Silver Oak Wealth Advisors, LLC

Mastering the complexity of wealth.℠

APRIL 2011 QUARTERLY NEWSLETTER

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Welcome to Silver Oak Wealth Advisor, LLC's quarterly letter covering the first quarter of 2011. This quarter, we will address a couple of themes that will impact our portfolio allocation decisions over the rest of 2011 and, perhaps, over the next few years.

- Global and emerging market investments should receive higher portfolio allocations.
- The U.S. equity markets, if not currently overvalued, could produce significantly lower returns than the long-term averages would suggest.

Our goal is to share with you pertinent financial information and timely economic data that shapes the investment decisions we make on your behalf. While there is a science involved in portfolio design, a significant amount of artistry is also involved. As a sculptor works with clay to create a pot, we utilize the type of financial data we will share with you in this letter to mold our asset allocation decisions.

AS THE OPTIMIST PLUMMETING OFF A SKYSCRAPER SAID, "SO FAR, SO GOOD."

The economy and the markets have come a long way since the demise of Lehman Brothers and the near collapse of our financial system in 2008. There is certainly cause for optimism as we slowly see employment numbers increasing and signs that our economy is gaining strength. Yet the budget deficit hangs over everything like the proverbial Sword of Damocles. With the country seemingly polarized between two political camps, solutions may prove to be difficult, especially if positions become even more intractable.

Besides politics and our own national challenges, it seems as though the whole world has been impacted by panoply of major events recently. Europe has been plagued by its own debt crises. Japan was rocked first by an earthquake of almost unprecedented power which was followed immediately by a tsunami and a nuclear disaster. Each event on its own would have challenged global prosperity, but taken together creates serious impediments to the uninterrupted demands of international trade. This all becomes the macroeconomic backdrop for this quarter's letter.

There were a number of articles during the last few months that caught my eye. Some had colorful graphics that easily explained certain key investment related issues without requiring extensive paragraphs of explanations. My hunch is that you will also appreciate that point about brevity as we interpret issues that are complex and nuanced.

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The first graphic that caught my eye was this one from Rob Arnott, CFA, who is president of Research Affiliates, LLC, an editor of the Journal of Portfolio Management, editor of three books on tactical asset allocation, and author of over 70 academic papers in numerous professional journals.

Figure 1

Comparing Debt Levels: Developed versus Emerging Countries

Comparing Debt Levels with Factors of Production

TABLE 1a. DEVELOPED MARKETS, SHARE OF GLOBAL SOVEREIGN DEBT

Developed Country	Bond Cap Wt	Public Net Debt	GDP Weight	Pop Weight	Sqr Area Wt	Energy Wt	RAFI Wt
Australia	0.5%	0.4%	1.5%	0.4%	5.2%	1.2%	2.1%
Austria	1.0%	0.8%	0.6%	0.2%	0.5%	0.3%	0.4%
Belgium	1.5%	1.3%	0.7%	0.2%	0.3%	0.7%	0.5%
Canada	1.6%	2.9%	2.2%	0.6%	6.0%	3.3%	3.0%
Denmark	0.5%	0.0%	0.4%	0.1%	0.4%	0.2%	0.3%
Finland	0.3%	0.3%	0.3%	0.1%	1.1%	0.3%	0.5%
France	5.2%	6.0%	3.9%	1.2%	1.4%	2.7%	2.3%
Germany	5.3%	7.3%	5.0%	1.6%	1.1%	3.3%	2.7%
Greece	1.4%	1.1%	0.5%	0.2%	0.7%	0.4%	0.4%
Ireland	0.6%	0.4%	0.3%	0.1%	0.5%	0.2%	0.3%
Italy	6.2%	7.0%	3.2%	1.1%	1.0%	1.9%	1.8%
Japan	28.8%	26.3%	7.6%	2.5%	1.2%	5.4%	4.1%
Netherlands	1.4%	1.4%	1.2%	0.3%	0.4%	1.0%	0.7%
New Zealand	0.1%	0.1%	0.2%	0.1%	1.0%	0.2%	0.4%
Norway	0.1%	0.5%	0.5%	0.1%	1.1%	0.4%	0.5%
Poland	0.5%	0.5%	0.9%	0.8%	1.1%	1.0%	0.9%
Portugal	0.6%	0.5%	0.4%	0.2%	0.6%	0.2%	0.3%
South Korea	1.6%	0.7%	1.8%	0.8%	0.5%	2.4%	1.4%
Slovakia	0.1%	0.1%	0.2%	0.1%	0.4%	0.2%	0.2%
Slovenia	0.1%	0.0%	0.1%	0.0%	0.3%	N/A	0.1%
Spain	2.4%	2.6%	2.3%	0.8%	1.3%	1.5%	1.5%
Sweden	0.3%	0.4%	0.6%	0.2%	1.3%	0.5%	0.6%
Switzerland	0.4%	0.0%	0.7%	0.1%	0.4%	0.3%	0.4%
United Kingdom	5.8%	4.4%	3.5%	1.2%	0.9%	2.3%	2.0%
United States	23.2%	26.5%	23.6%	5.9%	5.9%	24.1%	14.7%
Prudent Nine	3.6%	5.2%	6.4%	2.4%	17.7%	7.2%	8.3%
"PIIGS"	11.2%	11.7%	6.7%	2.5%	4.1%	4.2%	4.3%
G-5	68.3%	70.5%	43.7%	12.5%	10.6%	37.8%	25.8%
ALL DEVELOPED	89.5%	91.7%	62.4%	19.1%	35.3%	54.1%	42.2%

