Financial Common Sense

ROCKBRIDGE INVESTMENT MANAGEMENT, LLC

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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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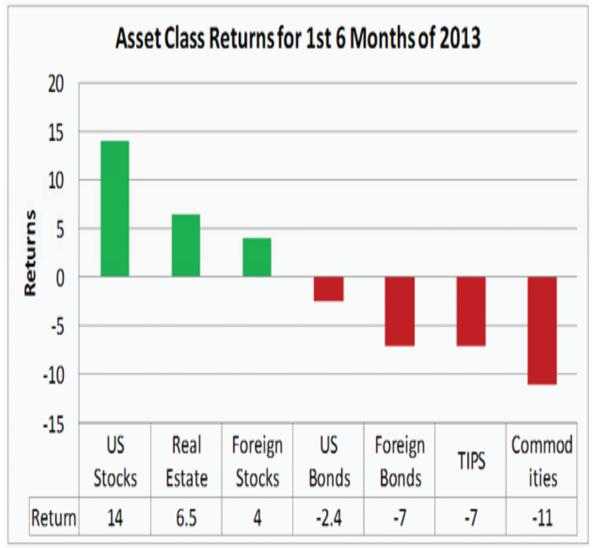
Market Commentary by Anthony Farella

Volatility returned this quarter in both stocks and bonds as fears about the central-bank actions across the globe made investors nervous about the future. Large Cap U.S. stocks, represented by the S&P 500 Index, returned 2.9% in the second quarter, bringing the year-to-date return up to a lofty 14.0%. By contrast, the EAFE Index, a measure of developed international markets, lost 1.0% in the quarter, bringing the year-to-date return down to 4.0%. In fact, as shown in the graph at right, no other asset class comes even close to the return on U.S. stocks so far this year.



Source: The Capital Spectator

Bonds

The Barclays U.S. Government/Credit Index had a negative return of 2.5% for the quarter. Bond returns move in the opposite direction of interest rates. The yield on the 10-year Treasury moved from 1.6% at the beginning of May all the way to 2.6% in June, before pulling back slightly to end the quarter around 2.5%. The increase in interest rates was the cause of the negative bond returns for the quarter.

Bond markets were hammered after Fed Chairman Ben Bernanke announced last month that the bank may start winding down its bond-buying programs. The Fed policy of buying bonds to keep interest rates artificially low was intended to spur the economy and reduce unemployment. Many economists came out against the policy fearing a dramatic increase in inflation. However, inflation has been quite modest and the market expectation for future inflation is quite low. While the

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How Bad Was This Quarter for Bond Investors? by Craig Buckhout

The benchmark bond index that we follow, Barclays U.S. Government/Credit Index, lost 2.5%, the worst quarter since 1994. In fact the quarterly result has only been worse 8 times in the past 40+ years (162 quarters).

The Barclays U.S. TIPS Index had its worst quarter ever losing 7.1% (data only goes back to 1997).

Markets do not like surprises – even when the information is not really a surprise. The financial media has dubbed it the Taper Tantrum, which started when Ben Bernanke came out of the Fed's June meeting and said the Fed would taper its purchases of long-term bonds, if the economy continues to improve. The so-called quantitative easing program was intended to hold down

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Geoff Wells

2013 Rockbridge Survey and Company Updates
by Geoff Wells

First and foremost, we would like to thank everyone who participated in our 2013 Client Survey. We are constantly looking for ways to improve our business and services, and we greatly value your feedback.

For those of you who didn't get an opportunity to take the survey, I will summarize the results of each of the three sections. The full results of the survey can be found on our website, www.rockbridgeinvest.com.

Rockbridge Quarterly Performance Reports
The majority of survey participants responded that our quarterly statements contained the right amount of information without being overwhelming.

Client Communication Channels
In general, more and more clients are using electronic communications and social media (Facebook, LinkedIn, etc.). We continue to spend a great deal of time updating and maintaining our website and blog to keep clients up to date. Unfortunately, we have not made clients aware of the updates, so we plan on increasing that communication in the near future.

