Oakwood Outlook & Quarterly Review

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A Word from the Advisor

Asset Allocation - Now More than Ever

The past year disappointed many stock investors no matter how large or sophisticated their portfolio. Just about everyone took painful hits relative to expectations, and depending on their age, relative to their time horizon.

Asset allocation is a vital component of wealth management. At Oakwood Capital Management LLC, we take asset allocation very seriously, because getting this decision right up front eliminates many challenges going forward. We emphasize the importance of revisiting your asset allocation annually or periodically—now more than ever. With this in mind, let's consider the relative performance of bonds and stocks over the past year.

Performance by Asset

At Oakwood, bonds were rewarding for our investors this year. While plenty of bond funds were negative for the year, our bond portfolios were up, owing to selectivity and discipline. Oakwood clients predominantly holding bonds earned attractive returns and a steady stream of income. But in preceding years, many of these same clients questioned the viability of investing in bonds, as they missed out on the equity boom.

On the stock side, our global strategies provided a better experience than global benchmarks and international indices, due to their US bias. In the purely domestic stock portfolios, our defensive posture deftly avoided areas that inflicted the most pain on investors. For example, we were underweighted in financials, and we took profits in energy and money off the table in July when oil peaked around $147/barrel. Some of the securities we are holding have naturally declined, and we've used the opportunity for tax management, offsetting gains taken earlier in the year. In some cases, we are harvesting tax losses for clients. We recognize how valuable these losses can be in the future as investors can use them to reduce or even pay no tax on capital gains.

Many Oakwood clients hold balanced portfolios with a conservative blend of stocks and bonds. These are the clients who are best positioned to tolerate the inevitable market swings. Looking back on the year, they have experienced the attractive balancing characteristics of high-quality diversified portfolios.

Honest Self-Evaluation

For clients who are building their wealth, we can only strive to reassure you that things will get better. But if investors continue to take more equity risk in pursuit of high returns without the expectation and acceptance of volatility or risk, now is the time for honest self-evaluation. It requires genuine self-knowledge and self-discipline to recalibrate goals and expectations.

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No Required Distributions from Retirement Accounts in 2009

New law suspends them for 2009 only.

Minimum required distributions (MRDs) from certain retirement accounts have been *suspended* for 2009 with the signing of the Worker, Retiree, and Employer Recovery Act of 2008 by President Bush on December 23.

This is important news for retirees because it suspends — for 2009 only — the IRS regulation that generally requires individuals, beginning in the calendar year following the year they turn 70½, to withdraw a minimum amount of money from their retirement accounts like Traditional IRAs and 401(k)s each year. This is called a minimum required distribution (MRD) or required minimum distribution (RMD).

No change to 2008 distributions

The provision in the Act does not impact 2008 MRDs. This may be confusing for those who turned 70½ in 2008 and are taking their first MRD in 2009, as the IRS allows. (According to IRS regulations, they have until April 1, 2009 to take their first MRD.) They still must take the 2008 MRD.

Key details about suspended 2009 MRDs

The minimum distribution suspension applies to individual retirement accounts and employer-sponsored qualified retirement plans. Examples of these accounts: Traditional IRAs, Rollover IRAs, SEP IRAs, Inherited IRAs, Inherited Roth IRAs, 401(k)s, and 403(b)s. (It does not apply to *non-inherited* Roth IRAs.)

If you are turning 70½ in 2009, you will not have to take your first distribution by April 1, 2010. You will, however, have to take a 2010 MRD by December 31, 2010.

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We also note that the Oakwood clients who are best able to tolerate the downturn are those who took the time to assess their risk profile and asset allocation during happier days. At every opportunity, we continue this discussion to stay current with changing events in our clients' lives.

How We Allocate

When you commit a portion of your net worth to financial assets—for the liquidity and diversification they offer—then your next important decision is the asset mix.