Debt is More than Double RAFI Scale

Debt is More than 25% above RAFI Scale

Debt is Less than Half RAFI Scale

Debt is More than 25% below RAFI Scale

TABLE 1b. EMERGING MARKETS, SHARE OF GLOBAL SOVEREIGN DEBT

Emerging Country	Bond Cap Wt	Public Net Debt	GDP Weight	Pop Weight	Sqr Area Wt	Energy Wt	RAFI Wt
Argentina	0.2%	0.4%	0.7%	0.8%	3.1%	0.7%	1.3%
Brazil	0.8%	2.3%	3.0%	3.7%	5.5%	2.2%	3.5%
Bulgaria	0.0%	0.0%	0.1%	0.2%	0.6%	0.2%	0.3%
Chile	0.0%	0.0%	0.3%	0.3%	1.6%	0.3%	0.6%
China	2.3%	-1.4%	11.9%	25.9%	5.9%	17.8%	15.1%
Colombia	0.2%	0.3%	0.5%	0.9%	2.0%	0.3%	0.9%
Croatia	0.0%	0.1%	0.1%	0.1%	0.4%	N/A	0.2%
Czech Republic	0.2%	0.1%	0.4%	0.2%	0.5%	0.5%	0.4%
Dominican Republic	0.0%	0.1%	0.1%	0.2%	0.4%	N/A	0.2%
Ecuador	0.0%	0.1%	0.1%	0.3%	1.0%	0.1%	0.4%
Egypt	0.1%	0.4%	0.6%	1.4%	1.9%	0.6%	1.1%
El Salvador	0.0%	0.0%	0.1%	0.1%	0.3%	N/A	0.2%
Gabon	0.0%	0.0%	0.0%	0.0%	1.0%	N/A	0.3%
Ghana	0.0%	0.0%	0.0%	0.4%	0.9%	N/A	0.5%
Hong Kong	0.0%	-0.3%	0.4%	0.1%	0.0%	0.3%	0.2%
Hungary	0.2%	0.2%	0.3%	0.2%	0.6%	0.3%	0.3%
India	1.8%	2.1%	4.2%	21.6%	3.4%	4.0%	8.2%
Indonesia	0.3%	0.4%	1.3%	4.4%	2.6%	1.2%	2.3%
Israel	0.2%	0.3%	0.3%	0.1%	0.3%	N/A	0.2%
Lebanon	0.0%	0.1%	0.1%	0.1%	0.2%	N/A	0.1%
Lithuania	0.0%	0.0%	0.1%	0.1%	0.5%	0.1%	0.2%
Malaysia	0.4%	0.2%	0.5%	0.5%	1.1%	0.6%	0.7%
Mexico	0.6%	1.0%	2.0%	2.1%	2.7%	1.6%	2.0%
Morocco	0.0%	0.1%	0.2%	0.6%	1.3%	N/A	0.7%
Pakistan	0.0%	0.2%	0.5%	3.0%	1.7%	0.6%	1.4%
Panama	0.0%	0.0%	0.1%	0.1%	0.5%	N/A	0.2%
Peru	0.1%	0.1%	0.3%	0.5%	2.1%	0.1%	0.8%
Philippines	0.2%	0.2%	0.4%	1.7%	1.0%	0.3%	0.8%
Romania	0.0%	0.0%	0.3%	0.4%	0.9%	0.4%	0.5%
Russia	0.4%	-0.5%	2.8%	2.8%	7.8%	7.0%	5.0%
South Africa	0.4%	0.2%	0.7%	0.9%	2.1%	1.3%	1.2%
Serbia	0.0%	0.0%	0.1%	0.1%	0.6%	N/A	0.3%
Singapore	0.2%	0.2%	0.4%	0.1%	0.0%	0.5%	0.3%
Sri Lanka	0.0%	0.1%	0.1%	0.4%	0.5%	N/A	0.3%
Taiwan	0.6%	-0.3%	1.3%	0.5%	0.2%	1.2%	0.8%
Thailand	0.3%	0.2%	0.7%	1.3%	1.4%	0.9%	1.0%
Tunisia	0.0%	0.0%	0.1%	0.2%	0.8%	N/A	0.4%
Turkey	0.5%	0.8%	1.3%	1.4%	1.7%	1.0%	1.3%
Ukraine	0.0%	0.1%	0.3%	0.9%	1.5%	1.4%	1.0%
Uruguay	0.0%	0.0%	0.1%	0.1%	0.8%	N/A	0.3%
Venezuela	0.1%	0.1%	0.5%	0.5%	1.8%	0.7%	0.9%
Vietnam	0.0%	0.1%	0.3%	1.6%	1.1%	N/A	1.0%
BRICs	5.2%	2.5%	21.9%	54.0%	22.6%	30.9%	31.9%
ALL EMERGING	10.5%	8.3%	37.6%	80.9%	64.7%	45.9%	57.8%

