THIRD QUARTER
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DEIGHAN WEALTH ADVISORS

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MARKET COMMENTARY

Since the recession ended, the U.S. stock market has rallied significantly. Though it has experienced some dips along the way, the S&P 500 Index, the most common indicator of U.S. stock market performance, has doubled in value since reaching a bottom in March 2009. Stock market volatility, as measured by the CBOE Market Volatility Index (VIX), sits near a five-year low (see chart on page 2).

Given this good news, you might be surprised to read, then, that we're still enduring one of the most difficult investing environments in recent history. Even though the stock market is up, the U.S. economy hasn't quite followed suit. Because of this, and because we're still grappling with the fallout from the extraordinary measures taken to contain the 2008 financial crisis, things are quite mixed up at the moment. Here are the primary issues giving us pause:

1 Real yields on Treasuries are negative going out almost 20 years, and spreads on investment grade corporate bonds have compressed such that there's little risk premium being paid to hold corporate versus government debt. Because high quality bonds have become so unattractive, investors have been forced into riskier asset classes like stocks and junk bonds.

2 With a trailing Price to Earnings Ratio (PE) of 16.5, the S&P 500 Index looks approximately fairly valued relative to its long-term historic average PE of 15.5. Its Cyclically Adjusted PE Ratio, which adjusts for the impact of inflation on earnings, sits at 22.8 versus its long-term historic average of 16.4. This means that stocks are no longer cheap just at a time when investors are being driven into them because of low interest rates. The current bull market is now 39 months old, just shy of the 44 month average.

3 Chinese stimulus in response to the 2008 crisis helped pull the global economy out of recession by lifting the prices of iron ore, oil, and other commodities. But China may not have the political willpower or the financial resources necessary to save the world again if needed. Expected Chinese GDP growth has been revised downward in the 7-8% range, and the HSBC China Purchasing Managers' Index ended September at 47.9. This is the second month in a row that the index ended in contraction territory.

4 Europe's sovereign debt crisis highlights just how overextended governments and central banks around the world have become. It also underscores the potential for social unrest in the Western world. Furthermore, economies across Europe have either stalled or are beginning to stall, which will likely have some impact on the U.S economy. The German Ifo Business Climate Index ended at 93.2 in September, its lowest level since May 2009. The Markit Eurozone Manufacturing Purchasing Managers' Index ended at 46.1, its 14th month in contraction territory.

5 In the U.S., we are left with increasingly less potent and less popular monetary policy options. The Fed tried to go big, or as big as it could, with its latest round of quantitative easing, offering no specific end date or fixed purchase amount. But with interest rates having already been this low for this long, it's unlikely the Fed's action will have a meaningful impact on spending or unemployment. The Fed has very few tools left to boost the economy

> *"THE S&P 500 HAS DOUBLED IN VALUE SINCE REACHING A BOTTOM IN 2009"*

MARKET COMMENTARY cont.

should conditions worsen, and there is always the risk that the inflation genie escapes the bottle.

6 In the absence of effective monetary policy, one might hope for sane fiscal policy to spur employment and boost economic growth. But there is no political consensus on fiscal policy. Instead, the American people have been treated to round after round of brinkmanship, the latest coming in the form of the "fiscal cliff". Although some band-aid will certainly be pushed through at the eleventh hour, it's unlikely to have any long-term benefit. One must question whether our fractured political system has the ability to generate the type of grand bargain necessary to quell deficits and spur sustainable GDP growth.

This list is not meant to scare, but rather to illustrate the issues that we believe have the potential to most impact portfolios today. The investing environment was turned upside down in 2008, and it remains just as non-traditional now. We've therefore had to be a bit non-traditional in our approach, in order to capitalize on certain opportunities and protect against particular threats.

Up until the recent quarter, we were a bit overweight on risk assets, such as stocks and high yield bonds. This proved mostly beneficial, as risk taking has been rewarded. High yield bonds, for example, have not only provided outsized income during a period of historically low interest rates, they have also risen in value.