Financial assets can be segmented into asset classes comprising small cap and large cap stocks, value and growth stocks, domestic, international, and emerging markets stock, government, corporate, and municipal bonds, and REITS (real estate investment trusts). Because each asset class plays a distinct role in the portfolio, the whole is often greater than the sum of its parts. Allocating intelligently among these securities allows investors to achieve attractive returns and meet their long-term goals with less price fluctuation, lower costs, and more consistency than if they took a less comprehensive approach.

Since no two investors are alike, there is no single optimal asset allocation. Each investor has his or her own unique risk tolerance, goals, and life circumstances that dictate the weightings of core and asset class portfolios. In general, the greater the proportion of stocks in a portfolio, especially small cap and value stocks, the greater the risk and the greater its expected return.

Another rudimentary gauge is the number 100 to 110 minus your age; this suggests a desired stock allocation, e.g., if you are 60 years old you shouldn't hold more than 40 to 50% stocks. But rote formulas tend to trivialize a complex issue. The point is that as skilled professionals we have the experience, tools, ability, and commitment to help you reach your financial goals through all market cycles.

Rebalancing Act

Maintaining an asset allocation suitable to your specific risk profile requires periodic rebalancing. The motivation for rebalancing should be to maintain a consistent target asset allocation, rather than to pursue higher expected returns. If the portfolio is never rebalanced, the allocation can drift away from its initial target, which has an impact on the agreed-upon financial goals. For example, your portfolio may grow increasingly concentrated in stocks, which increases the risk over the well-balanced global portfolio you originally envisioned.

Like asset allocation in general, there is no one-size-fits-all rebalancing solution. The optimal rebalancing strategy will differ for each investor, depending on his or her unique sensitivity to deviations from the target allocation, transaction frequency, and tax costs.

What's Next?

After almost all of Oakwood's clients enjoyed outperformance in the up market of 2007, and then outperforming in the down market of 2008, what's next? We contemplate a challenging first half of 2009 and a better second half of the year as the financial markets look ahead to an improving 2010. As value managers, we will weather this period and our value stocks should do well as markets improve. We are holding lots of cash—dry powder—in our US portfolios and less cash in our global strategies. These highly diversified global portfolios—with their scientific structuring and cost-effective design—do provide an extremely viable and intelligent approach to asset allocation and diversification of risk. Bonds will continue to effectively counter-balance the risks of the equity market for clients seeking lower risk.

It's beneficial to revisit asset allocation no matter what your holdings or whether the market improves or remains difficult. It's also important to determine whether a five or ten-year time horizon dictates your expectations. We have a range of tools—and solutions—at our disposal to aid in your wealth management experience. We use these tools to help you clarify your range of options. We look forward to continuing the dialogue with you in person. ■

MRDs from page 1

If you have a 2009 MRD automatically scheduled

If you have directed your financial advisor or custodian to automatically take an MRD for 2009 and you don't want to take it, you must instruct them to stop the MRD. The good news: If you do end up taking the distribution by mistake, it can be rolled back into your retirement account without penalty.

If you have an Inherited IRA

Some plans require that all distributions be taken from Inherited IRAs within a five-year period. Because of the suspension of 2009 MRDs, the five-year period will be determined without calendar year 2009. For example, for an Inherited IRA from an individual who died in 2007, under the provision in the Act, the five-year period ends in 2013 instead of 2012.

If you are over 70½ and rolling over an employer-sponsored account

No MRDs will be required from retirement plan accounts that are rolled over to IRAs in 2009. Normally, if you are 70½ and older, you must take an MRD before rolling over to an IRA. Because MRDs are suspended for 2009, you will not need to take that MRD. ■

When will Turvy Revert to Topsy?

Even when the financial world seems to have gone topsy-turvy, we remain firm in our conviction that investors seeking the opportunities inherent in global investing will again reap rewards from participating in our intelligently structured, highly diversified global portfolios.

Following five years of gains, global stock markets collapsed in 2008, leaving investors little place to hide. The financial maelstrom hit every major world market. The sole assets to prosper were government bonds of developed countries and certain commodities like gold, where investors fled and prices rose. Global stocks lost 40 percent of their value in 2008, as calculated by the MSCI world index, erasing more than $29 trillion in value and eroding gains made since 2003.