Source: Research Affiliates, LLC, based on data from CIA World Fact Book 2010, International Monetary Fund.

This is a very simple chart if you ignore all of the numbers Arnott is comparing and just look at the two major colors – Red vs. Green. The point is that the debt levels in the developed world (left box) compared to the level of growth in each country is flashing warning signs. The amount of red ink is a clear sign of danger for investments in developed countries. Conversely, the debt levels and growth prospects in what we previously called the third world are flashing green, a color of which we would all like to be seeing more.

Here is another chart with similar implications.

Figure 2

We have written about GDP before. Let's take a minute and be a little more specific about the influence of GDP on the potential for stock market returns to increase. There are two factors that affect stock prices:

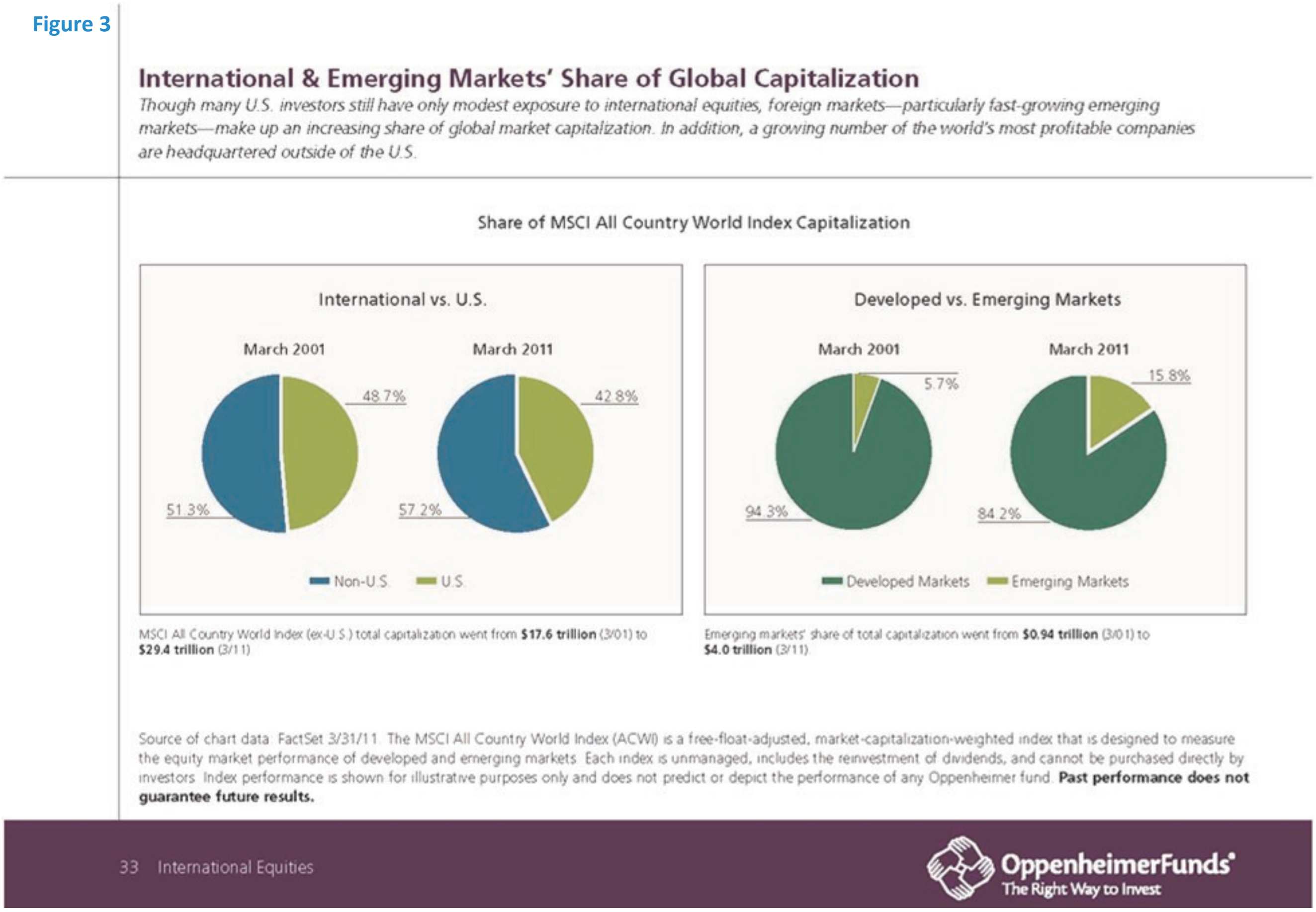
- Their values which are driven by earnings and earnings growth, with the national economic measure known as gross domestic product (GDP) being a good proxy for the long-term growth rate of the stock market;
- Their prices are determined by the market's valuation multiple (P/E ratio) which is driven by the earnings growth rate and the inflation rate. While earnings are quantifiable, prices are subjective and may be driven more by factors such as short-term consumer sentiment.

As you look at this global GDP map, it should be apparent that the growth rate in many developing countries is significantly higher than in the U.S. and many other developed countries. This fact reinforces the first chart, Figure 1, in which developing countries with lower debt levels appear to have a more attractive prospect for growth.

Let's consider one additional development over the last decade or two. There was a time over twenty years ago when the U.S. comprised over half of the world's stock market capitalization. This is important since asset allocation has generally been implemented with country or regional weightings consistent with global capitalization. I say generally because Americans have typically been more comfortable overweighting the U.S. equity markets.

Today, the global picture has shifted strikingly. Consider the following chart.

Figure 3



This chart is critically important for asset allocation. The chart implies that international equities should comprise over half the equity weighting in our portfolios, and that the allocation to emerging market equities should be about triple what they were ten years ago.