But now, after a nearly four-year climb in the value of risk assets, bargains are becoming harder and harder to come by. For this reason and the others mentioned above, we have decided to scale back risk in client portfolios. In the third quarter:

A We reduced equity allocations, especially for our most risk sensitive clients, in favor of hedged equity investments. These hedged investments will still go up if the market continues to rise, just not as much. At the same time, they will not fall as far if the market drops.

B We reduced exposure to high yield and other credit-sensitive bonds in favor of investment-grade bonds. Yes, investment-grade bond yields are unattractive, but these bonds still offer a degree of portfolio stability that cannot be matched elsewhere. We have not eliminated our high yield bonds. They still have a role to play, but we have pared them back.

C We reduced commodity exposure because commodities are volatile investments that imperfectly track inflation in the short term. With growth in China slowing, and with growth stagnant elsewhere, there appears to be less upward pressure on commodity prices for the time being. That said, we recognize governments have an incentive to inflate their debts away, and we maintain core commodity holdings to protect against this threat.

As a matter of discipline, we typically don't make large shifts in allocation all at once. There are many nuances to consider when managing assets for individuals, such as each individual's time horizon, risk tolerance, and tax sensitivity. That said, this was one of the larger changes we've made in some time. We believe the macro environment necessitates such change, but only time will tell if we are correct in our thesis. If the economy significantly improves and markets move higher, then we will have left some gains, certainly not all, on the table. However, if volatility flares back up or valuations peak, then clients will have been better protected for our actions. During mixed up times like these, we prefer to err on the side of caution.

When next we write, it will be the New Year! Until then, each of us at Deighan Wealth Advisors wishes you a healthy and happy holiday season. As always, we welcome any comments or questions you might have.

Matthew T. Skaves, CFA
Chief Investment Officer

PRESIDENTIAL ELECTIONS & THE STOCK MARKET

Both parties have characterized the 2012 presidential election as one of the most important elections in recent history. This may or may not turn out to be the case, but such rhetoric has prompted many people to ask us what the impact might be on the stock market, should Obama or Romney win. Without wading too deeply into the politics, we can say with confidence that, statistically, it hasn't mattered whether a Democrat or a Republican wins the White House. Either way, the market has generally proven to be agnostic with regard to party.

There has, however, emerged a broader, if not totally agreed upon, trend relating stock market returns to the four year presidential election cycle. Ned Davis Research determined long ago that the third and fourth years of a president's term tend to outperform the first two years. A study done later by Marshall Nickles of Pepperdine University supported this initial finding and generated a few additional factoids, which we will share.

In his research, Nickels was able to illustrate that, from 1942 to 2002, market cycles tended to last for four years on average: three years of bull market and about one year of bear market. Furthermore, these cycles almost always troughed two years into a president's term, right around the mid-term election, and peaked around the presidential election. In Nickels' study, he found that 15 of 16 bear market lows occurred in the first two years of a president's term, with 12 of 16 coming in the second year. Only one bear market low occurred in year three, and no bear market lows occurred in the election year.

Taking his analysis one step further, Nickels then went on to measure two different scenarios. In the first scenario, Investor A followed the same pattern religiously from 1950 to 2004: Investor A would purchase stocks during the mid-term election (the bear market low) and sell them two years later after the presidential election. Investor B, by comparison, followed the opposite pattern just as religiously: Investor B would purchase stocks just after the presidential election and sell them two years later during the mid-term election.

The results of Nickels' study were quite stunning. Investor A, who essentially bet on the fact that stocks go up as the election nears, experienced a gain of 7,170% over the entire 50 year period. Investor B, who essentially did the opposite, was not as fortunate; he incurred a loss of 36% over the period.

Now, before you take this strategy to the bank, it's worth noting that the 2008 election year completely obliterated Nickels' findings. The S&P 500 Index lost 37% in 2008 and started roaring back to life in mid-2009, the first year of the presidential election cycle. This just reminds us that there's no such thing as a free lunch in the investing world! Past performance is no guarantee of future results, even when you have full power of the presidency on your side.

