21.04%
2000	-22.43%	22.83%	-11.75%	19.18%	-24.53%	2.32%	-9.11%
2001	-9.23%	14.02%	-20.15%	2.33%	-20.49%	-8.79%	-11.88%
2002	-30.26%	-11.42%	-27.41%	-9.64%	-27.98%	-18.02%	-22.10%
2003	48.54%	46.03%	42.71%	38.07%	26.63%	26.75%	28.68%
2004	14.31%	22.25%	15.48%	23.70%	3.74%	13.34%	10.90%
2005	4.15%	4.71%	12.10%	12.65%	2.88%	4.60%	4.90%
2006	13.35%	23.48%	10.66%	20.22%	8.56%	22.99%	15.79%
2007	7.05%	-9.78%	11.43%	-1.42%	12.15%	0.25%	5.49%
2008	-38.54%	-28.92%	-44.32%	-38.44%	-36.06%	-36.09%	-37.00%
2009	34.47%	20.58%	46.29%	34.21%	34.01%	14.59%	26.46%
2010	29.09%	24.50%	26.38%	24.75%	13.21%	11.69%	15.06%
Average	**12.20%**	**16.14%**	**13.05%**	**14.52%**	**9.86%**	**12.16%**	**11.77%**
Geo Mean	**9.15%**	**14.11%**	**10.54%**	**12.83%**	**7.74%**	**10.83%**	**10.20%**
Std Dev	**25.54%**	**21.32%**	**22.72%**	**18.93%**	**20.82%**	**16.63%**	**17.87%**
Beta	**1.16**	**0.81**	**1.17**	**0.89**	**1.10**	**0.89**	**1.00**

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provides a substantial opportunity for those who are willing to roll up their sleeves and do their homework.

Prior to the 2008 credit crisis, our core bond holdings were built primarily around high-quality corporate bonds, government agency bonds, and Treasury bonds. After the meltdown in early 2009 we altered our bond holdings dramatically in order to take advantage of mispricing that was driven by the wholesale selling of any and all fixed-income instruments not backed by the federal government. Specifically, we moved into funds that held bonds which had been the hardest hit, including mid and lower-quality corporate bonds, convertible bonds, and some foreign bonds. We did this because we knew these assets provided unusually attractive upsides and because we had bond managers in these areas with many decades of experience in their respective areas that we trusted implicitly. Bond fund returns in excess of 35% in 2009 and 10% in 2010 suggest that this was a good move. Again, we remain surprised that many advisors failed to capitalize on this opportunity. So maybe there's another "disconnect" in the financial advice model?

Regardless, now we face a very different situation, where bonds look to be fairly priced and where rising interest rates in the future are expected to drive bond prices down, especially in the longer maturities. Given these new challenges, we believe "flexibility" remains paramount and have moved away from bond funds with more restrictive mandates. As we move forward, the most likely scenario is that interest rate changes will be gradual and orderly. However, there is always a possibility we could see significant changes in interest rates over a relatively short period and we want to own funds whose managers have the ability to alter their portfolios quickly in order to follow suit. We think the mix of bond funds in our core bond portfolio today is the best possible mix for this environment. It provides a great deal of flexibility while also providing a high level of safety for investors. However, we're always looking for opportunities and, as the fixed income environment continues to change, opportunities may arise that we want to capitalize on. So while we love the mix of bond funds we're using today, don't be surprised if at some point in the future we bring additional tools to bear in order to help combat (and even capitalize on) rising interest rates.

Overall

Overall, we see plenty of opportunities to grow our investment portfolios over time. We know there will be surprises, but we actually welcome some of these surprises because of the opportunities they present. Remember, we build portfolios that are well-diversified and very flexible, and we have a track record of using market volatility to our advantage over time. So while no one can predict what the future surprises will be or when the will occur, as we look out over the next decade we feel very good about the way our portfolios are positioned. We also look forward to the challenges ahead and believe our strategic asset allocation approach will be able to take advantage of the disruptions and market dislocations that will invariably occur.