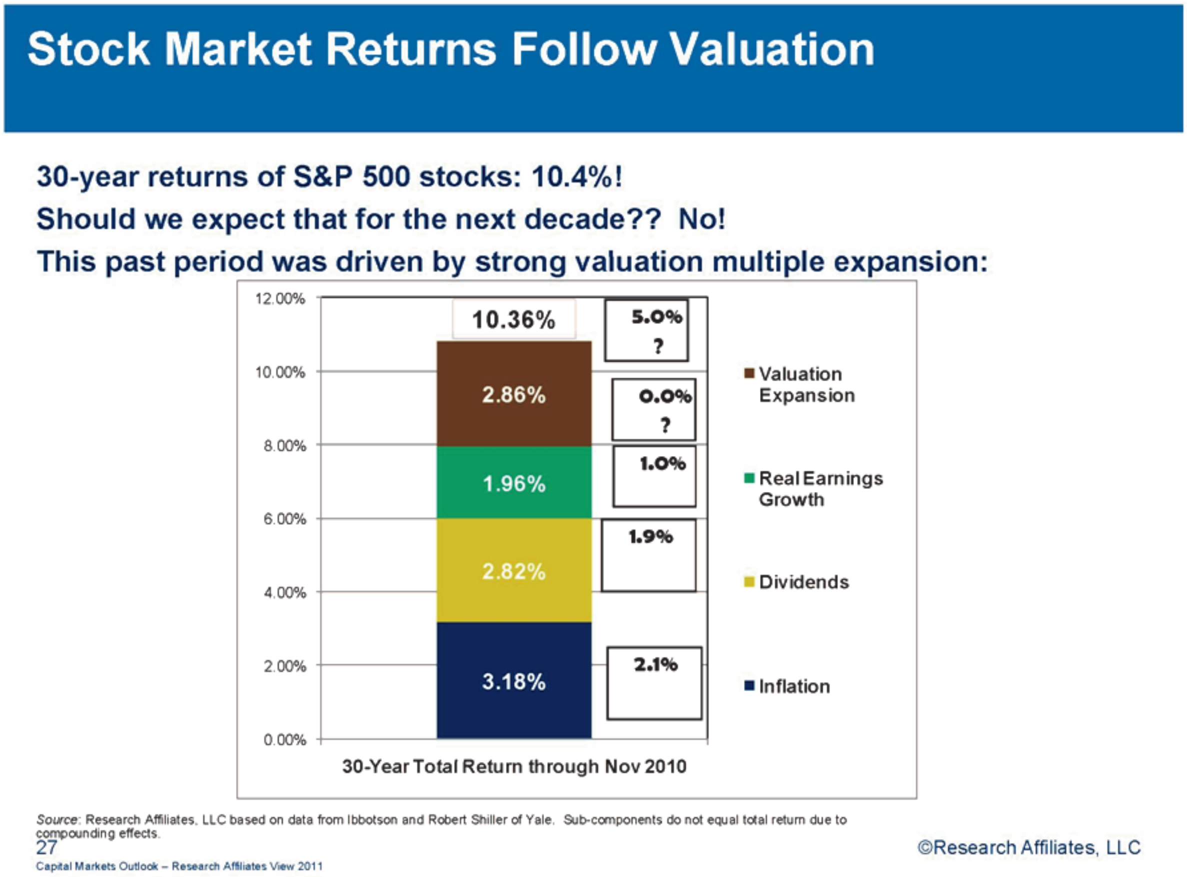
Given the GDP Growth vs. Debt comparisons in the previous charts, we would argue that emerging markets should be over-weighted in our portfolios and developed markets under-weighted.

When risk and the potential for returns are factored into the analysis, the countries with lower debt and higher growth rates should receive a higher allocation.
This is certainly a more tactical approach than would be derived from investing in an international index based on world capitalization. We believe the body of knowledge is quite pervasive in supporting this approach. And, since we believe that this is also consistent with our risk control-based approach to investing for returns we believe to be consistent with the amount of risk taken, we continue to look to emerging markets for a significant portfolio weighting.

What about the U.S. equity markets? We do see signs of economic improvement. Because of that, we continue to allocate part of our portfolios to domestic equities. However, we are not completely sanguine about sustainable market growth rates of 10% or more going forward. There are too many conflicting signs, some intimating that the market is already too high. , and others offering credible analysis supporting why the growth rate for equities should be only 5-6% annually.

Consider this next chart with information, again, provided by Rob Arnott. Rob offers a credible analysis supporting the contention that the growth rate for equities should only be 5-6% annually over the next decade.

