ROCKBRIDGE INVESTMENT MANAGEMENT, LLC

Financial Common Sense

April 2010

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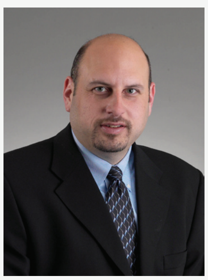
CFA



Anthony R. Farella
CFP®, AIF®

Rockbridge Investment Management is a group of like-minded professionals working with a select group of clients with whom we can have a significant impact. Everything we do is focused on building and preserving wealth for our clients. We help remove complexity so clients can focus on the simple but difficult process of successful investing.

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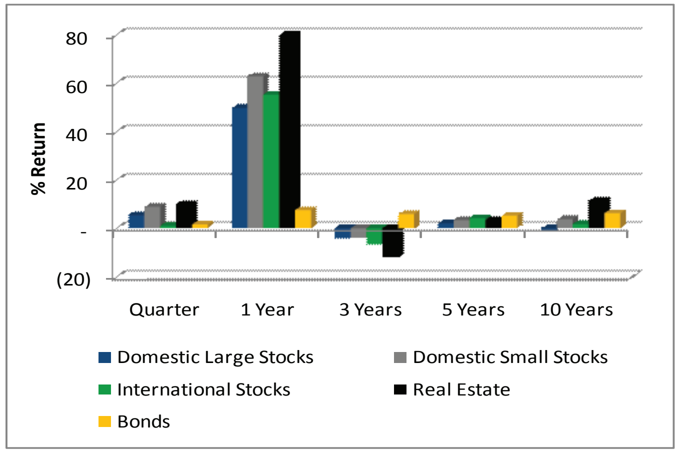
Market Commentary by Craig Buckhout



Financial markets continued their winning ways in the first quarter of 2010 marking four consecutive quarters of positive stock market returns. The chart at right shows the impressive performance of small company stocks during the past three months and the fact that all major asset classes had positive returns.

The chart also shows impressive gains over the past twelve months, reminding us how dramatic the recovery has been from the depths of the financial crisis (S&P 500 up 50%). The consensus forecast a year ago was for a long, slow recovery of the world economy, which appears to be occurring. The snap-back in equity values can be attributed to a stabilization of the economy that has reduced uncertainty. No one expects a sudden jump in sales and earnings, but stock values have responded favorably as the risk of a market meltdown fades in the distance.

Can The Market Continue To Improve?
Many of us are feeling better about our nest eggs as we watch them recover much of their pre-crisis value. So how much upside remains? Unemployment remains high and sales and

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Is it Time to Convert Your Traditional IRA?
by Anthony Farella

Individuals are permitted to convert their Traditional IRAs ("TIRA") to Roth IRAs if they meet current income limitations set by the IRS. In 2010 the income limits are removed allowing anyone to convert. I set out to examine when OR if a client should convert their traditional IRA to a Roth IRA.

Facts:

1) Individuals converting to Roth IRAs must add the amount of conversion to their income and pay federal and state taxes on the converted amount at their highest marginal tax rates.

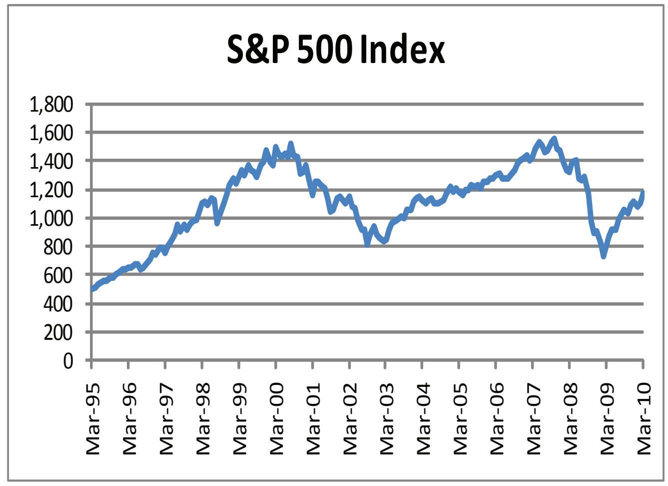
2) For any conversions in 2010, tax liability can be spread equally over the 2011 and 2012 tax year.

3) Conversions are designed to be tax neutral. If client IRA assets are invested the same way in either a Traditional or Roth IRA, and marginal tax rates are the same, then after-tax income is the same for either IRA account. See example:

(Continued on page 4)

Market Commentary (cont.)

profits are still far from pre-crisis levels. The chart at right provides an interesting perspective, showing the value of the S&P 500 index over the past 15 years, ignoring dividends. This provides a clear picture of the technology bubble and the financial crisis. Over the 15-year period the index has nearly tripled in value, but what a ride! It also shows that the 500 largest U.S. companies have, twice in the past ten years, been valued 30% above their current valuations. If we have some faith in the U.S. economy, it seems that we should be able to achieve those levels again, but through sustainable growth in sales and earnings and without the aid of an economic bubble. We are also certain to see some bumps in the road and some negative quarters along the way.