THE FINANCIAL MARKETS

As we alluded to earlier, the stock market recovery from the lows in March 2009 has been quick and powerful. During the first quarter of 2011, this recovery continued. Over the quarter, the S&P 500 index (large-cap stocks) increased more than 5%, while the Russell 2000 index (small -cap stocks) increased more than 7%. Over the previous year, the S&P 500 has increased over 12%, while the Russell 2000 gained more than 22%. Over the past two years, the S&P 500 is up over 70%, while the Russell 2000 has more than doubled! Two years ago, many people were convinced that the market indexes would never again reach their all-time highs. However, during the first quarter of 2011, small caps hit all time highs on the last day of the quarter, while mid caps hit all time highs at number of times in March and peaked on April 6th. So maybe the sky didn't fall after all?

The Style Index Numbers

Looking at the twelve months preceding the end of the quarter, all nine style boxes were in positive territory once again. Overall, small and midcap stocks performed better than their large cap counterparts, while the difference between value and growth stocks was slanted in favor of growth. In terms of the individual indexes, small cap growth led the way again after also leading the way in 2010. Over the last two years, the "pattern of performance" remains typical of an economic recovery, with small and midcap stocks outperforming large caps by a substantial margin.

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1 yr. Russell Style Index return through 03/31/2011

	Value	Blend	Growth
Large	15.15%	16.69%	18.25%
Mid	22.26%	24.27%	26.60%
Small	20.63%	25.79%	31.04%

If we examine style box performance over the last two years a similar pattern emerges, with small and mid-cap stocks outperforming large caps by a wide margin. As we keep reminding everyone, this pattern of performance is not new and is typical of recoveries. While the pattern may have been typical, the magnitude has been anything but. In fact, the rebound in stock prices has been nothing short of remarkable and is a strong testament to the resiliency and innovativeness of American companies.

2-Yr. TOTAL Russell Style Index return through 03/31/2011

	Value	Blend	Growth
Large	76.82%	76.90%	77.08%
Mid	110.78%	108.42%	106.36%
Small	99.12%	104.74%	110.08%

Finally, if you go back ten years, the differences between size and style become even more pronounced. Small and mid-cap stocks of the value and blend persuasion all ***averaged double-digit gains annually*** over the past decade. Over the same period, however, large growth barely beat out inflation. Clearly, it pays to own small and mid-cap stocks because they tend to provide superior long run returns, while also helping to mitigate your risk exposure. In fact, a diversified portfolio, spread equally across all nine style boxes, outperformed an all large-cap portfolio by more than 4.7% annually. When you factor in active management and proper rebalancing, it's obvious that for investors who were properly diversified, the last decade was clearly NOT lost.

10-Yr. Average Annual Russell Style Index return through 03/31/2011

	Value	Blend	Growth
Large	5.58%	4.56%	3.43%
Mid	14.19%	12.66%	9.57%
Small	13.69%	11.33%	8.67%

Our Take

The amazing thing about the last ten years is the period includes both the tech-wreck of 2001/2002 and the credit crisis of 2008. Yet, the 10-year average return for small and mid-cap value and blend are above the historical long-term average for the overall market (which is just under 10%). That's amazing! These returns only show the market averages. When you examine our managers (on page 14) and factor in some basic rebalancing, the returns are even better. It's why we continually preach a long-term focus and a consistent commitment to a basic set of investing principles. It works…but only if you remain patient and are able to keep your emotions in check.

One of the biggest mistakes investors make is placing too much emphasis on short run market performance. Everyone knows it would be ridiculous to attempt driving a car by looking only in the rear view mirror. All you'd be able to see is what you just ran over! Yet investors use their rear view mirrors to steer their portfolios all of the time. Don't believe us? When was the last time you had an inclination to buy what was last year's best performing stock or mutual fund? When was the last time you wanted to sell a stock or mutual fund that underperformed in the previous quarter or year? Humans have a natural tendency to want to buy what has been recently hot and sell whatever wasn't. To make matters worse, the media exacerbates this short-term bias.

During periods of economic turmoil and market declines the media uses the "fear" of recent events (like our deficit or potential changes in Americas credit ratings) to drive their storylines (and their advertising profits). Keeping this in mind, we thought it would be a good idea to do an in-depth examination of some of the larger fear-eliciting events we've seen recently, looking at both their short-run impacts and the longer–term prognoses. We think the title of the next section pretty much speaks for itself.

