LOTUS GROUP ADVISORS

Financial Exploration | Investment Advice | Portfolio Management

Mid-Quarter Report

INSIDE THIS ISSUE:

ONLINE EDUCATION

We take pride in providing clear, concise and honest information to our clients and have launched a series of online blogs:

Best 529 Plans

College tuitions continue to rise so the real risk is whether there is enough money to pay for school when the time comes. Will you? http://bit.ly/1aLeqs

Roth IRA Conversions

Given the law changes in 2010, everyone has the option of converting their Traditional IRA to a Roth IRA. Should you? http://bit.ly/7Rv1SO

401K to IRA Rollover

A perk of leaving your job is the ability to roll your 401K to an IRA. Check out our 7 keys to building a successful rollover portfolio. http://bit.ly/8YzPqR

Split Dollar Insurance Guide

This insurance allows family properties to be inherited by children with minimal if any, additional taxes. More on this tax saving strategy. http://bit.ly/8NOMBO

We encourage you to share these links with friends & family that have questions / needs, or send them our way to discuss in more detail.

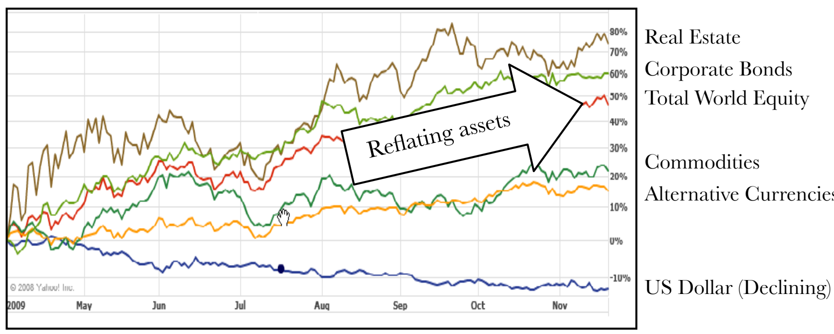
www.LGAdvisors.com

Market Update & Commentary

After a tremendous rally from the lows in March of this year, the markets have been somewhat choppy during Q4/2009. A continuing theme has been "reflation", loosely defined as the inflating of hard assets at the expense of our currency. Easy monetary policy and large fiscal stimulus has resulted in a depreciating US dollar relative to many other developed nation currencies, but more importantly relative to hard assets such as oil, gold, and real estate (see Chart 1).

Chart 1: "Reflation" in markets since March 2009

(US Dollar down while most other assets up)



This reflation trend is seen on a daily basis, where the stock market advances when the US dollar declines, and vice-versa. Almost all asset classes have participated in this trend, which negates the benefits of portfolio diversification. Provided everything is moving up, this is a net positive. However, if this trend reverses, the lack of real diversification could present a problem to investors. We will further discuss this phenomenon in the next section, providing our view on where conventional portfolio theory works versus where there is room for improvement.

Looking forward, there continues to be a very wide disparity between bullish and bearish outlooks proffered by various highly respected economists. The bulls believe that we are in the midst of a rebound that is proportional to the massive decline, due to inventory restocking and a return to business as usual. The bears believe that de-leveraging still has much further to go, and that the government has been pushing out the problem with massive stimulus, which will lead to larger issues down the road. Investors have been digesting these varied forecasts, resulting in 'mood swings' or choppiness as described above. However, the general mid-term equity trend has continued to be upward, although the pace of advance has declined drastically since earlier this year. We remain vigilant in managing each of our client's portfolios during this interesting time in investment history.

Reminders of Why we Save and Invest

It is well documented that one of the major keys to happiness is the ability to **appreciate**. As we've done for the past few years around this time, we'd like to spread some cheer and appreciation. During the past year, three of our clients either got engaged or married; twelve clients became pregnant or gave birth and numerous young toddlers took first steps and spoke first words; nine clients became grandparents; eight clients made exciting job changes while others began interesting new entrepreneurial ventures / investments; five clients bought a new home; two clients retired; and finally, lives of those who were lost were celebrated.

Along the way, we hope that many sunsets were enjoyed, laughter was shared, and songs were sung. We urge you to take a few moments this holiday season to close your eyes, soak in the warmth of the sun, and indulge in thoughts of appreciation for some of the wonderful moments that touched your life during this past year. We are honored to help support your financial needs, and truly appreciate the blessing of participation in each of your respective stories as they unfold.