Why Bonds?

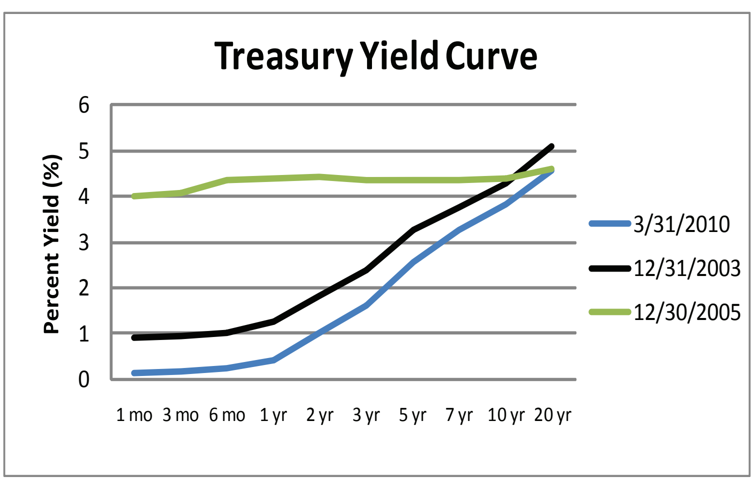
With returns that appear insignificant compared to stocks and the threat that inflation and higher interest rates will chew up bond values, why continue investing in bonds? Diversification is the key benefit of bonds, which was clearly demonstrated in 2008 when stocks were down 37% and the bond market was up 6%.

If Interest Rates Are Sure To Rise, Should We Get Out Of Bonds To Avoid Devaluation?

Not necessarily, because if rates rise, a diversified bond portfolio could still perform better than cash or short-term bonds. Rising rates devalue bonds, but rates do not always rise for all bonds. The chart below shows how money market rates rose from less than 1% to over 4% between December 2003 and December 2005, and yet long-term rates actually fell. The steepness of the current yield curve reflects the expectation of increasing rates, but the increase could flatten the curve rather than result in higher yields at all maturities.

It is also worth noting that bond returns were positive in 2004 and 2005. As rising rates were devaluing bonds, interest income was sufficient to keep total returns positive.

But What If Inflation Takes Off Like It Did In The 1970s And Rates Skyrocket? Then it might make sense to look toward TIPS (Treasury Inflation Protected Securities) as a source of positive returns. The principal value of TIPS, which is paid at maturity, grows at the rate of inflation. However, this insurance against inflation is not free. If inflation turns out lower than projected, TIPS will underperform normal Treasury bonds.



In summary, bonds provide diversification and TIPS diversify the bond portfolio and provide protection from unexpected inflation. Diversification has been described as, "always owning something that you wish you didn't own." In 2008 we were glad to own some bonds. Over the past twelve months it would have been nice to own only stocks. Bond diversification helps to stabilize returns, and in the long run, that is a good thing. ◆

Control the Controllable, Ignore the Rest

Patrick E. Rohe
CRPC®

Like most things in life, the simple approach to doing something almost always tends to be the best. This theory holds true when it comes to investing and is one of the cornerstones behind our investment philosophy.

> *"Gross return in the financial markets, minus the cost of financial intermediation, equals the net return actually delivered to investors."*
> - John Bogle

At Rockbridge Investment Management, we feel that one of the main culprits of investment underperformance is the cost associated with investing. It is because of this that we construct all investment portfolios using passively managed index funds, which are a fraction of the cost when compared to their actively managed counterparts.

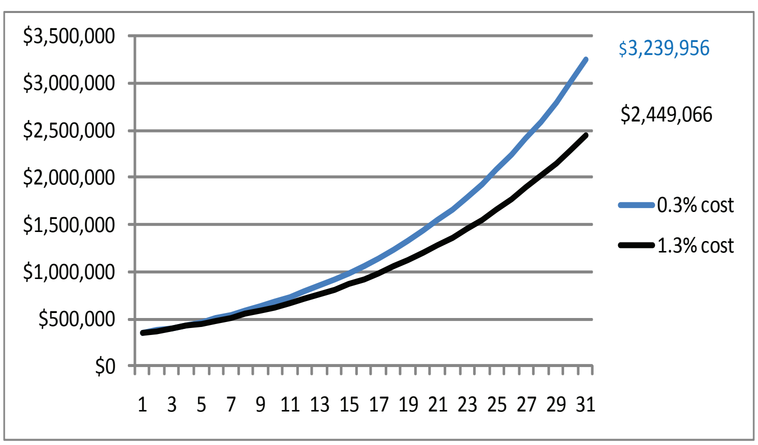
Numerous studies have shown that only about 20% of active portfolio managers will outperform their respective portfolio benchmarks over a 20- or 30-year time period. This is not due to lack of intelligence by these money managers, but rather to the efficiency of capital markets.

