

PORTFOLIO WATCH



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Fee **FO** Only

The Role of Alternatives

According to conventional wisdom (and what we are taught in CFP school) there are 3 major asset classes: stocks, bonds and cash. The reason there are only 3 is because the behavior of most investments tends to be similar to one of these classes. It's either that, or some of us just get confused with larger numbers. To be a little more sophisticated, most portfolio managers go down to the sub-class level, which includes U.S. and foreign stocks, small-cap and large-cap companies, short-, intermediate-, and long-term bonds, etc. The idea is to increase diversification, which means finding investments that don't behave the same. This is where Alternative Investments come in.

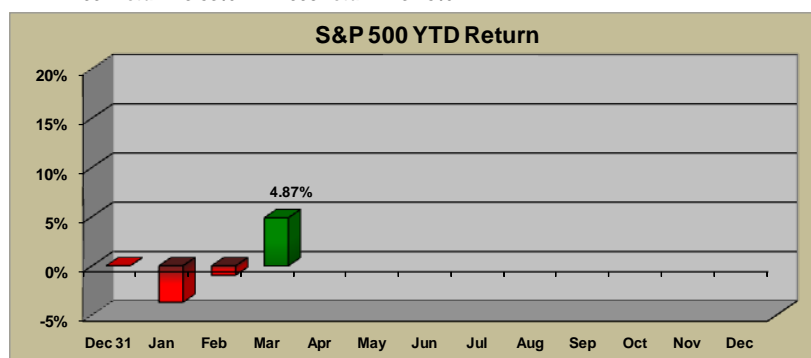
Collared Stock

Collared stock strategies are becoming more popular, and as I've written about previously, I like The Collar Fund (COLLX). However, this type of investment doesn't fit neatly into one of the Big 3 asset classes. Equities (stocks) tend to be characterized by high growth potential but higher risk, Fixed Income (bonds) tends to give predictable income without much growth, and cash just kind of sits there (particularly right now). Collared Stock uses options to set an absolute limit on losses, but its growth potential is dependent on stocks. This makes the risk profile look more like a bond, although it is not an income strategy and has higher growth potential. In other words, it doesn't fit in the traditional asset classes.

Commodities

Commodities include things like oil, soy beans, frozen orange juice, etc. Commodity prices tend to run in cycles, but these cycles don't necessarily depend on what's going on in the stock market. Most investors can get some exposure to commodities through investments like an Energy ETF or gold, but much better diversification can be achieved through a Managed Futures fund. Most commodities are traded through futures contracts, and traders

2006 return: 13.62% 2008 return: -38.49%
 2007 return: 3.53% 2009 return: 23.45%



take advantage of the commodity cycles by buying during the up cycles and selling in the down cycles. Because managed futures are more sophisticated than just buying a stock fund, they are only available to investors with a net worth greater than \$1M (accredited investors).

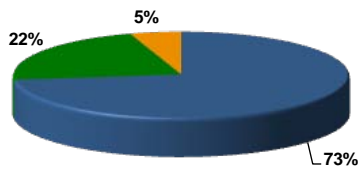
Secured Income

This is another asset class that is typically only available to accredited investors. Secured Income funds get their income from property the fund owns, such as interest payments on mortgage notes or leasing business equipment (MRI machines, microscopes, storage bins, etc). With these types of funds, there is a risk that a company will not honor its lease agreement or a mortgage holder will not pay, but this is a different risk than betting on stock or bond prices. Secured Income Funds come in all flavors with different risk profiles. A fund that has lease agreements with Walgreens will have lower risk and yield than a fund that invests in mortgages that banks won't touch, but a fund can be found to suit almost any investor. In general, conservative Secured Income Funds will pay a yield that is in the ballpark of high-yield (junk) bonds. Instead of getting paid for taking more risk, investors in conservative Secured Income Funds get paid for the lack of liquidity. Most of these funds are not publicly traded, so there is a minimum holding period (often a year or more) and selling back shares may require several weeks notice. This type of investment may be boring...kind of like watching paint dry...but the return can hold up regardless of market conditions. For long-term investors it can be a good addition to a diversified portfolio.

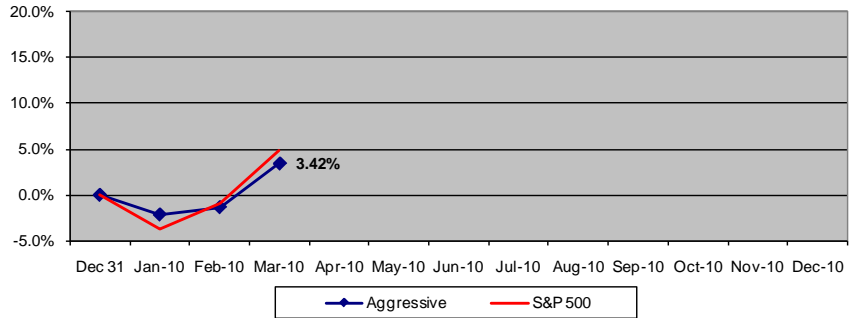
Model Portfolio Performance

The following allocation models and Year-To-Date performance graphs represent the preferred investments in Veripax Financial Management's target portfolios. Investment allocation for each model is determined based on time horizon and risk tolerance. Individual client portfolios will contain slightly different investments and allocation mixes based on individual financial goals, investment priorities, tax considerations, and investment timing. Therefore, the performance of the Model Portfolios do not represent any actual portfolios. The Model Portfolios invest primarily in Exchange Traded Funds and no-load bond funds.