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CONFRONTING OUR FEARS

Over the past few months, we have been getting a lot of questions about recent "fear-inducing headlines." As a result, we've become a little concerned about the level of fear some of our clients are experiencing. Thus we wanted to examine each of these issues in-depth and from the perspective of a long-term investor. The questions have been about a variety of events and issues, but most revolve around the following:

- The Japanese tsunami and ensuing nuclear crisis.
- The widespread unrest in North Africa and the Middle East and resultant high oil prices.
- A ballooning federal budget deficit and ongoing budget battles in Washington.
- The potential impact of accommodative (QE2) monetary policy on inflation.

So instead of including our customary Q&A section, we thought we'd simply address the most pressing questions asked by our clients. Interestingly, these are the predominant topics being bantered about on the boob-tube each day. Do you think there might be a coincidence?

Fear as a Motivator

What always concerns us most about fear, is that it motivates investors to make the wrong decisions at the wrong times. The most recent example was in late 2008 and early 2009, when fear motivated millions of investors to sell their stocks and bonds and move into cash. Then they watched as stocks and bonds recovered to pre-crash levels in relatively short order, while their cash holdings sat motionless. In other words, many investors sold near the market lows and subsequently missed the rebound. What a rebound it's been! Take a look...a good look!

Post-Crash Recovery of the Russell Style Index
03/09/2009—03/31/2011

	Value	Blend	Growth
Large	113%	109%	99%
Mid	158%	151%	144%
Small	150%	153%	155%

Every area of the stock market has more than doubled since the March 2009 lows (except for large growth, which at 99% has nearly doubled) and five of the nine style boxes are up more than 150% from their lows! For those who got out near the bottom, and are still sitting in cash, it will probably take them years to make up what for what they've missed during this rebound. How many years? Well, at the market's long-term average return of 10% annually, it would take roughly 15 years. Ouch! Unfortunately, the news gets worse.

Recently, we've seen fear used as a motivator (and powerful sales tool) in the investments industry, with advisors and insurance agents attempting to prey on the fears of clients by encouraging them to purchase annuities or long-term instruments that lock in very low but guaranteed rates of return…and somehow fail to mention the hefty sales commissions these products generate. These investments might appear safe on the surface, but don't be fooled. Getting locked into something that pays a very low rate of return for the rest of your life is anything but a bargain. When interest rates go up—and they will go up—you're stuck. Maybe the most interesting thing about annuities is that most people we come across can't even explain why they purchased them or how most of the features work. We suspect if the commissions were eliminated from these products, annuity sales would all but go away.

So before you or one of your friends purchases an annuity or moves any part of your portfolio into cash that pays anything less than 5% annually, you have to think about the long term consequence of that move. The truth is, when you take a realistic look at the issues being driven by the media, you may be surprised at how tame they are. In fact, in some cases you could argue a number of these events will have a positive effect on our portfolios over time.

Confronting the Fear: Japan

As most people know, this is not the first time Japan has been hit with a devastating earthquake. On January 17th, 1995, Kobe, Japan was hit with what the Guinness Book of Records called the 'costliest natural disaster to befall any one country.' When you see the pictures of the current disaster and listen to the news, you can't imagine anything worse than what the Japanese people are dealing with today. The aftereffects of the earthquake, tsunami, and ongoing nuclear crisis will change many lives forever. And for that, we are deeply saddened. This is a terrible humanitarian tragedy for Japan, as well as an economic tragedy — at least in the short run.

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So far, we have seen shortages of products that are built in Japan. In the short run, these shortages will no doubt continue. However, the overall economic impact globally has been minor, leading to temporary shutdowns in a few manufacturing facilities outside Japan. Fortunately, these shortages are transitory, as production of goods from Japanese plants that were damaged, is either being shifted to unaffected areas of the country or to facilities in foreign countries. In today's world, supply chains adapt rapidly and short-term interruptions are quickly resolved. Over the longer term, many people believe the clean-up effort will actually help Japan's GDP as they pour money into the rebuilding effort. So while the humanitarian toll is terrible, most economists agree that the long term economic effects will remain localized and relatively minor.