The Dow Jones Euro Stoxx 600, a measure of the broad European market, finished the year down 46 percent; the MSCI Asia-Pacific was down 43 percent and the MSCI Emerging Markets index was down 53.2%. US stocks fared slightly better, with the S&P 500 falling 37 percent.

Despite better economic data in Europe and Asia than in the US, overseas stocks fell faster as panicking dollar-based investors repatriated investments. Germany, France, and Australia all dropped by more than 40%.

In Asia, Japan's Nikkei Stock Average tumbled 42.1%, its worst-ever showing. But emerging markets suffered the most. China's Shanghai composite index fell 65 percent while India's Sensex 30 in Mumbai fell 52 percent.

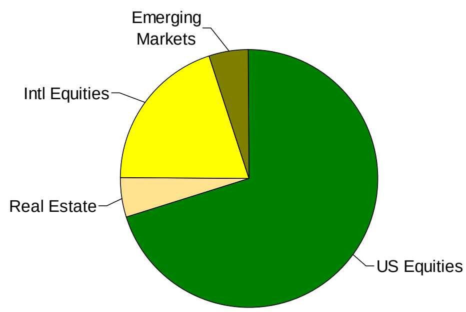
Russia, down 72 percent, was hit hard. Its August conflict with Georgia coincided with the global financial crisis's most virulent phase and a plunge in oil and natural gas prices. The ensuing investor turmoil exposed the weakness in the country's banking system, prompting a huge government rescue package. Russia dedicated more than a quarter of its foreign exchange reserves — nearly $600 billion at their peak in August — to stem the ruble's descent.

Coupled with the near-collapse of the world financial system and subsequent government takeover of banks, the commodities price bubble burst in the second half of the year. Oil prices that peaked in July at more than $147 a barrel, traded at year end slightly above $44, after falling to less than $40 a barrel.

Some analysts predict that the United States economy, which officially fell into recession in December 2007 and is poised to receive a stimulus package from Washington of as much as $1 trillion over the next two years, may actually lead the world out of the downturn in the second half of the year. ■

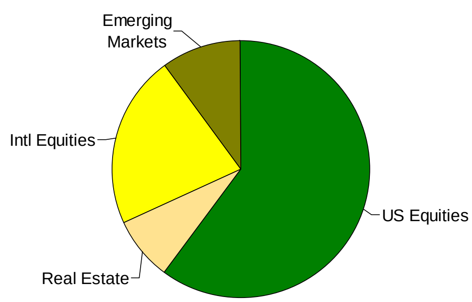
Oakwood Conservative Global Equity

- Balance of value and growth as well as large, medium and small capitalization stocks
- Suitable for investors seeking income and long term capital appreciation



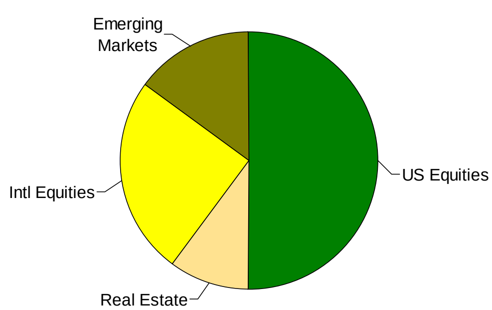
Oakwood Moderate Global Equity

- Has an increased bias towards value by using multiple asset classes and greater emphasis on smaller capitalization stocks than the conservative strategy
- Suitable for investors seeking above average returns through long term capital appreciation



Oakwood Aggressive Global Equity

- Has a higher non-US companies component as well as a greater value tilt and emphasis on smaller capitalization stocks than the moderate strategy
- Suitable for investors with a higher tolerance for risk seeking higher returns through long term capital appreciation



What Helped Global Strategies in the Quarter:

- Cash
- In December, US Real Estate (REIT) was +17.1% and Emerging Markets was +9.8%

What Hurt Global Strategies in the Quarter:

- US & International Real Estate (REIT)
- Emerging Markets
- US Small Cap Value

From Leverage To Deleverage

The fourth quarter closed with both the S&P 500 index and the Russell 1000 Growth index down -21.9% and -22.8%, respectively, and down for the year by -37.0% and -38.4%.