Rockbridge Growth
A majority of clients stated that Rockbridge's most valuable service was to provide unbiased financial advice. We were quite happy with this response as it is our primary goal as financial professionals. The survey also showed that clients do recommend Rockbridge to friends, family and colleagues; however, explaining the benefits of Rockbridge can be difficult to describe.

Upcoming Actions
With the survey feedback, we are in the process of implementing a few improvements.

To help clients see all of our new website/blog content, we plan on starting a new monthly email with all Rockbridge updates and key articles. With the relentless 24-hour financial news coverage, we hope to help clients sift through the noise and highlight the topics that are valuable and important.

We are also increasing our online and social media presence. Starting in 2014, we will have a completely new website design with video to help clarify the benefits of Rockbridge to both current and future clients. In addition, we plan on sharing all blog articles and Rockbridge updates on both Facebook and LinkedIn. You will be able to find links to our content on our website. With electronic mail, our website and social media, we hope to increase our client engagement and improve our communication above and beyond the traditional paper mail statements, phone calls and in-person meetings.

Last but not least, we are growing and our current office location is no longer big enough to support our staff and clients. We have signed a new lease for an office at 220 Warren St. which is a half block away from our current location. We are extremely excited about our new location and will keep everyone up to date on the progress in the near future. In addition, we felt that a new location goes along with a new logo. A sneak peak of our new branding can be seen below.

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Thank you again for your participation, and please feel free to contact us with additional ways we can make your experience with Rockbridge a better one!

Golf and Investing by Patrick Rohe

Patrick E. Rohe
CFP®

I know this might be hard to imagine for most of us golfers, but which of the following scenarios would you rather choose:

1. Shooting par every time you go out and play a round of golf.

2. Shooting below par 25% of the time you play and failing to reach par the remaining 75% of the time.

It's an easy decision, right?

The game of golf has many parallels to investing. A score of par is similar to a stock index. It is the base score everyone is trying to reach.

Continuously shooting par, similar to passive (index) investing, is what we do here at Rockbridge. We try to control costs, manage risk and get as much return as the markets allow. With index funds, you always get what you expect when it comes to returns and are left with no surprises. It's much like going out and shooting par every time you golf. Basically, we help you avoid the double and triple bogeys that we are all too familiar with!

The other scenario is to strive for a score lower than par, which is similar to active investing. You incur additional costs – Wall Street "experts"– in an attempt to beat the return produced by an index. However, evidence shows that you will only be able to do so 25% of the time. The remaining 75% of the time you will underperform; and to make matters worse, you will underperform by a much bigger margin than you will ever outperform! This makes perfect sense. When active managers continuously strive for outperformance, they must take additional risks which lead to mistakes. No different than a golfer trying to make eagle on every hole. He will find himself shooting much worse with that constant added pressure!

The situation only gets worse with time as well. Just like shooting a score below par gets harder as we age, your chances of beating index returns goes down drastically when you look at longer time periods. Over extended periods of time, your probability of beating index returns falls into the single digits! Larry Swedroe, in a recent CBS News article, goes on to state that this value is lower than what we would expect by sheer chance! When most investors are saving for long-term goals, like retirement, those don't seem like odds I would be willing to pay extra for!

So, if shooting consistent pars on the golf course sounds like the no-brainer choice, then why do so many people still engage in active management when it comes to investing? In golf, spending additional time/money to improve your game might pay off in a lower score, but unfortunately this does not hold true when it comes to investing. Control costs and shoot for par (index returns) and you will be much farther ahead in the long run. Sometimes it takes a simple analogy to help lead us to making wiser and more prudent life decisions!◆

Market Commentary (cont.)

Fed policy continues to be controversial, the unemployment rate has fallen to 7.6% as of the end of May 2013.

We still expect challenges ahead for the bond market as interest rates rise. However, we cannot predict when and by how much rates will rise in the future. Therefore, we continue to advocate holding high quality bonds in a portfolio. Bonds dampen volatility of a diversified portfolio while also providing income over a long investment time horizon.