Perhaps the largest impact of the Japanese crisis domestically will be on U.S. power companies that were planning to add new nuclear plants, as well as on the companies that were hoping to be involved in their design and construction. The U.S. hasn't started construction on a single nuclear power plant since the Three Mile Island incident more than 30 years ago. And given the magnitude of the disaster at the Fukushima Daiichi nuclear plant, we think it's probably unlikely new nuclear plants will gain U.S. regulatory approval for a very long time, if ever. While that's obviously bad for the nuclear power industry, it's potentially a major boost for companies involved in alternative energy like wind and solar, as well as domestic fossil fuels like natural gas and coal.

The Good News: Japan

It's important to remember that one of the primary reasons we stress holding well-diversified portfolios is because of the kinds of events we see unfolding in Japan today. Simply put, well-diversified portfolios are the best defense investors have against these rare and unpredictable "black swan" events. This is because broad diversification allows portfolios to better weather the panic driven downturns that typically follow such events and to more quickly recover once reason and rationality replace fear and panic. It's important to remember that panic selloffs come with a silver lining. When selloffs occur, companies become oversold; including companies that will feel no negative impacts from the event, and this creates opportunities for rational, long-run investors.

In fact, during a recent conference call, two of our fund managers expressed their disappointment that the downturn associated with the Japanese quake and uprisings in the Middle East were so short-lived. Since the market recovered more quickly than usual, they were unable to capitalize on as many bargains as they would have liked to have purchased. On the other hand, we think maybe the quick recovery is a sign that the high levels of fear and uncertainty that have dominated the market since the Lehman Brothers collapse in late 2008, are beginning to subside.

Confronting the Fear: Middle East Turmoil and Oil Prices

Over the last few months, the events in North Africa and the Middle East have been shocking…to say the least! Although the supply of oil has not changed over the past few months, the premium placed on that supply certainly has. This has resulted in higher oil prices, greater volatility in oil trading and higher prices at the gas pump. We think the volatility will likely continue for some time, as will elevated prices at the pump. However, this doesn't mean oil prices will rise far enough to jeopardize the economic recovery. The price of a barrel of oil would probably need to rise well above $125 per barrel for a sustained period of time to endanger the recovery. Fortunately, the last thing OPEC wants is a global recession because it would cause oil prices to fall dramatically. So should prices reach threatening levels for a sustained period, rest assured that the Saudis and other OPEC nations will open the spigots in order to drive prices down. Remember, during the last recession oil prices fell to $35 in very short order and Middle East economies suffered. OPEC needs the world economy to grow, particularly in this time of heightened unrest among their citizens, so it's in their best interest to make sure oil prices don't jeopardize the recovery.

The Good News: Natural Gas

Another factor working in our favor is the price of natural gas has remained low while oil prices have risen. This is important because natural gas can be a direct substitute for oil in many cases. Natural gas prices on the world market have fallen 50% over the past three years, and the drop has been largely the result of the U.S. importing far less natural gas, in spite of the fact that domestic natural gas consumption continues to rise. This has occurred because domestic gas production has grown rapidly in the past few years and continues to do so.

What's behind the increase in domestic natural gas production is new technology that allows drillers to tap into abundant natural gas reserves that were once locked up in vast, inaccessible shale beds. With these reserves now unlocked, estimates of recoverable natural gas in the U.S. are as high as 2,500 trillion cubic feet, which equates to enough gas to last the country more than 100 years! As

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we already mentioned, one of the major advantages of natural gas is that in many cases it can be used as a direct substitute for imported oil. For example, natural gas can be used to heat homes or fire power plants in place of oil, and it can be used to power trucks and buses. The northeastern U.S., which has long been reliant on heating oil to heat homes and businesses during those long New England winters, is now in the midst of a major shift to natural gas heat. As luck would have it, one of the largest concentrations of gas-bearing shale deposits in the world, the Marcellus formation, lies directly under the states of New York, Pennsylvania and West Virginia—right on the doorstep of our largest northeastern cities.