More than one year ago, Oakwood began to grow cautious on both the US economy and the market. The magnitude of the slowdown—and the reaction of the stock market—turned out to be larger than we expected, and yet we performed relatively well.

This is not a typical post-WWII-era recession in which the worst quarterly decline comes within two or three quarters of its start. This is more of a slow motion recession; almost five quarters old and we still haven't seen the end of it. We are estimating that the momentum of the economy's deterioration may ebb by the 2nd or 3rd quarter of 2009. Post-war recessions have more typically been characterized by inventory corrections accounting for about 80% of the slide in real GDP. The current recession, by contrast, is not just a consequence of the financial sector, but of excessive leverage in the broad US household sector. From the mid-1960s to the mid-1980s, the ratio of household debt to income was stable at 70%. By 2002, it rose to 101%. As of last year, the ratio was at an all-time high of 140%! This will require time to deleverage – liquidating assets, debt repayment, and rising personal savings rates. The trickiest policy challenge will be balancing this deflation with inflationary fiscal and monetary government policies to nominally reflate the economy.

Key economic indicators, among others, guide our (extremely) defensive decision making:

- **Retail sales**
  Over the July - November period, retail sales slumped at an unprecedented -7.4% annual rate, the first five-month decline in 50 years.

- **Industrial production**
  November capacity utilization came in the lowest since May 2003.

- **Housing**
  Continues to decline.

- **Federal Reserve**
  Cutting its fund rates from 1% to a range of 0-0.25%.

- **Inflationary trends**
  At their weakest since the 1930s, confirming that the Fed will be compelled to wage its largest deflation battle since the Great Depression.

Difficult times distinguish superior portfolio management

2009 will be a year of change. We plan to reposition the portfolios from a defensive posture to a more aggressive stance. We currently project this will occur mid-year, but the market and the economy will dictate optimal timing.

In the US Equity Income portfolios, we sold a number of stocks in the fourth quarter to capture tax losses to offset gains taken earlier in the year. New defensive sector positions purchased were in consumer staples and technology. The consumer staples company is a large snack and beverage company. The technology company, which is less sensitive to the economy than its competitors, is a leading global provider of management and technology consulting services and solutions. We also increased our weighting in the energy sector to equal the weight to the market; and reduced our weighting in the consumer discretionary sector to zero. At year end, we held above-average cash, which positioned us well for emerging opportunities.

For our Capital Appreciation clients, we added a biotech firm engaged in the development of cancer and inflammatory drugs. We also added an additional medical company, which is the leading maker of integrated cancer care systems and diagnostic imaging applications. We raised our energy sector weighting to slightly underweighted. We also made a few defensive purchases: the first, in the capital goods sector, is a leader in specialized contracting services for electric power, natural gas and cable industries. Another is a waste management firm that develops, constructs, owns and operates energy generating facilities. We believed these stocks to be undervalued at the time of purchase and anticipate clients will be well rewarded for owning these companies. ■

TAXABLE BOND COMMENTARY

In the Right Place at the Right Time

Sticking to our convictions

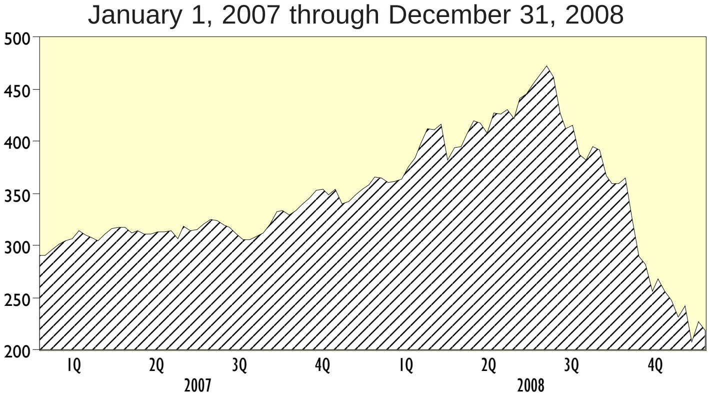
2008 was a good year for Oakwood's taxable bond clients. Returns are solidly positive. We credit these results to a significant underweighting in corporate bonds, especially the banking and finance sectors. Instead, we invested heavily in Treasury securities, despite numerous recommendations by strategists to avoid this lower-yielding sector and go for the higher yields offered by riskier securities. In addition, we held steady to our belief that 30-year mortgage rates, which are tied to Treasury yields, must move much lower in order to see a better economy, housing improvement and higher returns from corporate bonds.

