945 Technology Blvd., Suite #102, Bozeman, MT 59718

February 12, 2013

Dear Client,

We hope this letter finds you well and off to a great 2013! Enclosed find your fourth quarter and annual 2012 performance reports. 2012 IRA distribution reports and capital gain/loss reports are also enclosed (for those that need them) and be watching the mail for various tax documents, such as 1099s and 1099-Rs, which will come directly from TD Ameritrade. Our capital gains report and TD Ameritrade tax forms should be provided to your tax preparer. Additionally, for those clients over 70 ½ who made direct donations to charities from their IRA's, our IRA distribution report, showing those charitable donations, should be provided to your tax preparer.

We will first discuss, in general terms, where we have been and our opinion of where we are going in the markets. Then we will discuss the often misunderstood area of investment costs, including our fee. Clients have every right to be concerned about investment costs and the value received from paying them.

GENERAL MARKET COMMENTARY

Looking back at 2012, investors learned once again that there is no way to predict markets over short periods. Despite all the "gloom and doom" news about the European debt crisis, the looming "fiscal cliff," etc., the worldwide stock markets actually did pretty well in 2012, going up over 15% for the year. Despite the so-called experts in the financial media, no one, including us, has developed a "crystal ball" to accurately predict the future short- term market performance of any stock, mutual fund, or asset class.

Fortunately, unless the investor needs to liquidate a depressed investment during the period, returns over such short time periods as one, three, or five years are meaningless. The really important returns are over much longer time periods, and those long-term returns are normally far more predictable. For instance, the U.S. stock market is moderately overvalued now (despite reaching the level they were at 12 years ago, when they were *ridiculously* overvalued!), so investors should anticipate somewhat modest long term returns over the next decades.

Bonds returns, by comparison, are relatively easy to predict. The return on high quality bonds is probably going to be equal to the current yield on those bonds. Unfortunately, looking forward, the return on bonds will almost certainly not even keep up with inflation. To be sure, clients do need some bonds in their portfolio, but, at this stage, those bonds should be short term, and only sufficient to provide for liquidity for those making withdrawals and to keep the overall portfolio volatility within the investor's "comfort zone."

Realize that these are very general comments and that we will make specific recommendations tailored to your unique situation and objectives when we meet to discuss your portfolio.

ARE WE EARNING OUR PAY?

Even though our clients' total fees are among the lowest in the industry, clients are justifiably concerned about investment costs, especially the fee they pay advisors. Investors must consider their *total* fees, including advisory fees (such as ours), commissions (which you do not pay), mutual fund annual expense fees (which the investor does not see), and discount brokerage transaction costs ($24/transaction at TD Ameritrade). All of these fees, both obvious and hidden, have equal

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impact on the investor's ultimate returns. Most mutual fund investors, especially those investing through stock brokers, pay 1 1/2% or more annually in total fees. *You pay far less*.

A recent article in one of our professional journals addressed this very question, describing the "professional alpha," the excess return a client working with a competent, fee-only advisor receives compared to the average "do it yourself" investor and those who invest through stock brokers. Of course, just like the citizens of Lake Wobegon, most investors *just know* they are above average, but the research plainly proves otherwise. Two very reputable studies have compared the results of long-term mutual fund performance against the actual performance of "do it yourself" investors in those mutual funds. The average investor, over all periods studied, trailed the mutual fund performance and the overall stock market by 2 to 4% a year. This was due to investors chasing the latest "hot fund" or stock or buying (selling) when they should be selling (buying). Another study demonstrated that clients investing through stock brokers actually underperformed the "do it yourself" investors.

The fee-only advisor advantage doesn't end there. A knowledgeable advisor should be able to identify stock asset classes that both add performance and/or reduce risk over most long periods (think DFA funds), identify asset classes that are obviously mispriced (think long term bonds today), position the client in a tax efficient portfolio, and periodically rebalance the portfolio as necessary. All of these add an additional 1 to 2% a year to the portfolio's performance over the "do it yourself" or broker assisted investor.

We strive to select very low cost mutual funds. Your annual mutual fund expenses average approximately .25% annually, versus considerably over 1% annually for the overall mutual fund industry average. By using transaction fee funds at TD Ameritrade, we avoid using funds with far higher annual expenses, which is a very beneficial tradeoff for the client.

Note that this "professional alpha" does not include any ability to pick the next superiorly performing stock or mutual fund, an impossible task (despite what stock brokers may tell you). This degree of outperformance is simply due to the advisor having a knowledgeable, disciplined approach to investing, keeping abreast of new opportunities and changes in the tax law, realizing that unexpected downturns will occur, and convincing nervous clients to 'stay the course' during these downturns.

We recently analyzed how the stock portion of our actual client portfolios performed, *after all fees*, since the peak of the US broad stock market in April 2000 (a level that still has not been reached again 13 years later!). While an exact comparison is impossible, as the client portfolios included deposits and withdrawals, our client stock positions earned approximately 5.5% annually after all fees, while the broad US markets returned only approximately 1.5% (entirely due to dividends). While a 4% annual difference may not seem like much, it resulted in over *50% more ultimate wealth*, compared to the broad market, over this 13 year period for our clients. While we certainly cannot guarantee this level of outperformance over future periods, we are confident that we will provide long-term value considerably more than the clients are paying us. We encourage you to contact us if you have any concern whatsoever about the fees you pay.

As always, we thank you for the opportunity to serve you as your financial advisor.

Sincerely,

Doug Babcock Bob Frey