More Good News: A Tipping Point

Across the country, municipalities and large corporations are converting their fleet vehicles to run on natural gas, including city bus lines, because it's cheaper. Also because retrofitting existing diesel vehicles can be expensive. There is currently a bill before congress to provide tax breaks to truckers and trucking companies who convert their trucks over to natural gas. That said, while retrofitting existing diesel vehicles to burn natural gas can be expensive, building new family cars that burn regular gas, natural gas, or any type of ethanol only adds an extra $100 to the sticker price. That's why we think the day is approaching when all new cars sold in the U.S. will be "flexible fuel" vehicles, giving Americans the ability to choose whatever type of fuel is cheapest at that moment. You may recall that at our client dinners we discussed a "tipping point" where higher oil prices will drive producers and consumers to use more natural gas? Well, we may already be there.

So are higher oil prices something to fear? In the short run, higher oil prices can definitely cause some pain at the pump. However, because we have greater access to alternative fuels, we are less reliant on oil today than we have been in the past. In addition, higher oil prices will only accelerate the move toward alternatives, which is something the oil exporting nations are beginning to worry about. That's the kind of fear we actually like to see.

Confronting the Fear: The Federal Budget Deficit

Anyone who reads our newsletters knows we're debt averse. That's not to say all debt is bad— if used correctly, debt can be a powerful tool. In fact, almost every company in existence uses debt to some extent because it helps increase their earnings. Without bond issues, most public universities and community colleges in this nation wouldn't exist…and neither would much of the nation's transportation infrastructure…and so on. So the key isn't eliminating debt entirely, but identifying the appropriate uses of debt and eliminating the inappropriate ones.

The surge in federal budget deficits in the past several years has been a result of lower tax revenues combined with higher federal spending. This situation has been mostly driven by one of the worst recessions in history, coupled with a major financial crisis and two ongoing wars. Up until now we're fortunate that low interest rates have allowed us to finance this debt at bargain basement rates, and this has provided a window of time to get federal spending under control before rates rise and servicing new debt gets more expensive. That window won't stay open forever. Our view is that the national debt is manageable at current levels, but we need to act aggressively on our annual deficits before it's too late.

Americans need to collectively recognize that, in order to solve this problem, everyone is going to have to accept some changes to the federal budget that they may not like. The days of lower taxes combined with higher levels of government spending are over, and we need to get our fiscal house in order. The budget problems are definitely fixable, but fixes will not be without some pain. Our view is that Americans will simply need to learn to do more with less, which is something our parents and grandparents were very accustomed to…and very good at.

The Good News:There's a Solution

As we've mentioned before, an excellent roadmap for how we can get the country out of the budget mess we currently find ourselves in is available from the National Commission on Fiscal Responsibility and Reform (www.fiscalcommission.gov). This is a truly bipartisan commission co-chaired by Erskine Bowles and Alan Simpson and the commission's report is the most comprehensive analysis of our budget situation that we've read. It also provides a clear and concise set of directions for how to get federal spending under control. We believe that once Washington tires of playing politics and gets down to the actual work of making the tough decisions, much of what is laid out in this report will be adopted. As of last week, 64 senators from both sides of the aisle agree. In addition, Standard and Poor's issued a warning about lowering the rating on government debt. We don't think that's likely, but it provides additional motivation to get our debt amount under control. At this point, we believe there's an excellent chance that we'll make the changes that are required. This is good news…

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Confronting the Fear: The Federal Reserve, QE2, and Inflation

As we've written before, "quantitative easing" is something few understand but nearly everyone hates–which makes for an interesting dynamic. How quantitative easing works is that the Federal Reserve buys bonds from banks, in turn crediting the banks' balance sheets for the amount of the sale. This helps keep long term interest rates low because the Fed's purchases drive up the price of long term bonds, thereby driving down the yields. The Fed is doing this because lower long-term interest rates act as an economic stimulus, encouraging businesses to expand and consumers to spend on big ticket items like houses, cars, and washing machines.