Peering around the corner

Now that 30-year mortgage rates are decreasing, we have identified two remaining key indicators that are essential to an improving economy. The first is a significant reduction in energy prices. Lower oil and energy prices combine to reduce the cost of producing and transporting products and are a direct and ongoing stimulus to consumers. Motorists certainly feel relief from the drop in gasoline prices. Along with energy prices, commodity prices have also dropped significantly, as shown in the chart below. This lowers inflation by directly lowering the price of producing and consuming products. As this process continues, hopes for an improving economy and stable earnings should emerge and corporate bond spreads will begin to contract, perhaps sooner than many expect. In anticipation of this, we are currently adding to existing positions.

Commodity Research Bureau (CRB Index)

January 1, 2007 through December 31, 2008



Source: Bloomberg L.P., Oakwood Capital Management LLC

Housing woes continue to plague the market

In our belief that bankruptcies and declining home values would erode the value of the underlying collateral supporting mortgage-backed securities, we avoided every type of this investment over the past year. The loss of liquidity and widening of yield differentials to Treasuries has become a major cause of underperformance for most of this sector. Going forward, mortgage-backed securities will only be attractive as the inventory of unsold homes declines from its current record level of 11-12 months, to a more stable and sustainable 8 months – the threshold or minimum inventory level for our investment target. We continue to monitor this situation closely to identify the right time to make attractive investments.

Even the darkest clouds have silver linings

Despite generally challenging market conditions, specific opportunities continue to emerge. One example is a new investment vehicle called "FDIC guaranteed corporate bank notes." This product is designed to help alleviate credit market gridlock by allowing qualified bank holding companies access to the capital markets at a favorable interest rate expense. The notes have a maximum maturity restriction of 3.5 years and enjoy the unconditional guarantee of the US government. To compare, yields levels on similar-maturity Treasuries have fallen below 1%, while these securities yield around 2.10%. We view these securities as especially attractive in an environment where many investors have been willing to sacrifice yield for the safety of their investment.

"It's tough to make predictions, especially about the future." - Yogi Berra

At Oakwood, we always employ macro trends as an important component of portfolio structuring. As such, we monitor and forecast economic growth and interest trends, along with commodity prices, currency rates, inflation, etc. Even though we spend countless hours evaluating economic and monetary conditions, forecasting in today's environment is fraught with uncertainty and drawing preconceived conclusions is at best a guess.

While all factors impacting the markets normally merit our consideration, for now we rely heavily on criteria like risk/reward assessment, quantitative findings and confidence studies. Rather than focusing on forecasting or predicting trends in the economy and interest rates, we will focus on an individual assessment of the value of investment choices in each area of the maturity curve. This involves analyzing advantages and disadvantages for each investment choice, in order to select the best risk-versus-reward investment. The rigor of this method avoids the distraction of potentially unreliable predictions that can introduce more risk to the portfolio.