Matthew T. Skaves, CFA
Chief Investment Officer

A BIG THANK-YOU TO OUR GUESTS AND ARTISTS

We would like to thank everyone who turned out to make our Seasons of Maine Annual Art Exhibit and Reception a success. In case you couldn't attend, we decorated the halls and walls with paintings by the following Maine artists: June Grey, Jill Hoy, Richard Kapral, John LeBlanc, Jerry Rose, Diana Young, David Haskins, Cheri Walton, Paul Thibodeau, and Linda Packard. We also featured sculptures by Claude O'Donnell and the beautiful fabric designs of Michael Shyka.

Each year we pledge a contribution to the Penobscot County Fund of the Maine Community Foundation equal

SOUNDBYTES

Jenifer Wilson attended the CFA Institute Society Leadership Conference in Hong Kong as a delegate of CFA Society Maine. Sessions gave attendees a quick overview of the initiatives currently underway and the various resources that societies can leverage at CFA Institute. Jenifer is co-Vice President of CFA Society Maine.

Deighan Wealth Advisors has come of age. August 1st marked the 18th year since Jean and Jenifer founded the firm. We would like to extend a particular thank-you to those clients who have been with us since the beginning!

In case you missed our prior notices, we have contracted with Chicago Clearing Corp. to assist in the processing and payment of securities litigation. CCC continually monitors the legal landscape, meaning you no longer have to hold on to the litigation paperwork you receive in the mail. Please let us know if you would prefer to opt-out of this service.

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to 10% of all sales generated at the event or $1,000, whichever is greater. This year, we are pleased to report that fourteen different pieces were purchased by our guests, for a grand total of just under $3,500. Therefore, we will be making a $1,000 contribution!

If you were unable to attend and you happen to be in Bangor in the next few weeks, then we encourage you to visit. We still have paintings from a number of artists on display, and we'd be delighted to share them with you.

Again, thank you to everyone who helped make this year's event a success!

Jean M. Deighan, JD, CFP®
Chief Executive Officer

SECURITY CHANGES

The following security changes were made in the most recent quarter. Depending on your holdings and investment policy, these changes may not be applicable.

Removed
Diamond Hill Long-Short Fund
Ticker: DIAMX

Our decision to remove Diamond Hill Long Short Fund from client portfolios had nothing to do with performance. In fact, the fund has performed in the top 12% of its long-short peer group over the past year.

Instead, we removed the fund because it no longer has a role to play within our models. From a risk-return standpoint, DIAMX is neither quite as aggressive nor quite as conservative as we'd like. If we want long stock exposure, then we will stick to long-only investments. If we want to hedge our equity exposure, then we will use funds that more purely hedge stock returns. Hence, this fund is the odd man out.

Swapped
SPDR Gold Shares ETF
Ticker: GLD
Market Vectors Gold Miners ETF
Ticker: GDX

We made a relative valuation decision to sell SPDR Gold Shares (GLD), which holds gold bullion, in favor of Market Vectors Gold Miners (GDX), which invests in the stocks of gold mining companies. Whereas gold bullion has performed well over the past few years, gold miners have been beaten up. This dislocation has meant that gold miners are cheap. Since we made the switch, GDX has outperformed GLD by a margin of 2-to-1.

Because GLD has particular tax consequences, we were unable to liquidate it for all clients. In such cases, GLD continues to act as a currency hedge more than a stock play, which is how we view GDX. For smaller accounts, we have opted to use American Century Global Gold (BGEIX) in place of GDX.

Added
Vanguard Total Bond Market ETF
Ticker: BND

Because it is getting harder and harder these days to find attractively priced bonds in small sizes, we are using Vanguard Total Bond Market as a proxy for indvidual bonds in some instances. One benefit of BND is that it is highly liquid and very cheap, making it easy to gain bond exposure at a low cost. Another benefit is that it's highly diversified.

Disclaimer

Past performance is no guarantee of future results. The information contained herein is obtained from sources believed to be reliable, but its accuracy or completeness is not guaranteed. This commentary is for informational purposes only and is not a solicitation, or a recommendation, that any particular investor should purchase or sell any particular security. All expressions of opinions are subject to change without notice.

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