In addition, quantitative easing increases the nation's money supply because the "cash" the Fed uses to make the bond purchases goes onto the banks' balance sheets, where it earns nothing unless they lend it. This obviously stimulates and, in turn, the economy. The Fed used QE aggressively in late 2008 and early 2009 and it helped stabilize a shaky financial system at an extremely critical time. In contrast to QE2, the first round of quantitative easing had few opponents. Which is also puzzling…

One of the major criticisms of QE2 is it will be inflationary. However, we've seen no evidence of that occurring so far. Gas and food prices have obviously been rising, but those prices are not being driven by QE2. In the case of oil, the price increases are largely the result of unrest in the Middle East and increasing demand for oil from emerging markets countries. Food prices, on the other hand, are the result of global crop shortages driven by extreme weather (both floods and droughts) over the past few years. This has been a major windfall for U.S. agricultural producers, but is costing U.S. consumers more when they visit the grocery store.

Interestingly, since higher food and oil prices both act to slow economic growth, the Fed believes this makes QE2 even more essential than when it was first announced. Frankly, we agree, and remain puzzled by the strong opposition QE2 has had to contend with. Some of this opposition is no doubt political, but most can probably be attributed to a basic lack of understanding of Fed policy and monetary economics.

The Good News: A Track Record of Excellence

Finally, it's important to note that there are risks to everything the Fed does (or doesn't do). However, assessing these risks requires a basic working knowledge of macroeconomics and monetary policy. Judging from their comments, these are things many of the harshest critics of QE2 clearly lack. As a result, we feel it appropriate to repeat the words of Mark Twain (used in a recent email update) who once quipped, "It is better to keep your mouth closed and let people think you're a fool than to open it and remove all doubt."

Overall, we see little inflationary threat from QE2. First, it seems unlikely the economy will be able to grow at a rate high enough to cause inflation while unemployment remains in the 8%-9% range. Unemployment, while falling steadily, still has a long way to go before getting back to anything resembling "normal" levels. Second, when the economy does begin to grow fast enough to cause inflation, the Fed will sell bonds back to the banks, which will drive long-term rates up and shrink the money supply, thereby slowing economic growth. The Federal Reserve's number one target (adopted following the stagflation era of the late 1970's and early 1980's) is inflation—and they've been very successful in controlling it. Since 1982 inflation, as measured by the CPI, has averaged less than 3% annually and exceeded 5% only once (in 1990). In other words, history suggests that if you want something to worry about, almost anything would be worthy of your attention, except inflation.

The Economy and Our Managers

What's amazing to us is that even with all of the exogenous events over the last few months, the economy remains right on track. As we have stated numerous times, this is because the recent recession was driven by the financial sector, which will result in a slower than normal economic recovery. At this point, the economic recovery is no longer as fragile as it once was either. And, if you look at corporate Americas cash flows, it is clear that our economy is expanding. In fact, we've seen little effect on the long term trends of the economy from the most recent of these major exogenous events and that's a very good sign.

Overall, given where we started two years ago, it is hard to be depressed over the direction of the economy. There is clearly a lot of room for economic improvement, but we're pointed in the right direction and the vast majority of economic trends are positive. Many will want to dwell on things like the high unemployment rate and use it to characterize our country's prospects, but we've been saying all along that jobs are the last thing to recover in recessions and that credit-driven recessions tend to be plagued by

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high, persistent unemployment that can take years to return to normal levels. So while we hate to see a fraction of the U.S. population out of work, we don't believe it will have much of an effect on global growth…or on the long-term value of our portfolios.

Our Managers

We would be remiss if we didn't at least acknowledge the excellent job our managers have done over the last two years. Yes, they have performed well over the quarter, as you will see on page 14. However, just as we take a long-term view as investors, we also take a long-term view when analyzing the performance of our managers. If you look at our managers' long term track records, the numbers speak for themselves.

In addition to looking at their long term track record, another area we consider when evaluating managers is how they've behaved when things looked bleak or when they've been dealt a bad hand? As my father use to say, you find out a lot about people when times are tough. Over the last two years, we owe a lot of our success to our managers. Some of the best strategic decisions we've made were driven by research and in-depth economic analysis our managers generated. So, when you examine your quarterly returns—and smile—think not only of us, but of our group of excellent fund managers as well.