Other Asset Classes
Emerging Market stocks continued their year-long decline, reporting a negative return of 8.0% for the quarter. Global uncertainty in these young volatile markets likely fueled the sell-off in emerging market stocks. The Dow Jones REIT Index, a measure of the U.S. real estate market, also reported a negative return of 1.3% for the quarter but was positive year-to-date with a return over the last 6 months of 5.7%. Emerging Market stocks and REITs continue to offer investors diversification benefits in global portfolio construction.◆

How Bad Was This Quarter (cont.)

long-term interest rates to encourage investment, lending, and economic growth.

The market was surprised by Bernanke's comments, and long-term interest rates immediately jumped.

Morningstar recently reported, "Over the past two-plus weeks, many bond investors have headed for the exits, on the heels of Federal Reserve Bank chairman Ben Bernanke disclosing plans to end quantitative easing." This suggests that market participants were assuming the Fed would continue its bond buying indefinitely.

Two things strike me as very ironic:

1. The market was surprised to hear that something always considered a temporary measure, would eventually end… (when unemployment falls to a target of 6.5% and economic growth seems sustainable without the crutch of monetary policy).
2. The prospect of improving unemployment and economic growth hammered both stock and bond investors at the end of June, contrary to an expectation that confirmation of economic improvement should be good for stocks.

There is little doubt that markets will continue to be volatile as the Fed proceeds to unwind the unprecedented monetary policy currently in place. Market participants will try to predict what is going to happen (interest rates will rise – that's easy); when it is going to happen (more difficult); and how to take advantage (approaching impossible).

There has been a general consensus that interest rates must rise since the Fed took short-term rates to zero at the end of 2008. Since January 2009 the bond index has provided an annual return of 4.8%, including the most recent quarter, while money market funds and short-term CDs have provided almost no return. Once again illustrating our long-held beliefs:

- Markets work, and respond to new information.
- Markets cannot be predicted.
- Long-term investors must be willing to endure quarters like this and maintain the discipline of a long-term strategy that is consistent with their risk tolerance.◆

Returns from Various Markets

The following table shows the returns from various markets over periods ending June 30, 2013:

Market/Asset Class	Quarter	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
Money Market	0.0%	0.0%	0.1%	0.1%	0.3%	1.7%	3.1%
Bond Market	-2.5%	-2.7%	-0.6%	3.9%	5.3%	4.4%	5.9%
Large-Cap Stock Market	2.9%	13.8%	20.6%	18.5%	7.0%	7.3%	8.7%
Small-Cap Stock Market	3.1%	15.9%	24.2%	18.7%	8.8%	9.5%	8.9%
International Equity Market	-0.7%	4.5%	19.1%	10.6%	-0.2%	8.2%	5.6%
Emerging Markets	-8.0%	-9.4%	3.2%	3.7%	-0.1%	14.0%	7.6%
Real Estate	-1.3%	5.7%	7.7%	18.1%	7.0%	10.7%	10.4%
Inflation	0.3%	1.5%	1.4%	2.2%	1.5%	2.4%	2.4%

Market Benchmark Portfolios

The following table shows returns from our market benchmarks over periods ending June 30, 2013:

Benchmark	Quarter	YTD	1 Year	3 Years	5 Years	10 Years	20 Years
Capital Preservation	-1.2%	-0.4%	1.5%	3.4%	3.2%	3.6%	4.8%
Conservative	-0.9%	1.7%	5.5%	6.7%	4.6%	4.9%	6.1%
Moderate	-0.5%	3.8%	9.6%	9.8%	5.7%	6.2%	7.2%
Aggressive	0.3%	6.4%	14.0%	12.1%	5.5%	6.8%	7.5%
All Equity	1.4%	10.1%	20.1%	14.8%	4.6%	7.6%	7.5%

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 US Government/Credit Bond Index; the domestic large cap market by the S&P 500; the domestic small cap market by the Russell 2000 Index; the emerging markets by MSCI Emerging Markets Index; the real estate market by Dow Jones US Select REIT Index; and the international equity market by the MSCI 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.