Figure 4

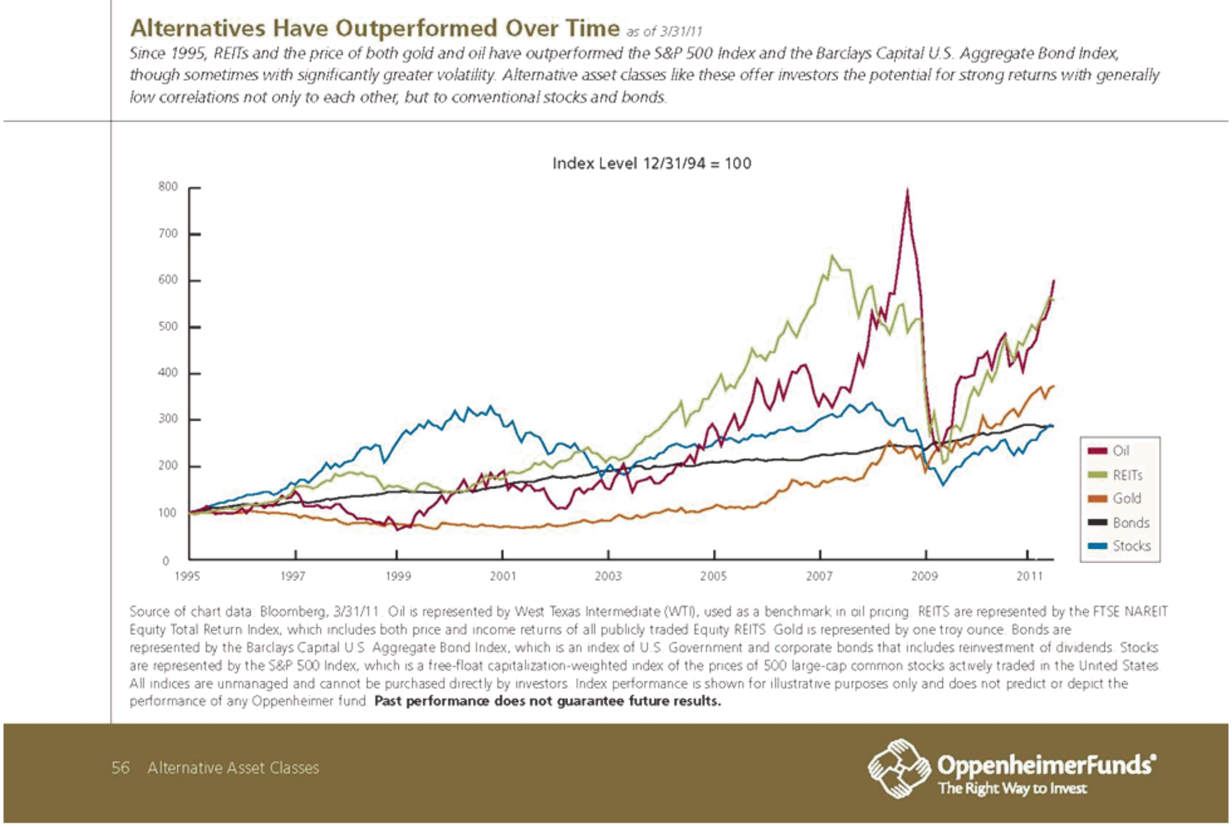


Arnott has built a column of colored boxes that reflect a building-block approach to explaining the 10.4% return of the S&P 500 over the past 30 years. This chart summarizes his many articles on the subject, introducing strong arguments why this average return is unlikely to be repeated going forward. The percentages furnished in the white boxes alongside the colored boxes represent Rob's estimate for the rest of this decade. With lower estimates in each box, and with a major question as to whether the price/earnings ratio can continue to expand at all, he suggests that we must consider a world of only 5% domestic equity returns. Additionally, we must note the recent frequency of significant geo-political events and natural disasters that negatively impact financial stability. These events result in higher levels of global risk and cause us to be even more deliberate in considering whether to add equities to portfolios given the risk and potential return dynamics.

Fortunately, there are other investment categories that continue to offer good prospective returns at appropriate levels of risk. We continue to focus some of our attention on the alternative investment group of securities. These include precious metals, real estate, oil & gas, and various hedging strategies. We have recently researched a private REIT that may be appropriate for some clients, and we continue to do our due diligence on other nonpublic opportunities.

There is one last chart that I will include because it reflects the opportunities in some of these assets.

Figure 5



As you can see from this graph, there are a number of asset classes that have outperformed bonds and equities. As the caveat highlights, however, past performance does not guarantee future results. Nevertheless, there are economic factors that are persuasive in arguing for inclusion of alternative investments in our portfolios. Some of these factors include potentially rising inflation, rising demand for oil, a U.S. dollar that appears to be rather weak, and the desire to find a currency (like gold) in which people have confidence during these challenging times.

At Silver Oak, we continue our primary focus of controlling fluctuation levels (downside risk) in our client portfolios.

There are certainly known risks out there: valuation levels are arguably at uncomfortable highs once again, and the ever present threat of a European sovereign default could trigger panic in the markets.

Then there are unknown risks - the uncertainty surrounding the ultimate economic impact of Fed policy on markets, the impact of global currency imbalances and living in the ever-present shadow of yet another natural disaster.

With these realities always top of mind, our post - 2008 investment strategy has successfully achieved our clients' required return objectives with substantially less volatility (risk) than the markets. Our commitment is to continue to seek out and uncover conventional and unconventional investment opportunities to diversify our portfolios and fulfill that mandate.

Sincerely,

Joel Framson

President