A FINAL NOTE

As usual, if you have any questions about this update, our newsletter, your accounts or our managers, please feel free to call or e-mail us at anytime. The recent referrals are much appreciated and we thank you for your continued confidence in our firm and our services. As we go forward, we remain committed to continuing to refine and improve our proactive strategies and portfolios. As always, our goal is to provide each of our clients with the best possible mix of assets given their particular situation. If you need anything or your goals or time horizons have changed, please do not hesitate to call or drop an e-mail to set up an appointment. We are here to serve your financial needs, whatever they may be.

Wishing you all a very Happy Spring and start to a wonderful summer!

~ Joe and The Gang at KWAG

COMPLIANCE NOTES

A Note From KWAG's Chief Compliance Officer

It is time again to offer our annual Disclosure Document. This year the U. S. Securities and Exchange Commission (SEC), renamed and revised this document. As we have previously described, this is the document in which the firm discloses their annual practices and policies. The document known as the Disclosure Document has now been renamed the FIRM BROCHURE. The SEC now requires a much more narrative document. These changes have been implemented at KWAG and we want to take the time to offer this document to you and encourage you to take the time to read it. ***Our KWAG FIRM BROCHURE can be found on our website at www.thekielygroup.com, under KIELY FORMS.*** If there is anyone who would like to receive a paper copy of this document, please email me at the address below or call our headquarters office at #877-366-5623. We will be happy to send one to you.

In addition to the newsletter and statements, we have also included in this mailing our most current Privacy Policy for you to read. As always, we want you to know how important your confidential information is to us and the policies we follow to ensure your privacy.

Thank you for your continued confidence in our firm. As always, we are committed to better understanding your investment objectives, goals and knowing how we can better serve you.

Best Regards,
~Katie Burr
katie@thekielygroup.com

THE GANG AT KIELY WEALTH ADVISORY GROUP

Left to Right: Brownie Cordell; Katie Burr; Joe Kiely; Kellie Kiely; and Scott Below

***IMPORTANT DISCLOSURE INFORMATION**

Performance results *represent results reported by each reflected mutual fund during the corresponding time period. Kiely Wealth Advisory Group, Inc. ("KWAG") currently utilizes these mutual funds in managing actual client portfolios. However, the individual mutual fund performance results* ***do not*** *reflect the results of any specific KWAG client portfolio or any KWAG composite.*

Past performance *may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal either the performance results reflected or any corresponding historical index. The historical index performance results are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a specific investment meets, or continues to meet, investment objective(s). It* ***should not*** *be assumed that any account holdings will correspond directly to any comparative index. The performance results do not reflect the impact of taxes.*

Please Note*: the individual depicted mutual fund results* ***do not*** *reflect the results of any specific KWAG client portfolio or any KWAG composite.* ***For reasons including*** *variances in portfolio account holdings, market fluctuation, and any account contributions or withdrawals, the performance of a specific client's account may have varied substantially from the indicated reported mutual fund results. In addition, the above results only reflect the results as reported by each respective mutual fund company. Portfolios managed by KWAG would also incur a KWAG advisory fee, the deduction of which would result in decreasing the reported performance results.* ***For example:*** *a KWAG advisory fee of 1% compounded over a 10 year period would reduce a 10% return to an 8.9% annual return).*

Please Remember: *In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise KWAG immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by KWAG) will be either suitable or profitable for a client's or prospective client's portfolio.* ***In addition****, the mutual funds depicted are funds that KWAG may utilize and/or recommend as of specific date, and are subject to change without notice* ***Accordingly****, no client or prospective client should assume that the above reflected mutual funds serve as the receipt of, or a substitute for, personalized advice from KWAG, or from any other investment professional.* ***Information*** *pertaining to each depicted mutual fund is set forth in each respective fund's prospectus, a copy of which is available directly from each mutual fund company or from KWAG upon request.*

All performance results *reflect the performance results reported by each respective mutual fund to Morningnstar**,** and have not been independently verified by KWAG. KWAG also maintains all information supporting the reflected mutual fund performance results.*

Information pertaining *to KWAG' advisory operations, services, and fees is set forth in KWAG' current disclosure statement, a copy of which is available from KWAG upon request.*