Modern Portfolio Theory

What Still Works & What Needs to be Improved

Modern portfolio theory (MPT) is a widely used approach in the financial industry that attempts to maximize return and minimize risk by selecting traditionally uncorrelated asset classes. MPT specifically uses backward-looking data to develop models that historically would have performed best given a certain investor's risk tolerance, coupled with a buy-and-hold approach.

MPT is a robust and analytical approach to investing that is far superior to using gut instincts, rumors, and other qualitative methods. Furthermore, MPT requires little investment manager effort and can be relatively tax-efficient due to low portfolio turnover. These attributes make MPT very attractive to large investment advisor firms because it provides a level of sophistication above the average investor and can be implemented in a low-cost, mass-scale manner, providing high profitability for the investment firm. Consequently, there is a high degree of positive marketing spin in the media surrounding MPT (for example, the following argument is quite common in mainstream media: "No one can figure out the market, so just minimize your costs, use a buy and hold approach, and invest for the long term").

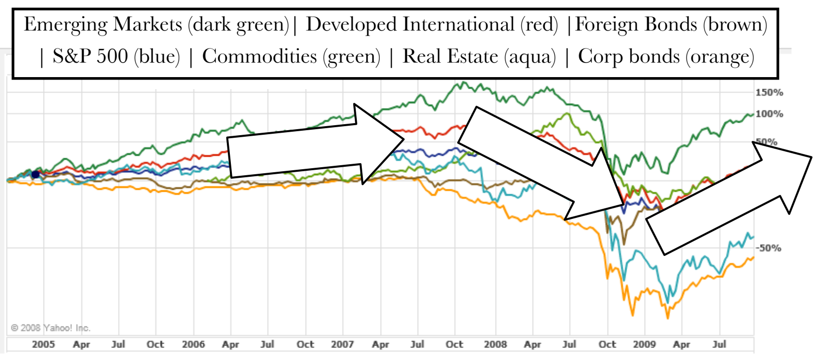
At LGA, we believe there are a number of short-comings to the MPT approach. First and foremost, MPT is backward looking, and assumes that the future will look the same as the past. At LGA, we believe it is very important to use history as a guide, but to also supplement such analysis with other inputs into the decision making process. For example, the study of behavioral economics shows how crowds tend to move in herds, making decisions emotionally and then justifying them with logic after the fact. As a result, there are opportunities in the markets to use investor sentiment in helping to improve the odds of figuring out where different markets could be headed. Additionally, markets tend to swing beyond expectations on both the upside and the downside due to this emotional and herd-like behavior of investors. These expected swings can often be used to help determine when a rebalance should occur.

Other examples of decision making inputs include fundamental analysis (used by Warren Buffet), technical analysis, and currency analysis. At LGA, we believe it is not only important to use a combination of inputs, but to also constantly strive for understanding which inputs are the most meaningful at different points in the economic cycle. While we agree that no one can ever fully "figure out" or predict the markets, we do believe that the aforementioned techniques can improve your odds of being right more often than not.

Another short-coming with MPT is that it uses asset classes that have historically exhibited a lack of correlation. The problem is that in recent years, these correlations have moved closer and closer toward 100%, much to the dismay of MPT investors. Whether this phenomenon is due to increased globalization, synchronization of credit markets, or something else entirely, it has certainly been occurring more frequently. For example, the inclusion of foreign equities in a traditional MPT portfolio has been documented as historically improving the diversification over a simple US equity strategy.

(Continued from page 2) However, US equities and foreign equities have moved in tandem over the past decade, and particularly so during recent downturns, providing no diversification benefits to investors (see Chart 2):

Chart 2: Recent Correlation of Various Asset Classes: 2004 – 2009



We believe that for this particular shortcoming of MPT, the answer lies in seeking new asset classes that are truly uncorrelated to traditional choices.

Chart 3: S&P 500 versus selected managed futures fund during recent downturn

We have added the following investments to diversify and hedge portfolios, especially for more conservative clients who desire less short-term volatility:

- Managed future funds
- Long-short equity funds
- Currency trading funds / ETFs
- Select short funds / ETFs

As always, we continue to look for ways to improve our client's real long-term investment returns, through investment strategy improvements and optimal client / investor behavior.

We encourage you to pursue life's dreams…and to appreciate along the way!

Warm Regards,

Andy Seth & Raphael Martorello
LotusGroup Advisors Management Team

QUESTIONS?

As always, we are available to discuss any questions you may have regarding our progress towards your financial and investment objectives.

REFERRALS?

We appreciate your referrals as they are the lifeline to our business. Please let your family, friends and colleagues know about our wealth management services.

Contact Your Advisor or Our Main Office
Phone 310-808-8080
Email info@lgadvisors.com