Dear Investor,

After a relatively good first half, the third quarter has been a difficult one for investment performance, with most accounts now at break-even for the year, after a profitable first half.

Outlook and near term portfolio strategy

The risk of a global recession increased this quarter as members of the European Union weighed their countries' interests against the interests of the union. There are two key risks for investors. The more immediate is that a disorderly default on debt obligations by the Greek government will jeopardize the stability of banks that hold that debt. I think that problem will be successfully addressed through a negotiated debt restructuring and possibly a recapitalization of the most vulnerable banks. The second risk, which will be more difficult to resolve, is that restrictive monetary and fiscal policies throughout the EU will lead to prolonged recessions in Ireland, Spain, Italy, Portugal, and Italy, ultimately resulting in additional sovereign debt crises and possible defaults. Those potentially larger debt crises would threaten the continuity of the European Union, and likely lead to a pronounced and extended global recession.

With the latter risk in mind I continue to move holdings to income generating investments. I believe these investments will help support your account value in this volatile period, and will generate positive returns over a slightly longer time period.

The income securities I have invested in to date range in their level of market correlation and risk. Some of the securities, such as real estate investment trusts (REITS), are highly correlated with the market on a short term basis, and lose value when markets are down. Except under the most pessimistic scenario, however, those holdings will be profitable over several years. Other income holdings, where you also have significant investment, have less market risk. Examples include highly rated municipal bonds, shorter maturity corporate bonds, and floating rate bonds. These alternatives generally offer lower yields than REITS or longer maturity bonds, but they have less price risk and should help to further reduce overall portfolio volatility.

Currently about two thirds of your IRA is in investments focused on income, with those holdings spanning the spectrum of risk described above. It's my goal to maintain this portfolio mix for at least the near future. The taxable account may have a slightly higher allocation to common stock when fully invested, depending on how inexpensive stocks get.

It is the case that despite a substantial level of risk currently associated with global stock markets, the recent market disruption has brought a number of stocks down to attractive valuations. Natural resource stocks have been hit particularly hard and are trading at or near multi-year lows despite relatively high resource prices. Many of these stocks have lost more than a third of their value in the last two months. We have modest exposure to this area, and that exposure has hurt account performance this year. These investments, however, have long term appeal as beneficiaries of demand growth from industrializing markets like China and India. They also serve as hedges against inflation. While inflation is not an immediate concern, the US may have to gradually devalue the dollar as a means of reducing its debt burden to non-US creditors. That development would most likely inflate the prices of dollar-quoted natural resources like oil, as well as the minerals used by large farms as fertilizers - phosphate rock and potassium.

I particularly like the miners of phosphate and potassium, because the minerals are limited in supply and their consumption is less cyclical than that of most natural resources. In addition, two companies (Potash Corporation and Mosaic) control the majority of North American reserves, giving them substantial pricing power. I have begun cautiously adding to these holdings at current share prices. In general, I remain alert to stocks which look inexpensive and well positioned for longer term growth, and plan to add cautiously to those positions over time.

Fees for the September quarter are enclosed as a separate attachment. Since the new joint account was in a ramp up phase through the quarter, I excluded it from fees – it will be included in the fee base in the fourth quarter.

As always, please let me know if you have questions or comments.

Doug