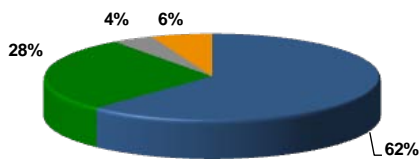
Aggressive Allocation



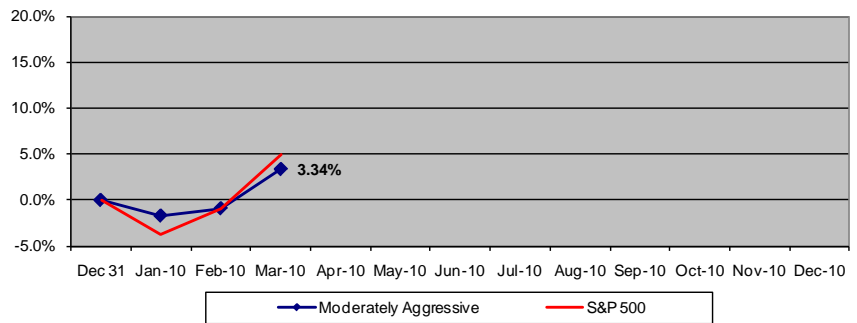
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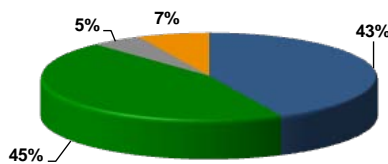
Moderately Aggressive Allocation



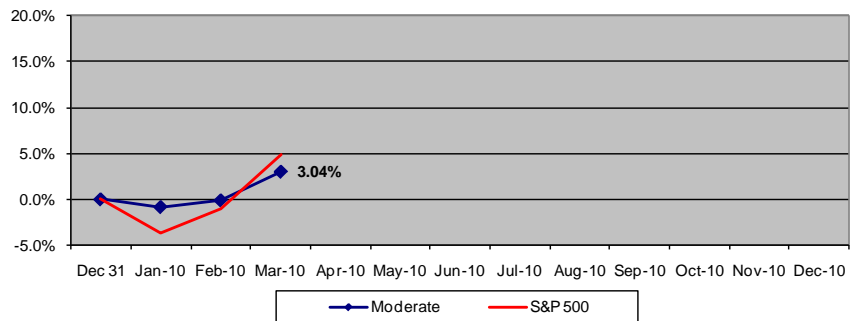
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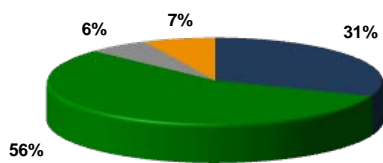
Moderate Allocation