To quote John Bogle again, investing "is a zero sum game before costs and a loser's game after costs." If a money manager charges a 1.5% fee, then he automatically must outperform the market by at least that before the investor sees any benefit. Since active management is run by individuals, this now adds another layer of risk to your portfolio. Human beings have a tendency of letting emotions dictate their investment decisions, and if they are already starting below market returns (-1.5%), then there might be the inclination to take on some unnecessary risk to make up for their high fees.

Below is a graph that shows how the additional costs of active management can greatly affect an investment portfolio. The graph portrays the difference an additional cost of 1% can have on a $350,000 portfolio earning an 8% real rate of return over a 30-year time horizon.

It is critical for any investor to control the factors that can be controlled, like costs, asset allocation and risk, while ignoring the rest. Contrary to what many people believe, proper investing should be simple and about taking calculated risks that will reward investors over time.

In conclusion, I would advise any investor to go out and enjoy their hobbies, channeling their emotions into their daily living, while leaving their simplified and disciplined investment portfolio to make them financially secure during retirement.◆



Is it Time to Convert Your Traditional IRA? (cont.)

TIRA v. Roth IRA	Tax Rate	Deposit	Avg Growth Rate	Balance in 20 Yrs	After-tax Balance
Roth IRA	32%	$6,800	8%	$31,695	$31,695
Deductible TIRA	32%	$10,000	8%	$46,610	$31,695

4) Higher or lower after-tax spendable income **only** occurs if future tax rates are different from current tax rates. For example, if future marginal tax rates are higher, then a Roth IRA would produce more after-tax income.

5) Roth IRA's are NOT subject to required minimum distributions.

Analysis:

- Client who has 2 assets – TIRA and Brokerage account (assumes 1.3% return loss to income taxes on the brokerage account – 70/30 portfolio):

TIRA v. Roth IRA	Tax Rate	Deposit	After-tax Growth Rate	Balance in 20 Yrs	After-tax Balance
TIRA	50%	$100,000	8.0%	$466,096	$233,048
Brokerage	50%	$50,000	6.7%	$182,919	$155,481
Total TIRA/ Brokerage		$150,000		$649,015	$388,529
Roth IRA	50%	$100,000	8.0%	$466,096	$466,096

While I cannot say there are hard or fast rules on when or if to convert an existing traditional IRA, below are some situations where the decision becomes easier to make:

YES - Convert

- For clients with after-tax investments, who are in a high marginal tax bracket and will be in a high marginal tax bracket during retirement;
- Clients who are subject to estate taxes;
- Clients who wish to pass their Roth IRA accounts tax free to their beneficiaries and future generations.

NO – Don't Convert:

- Anyone who has to pay the tax with existing IRA assets (no brokerage or savings);
- Clients in retirement living off their IRA money;
- Clients who are sure to be in a lower tax bracket at retirement.

Please contact me for a more detailed analysis if you are considering a Roth conversion.◆

Returns from Various Markets

The following table shows the returns from various markets over periods ending March 31, 2010:

Market/Asset Class	Quarter	1 Year	3 Years	5 Years	10 Years	20 Years
Money market	0.0%	0.2%	2.0%	2.9%	2.9%	4.0%
Bond market	1.5%	7.5%	5.8%	5.2%	6.2%	7.1%
Large-cap stock market	5.4%	49.8%	-4.2%	1.9%	-0.7%	8.7%
Small-cap stock market	8.8%	62.8%	-4.0%	3.4%	3.7%	8.9%
International equity market	0.9%	55.2%	-6.6%	4.2%	1.7%	5.6%
Inflation	0.2%	2.1%	2.1%	2.5%	2.5%	2.7%

Market Benchmark Portfolios

The following table shows returns from our market benchmarks over periods ending March 31, 2010:

Benchmark	Quarter	1 Year	3 Years	5 Years	10 Years	20 Years
Capital preservation	1.2%	8.3%	3.1%	3.9%	4.1%	5.7%
Conservative	2.1%	18.0%	2.3%	4.1%	4.1%	7.0%
Moderate	3.0%	28.4%	1.0%	4.2%	3.8%	7.9%
Aggressive	3.6%	37.8%	-1.2%	3.7%	2.7%	8.0%
All equity	4.2%	52.0%	-4.8%	2.8%	1.3%	7.8%

Note: These results were developed by simulating past returns in the various markets included in each benchmark, assuming the reinvestment of dividends and other earnings and deductions of costs totaling 0.20%. The money market is represented by 90-Day Treasury Bills; the bond market by the Barclays Capital Government/Credit Bond Index; the domestic large cap market by the S&P 500; the domestic small cap market by the Russell 2000 Index; and the international equity market by the EAFE Index. This data is presented to show the long-term relationship between returns at various levels of investment risk. It is not intended to present performance results experienced by clients of Rockbridge Investment Management, but is intended to provide a benchmark against which actual performance might be judged. Also, readers should recognize that future investments would be made under different economic conditions. It should not be assumed that future investors would experience returns, if any, comparable to those shown above. The information given is historic and should not be taken as any indication of future investment results.