We expect our bond portfolios to continue to perform well, on both a relative and absolute-return basis. Equally important, all of our investment choices remain highly liquid. This provides us with the ability to seek out attractive investment opportunities while consistently guarding against unknown challenges. ■

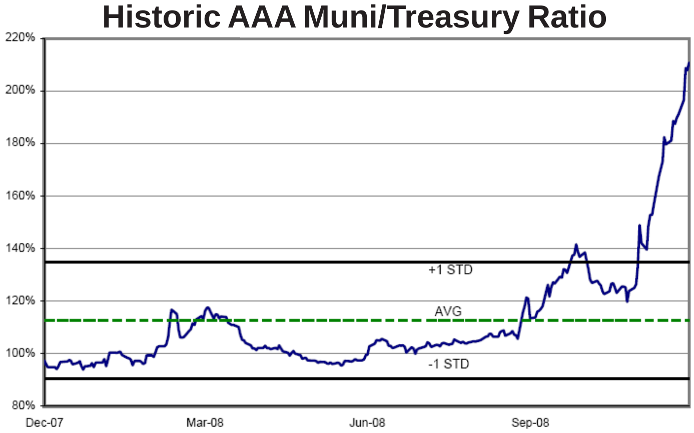
Municipal Bond Commentary

Munis Offer Attractive Opportunities

At Oakwood, we see an opportunity for investors in the higher income brackets and for investors living in highly taxed states like California and New York.

Spreads between tax-free bond yields and taxable Treasury yields have never looked more attractive. Specifically, municipal yields have surged in recent months as the weakening economy erodes the tax base of state and local communities, and as investors avoided munis in response to perceived increased credit risk. Adding to the rise in rates was heavy selling by hedge funds and ongoing downgrades of secondary bond insurers including FGIC, AMBAC, and MBIA. Unlike Oakwood clients, individual investors and municipal bond funds were hit by the muni market's abrupt sell-off.

Historic AAA Muni/Treasury Ratio



Source: Raymond James, Bloomberg L.P.

Tax regs exacerbate market woes

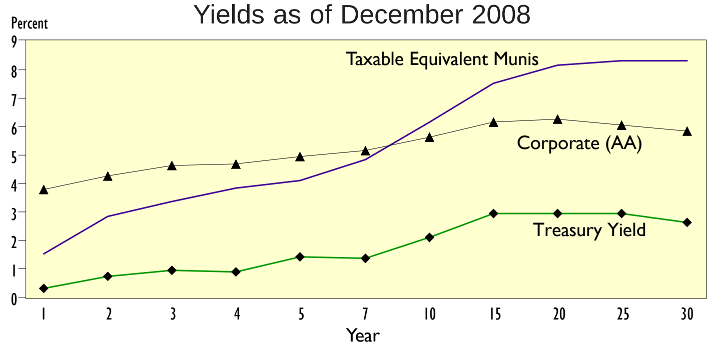
An additional element plaguing municipals is the enormous amount of secondary market munis falling victim to de-minimus tax rules. This rule specifies a market price discount level on each muni at which future price appreciation to par is exempt from taxes. If purchased below this threshold, all subsequent growth is taxed. In anticipation of this, at Oakwood, we limited our investments to premium-priced or above-market munis with a high cash flow coupon structure. This provides us with an especially valuable cushion in the event that prices decline. In fact, while many investors have suffered significant losses from the recent erosion in longer municipal bond values, our clients are still enjoying positive returns.

Standard tools for evaluating muni attractiveness still work

In order to identify attractive maturity areas for potential investments, we use the corporate bond sector as a roadmap for valuing municipals of similar maturities.

Taxable Equivalent

Yields as of December 2008



Source: Bloomberg L.P., Oakwood Capital Management LLC

While many areas of the curve suggest relatively good value, the graph clearly indicates the benefit of extending out to longer maturities. In response to reasonable concerns arising from recent credit quality deterioration, investors can take comfort from the fact that municipals have consistently delivered much better credit performance than corporate bonds. In fact, during the Great Depression, no state defaulted and overall defaults at local levels were very low.

Caution mixed with opportunity

Many municipalities around the nation face significant budget challenges. We understand and agree with consensus forecasts that this budget situation may indeed worsen in the months ahead. In response to this, we continue to refuse to compromise on quality and will only own the highest quality municipal bonds.

Oakwood's experience and judgment provides us the maximum flexibility to seek out attractive investment opportunities on our own timetable. We look forward to a time when the economy stabilizes and municipal bonds return to a more normal relationship to Treasuries. When this occurs, and we expect it to occur soon, we believe municipal bonds will provide solid performance to our clients. ■