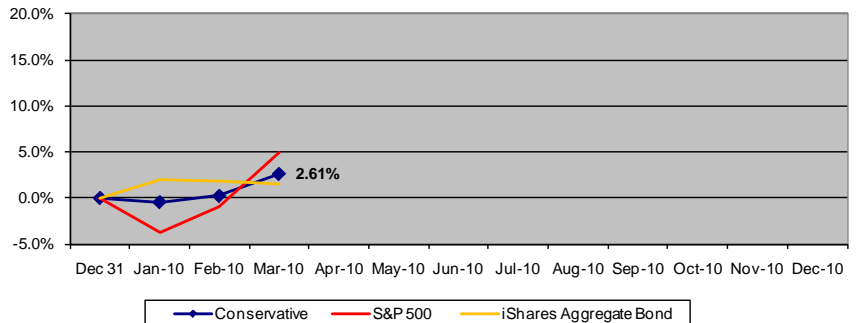
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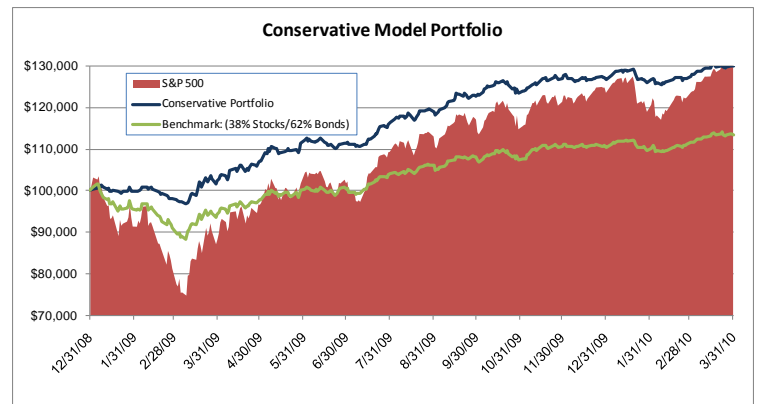
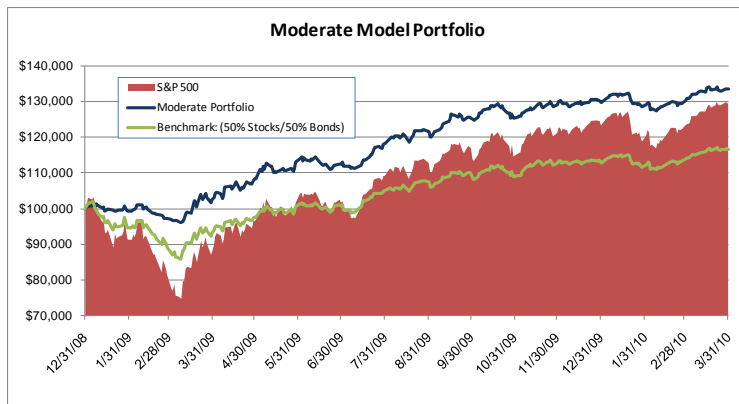
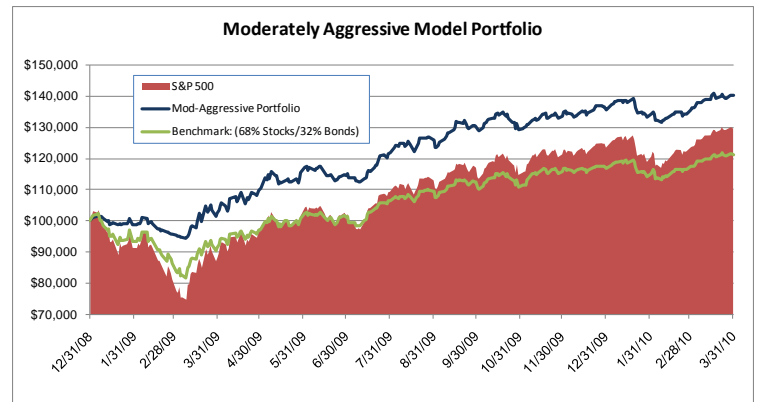
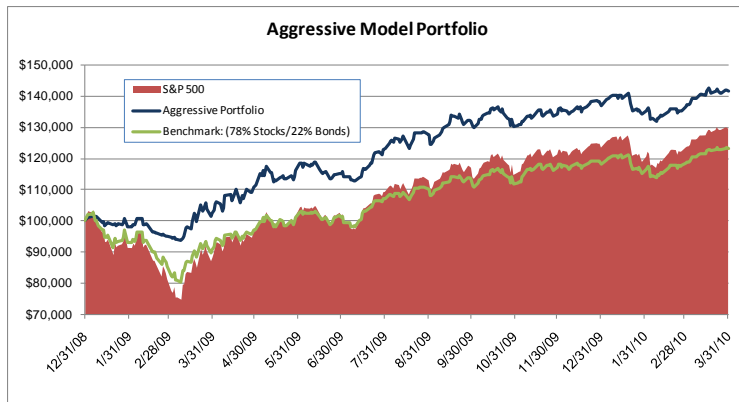
Conservative Allocation



■ Stocks ■ Bonds ■ Collared Equities ■ Precious Metals



Daily Performance Charts



Benchmarks: The Benchmark for each of the above graphs utilizes the Russell 1000 Index for stocks and Total Bond Market Index for bonds. The ratio of stocks and bonds in each Benchmark matches the ratio of the associated VFM model portfolio.

Portfolio Construction: Each Model Portfolio consists of up to 8 stock sectors, 7 bond sectors and gold. Buy/Sell decisions are based on VFM's proprietary algorithm and are consistent across all portfolios.

Portfolio Comments

Investors were in the mood to buy more stocks last month, which worked out great for the portfolios. Some positive growth signs seemed to indicate that the economy is recovering. I'm very skeptical about the prospects of a continued, smooth recovery, but for now the market is shaking off any bad news and doomsday predictions from those worried about the debt the U.S. is piling up, so for now we simply enjoy the ride.

With the market marching steadily higher throughout the last month, there wasn't a lot to do except trying to determine when to invest new money when it came in. When the market advances almost every day, it doesn't make buy points very obvious. All sectors remained well above their sell thresholds. The only sector that lost ground was Gold (less than 1/2%). The big gainers were Real Estate (9.37%), Financials (8.86%), Small Caps (8.44%), and Basic Materials (8.13%).

Fixed Income was a drag on all of the model portfolios last month, so although they all posted gains, they lost a little ground to the S&P 500. However, every portfolio beat its diversified benchmark, which is the real goal. I mentioned above that I'm skeptical of a continued smooth recovery. The reason is that much of the economic gains in the last year can be attributed to government stimulus spending. This money spigot is going to be gradually shut off over the next quarter or two, which means growth will be dependent on actual business growth, and so far that hasn't been all that impressive.

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