

A WORD FROM THE ADVISOR

One Size Doesn't Fit All



"You can't learn the path to financial independence from just ANY infomercial."

The once broadly accepted notion of 'stocks for the long run' has been somewhat tarnished lately. While equities represent a substantial portion of many investors' portfolios, putting one's faith solely in an undiversified equity portfolio tempts fate. Every investor needs to deeply consider his or her life cycle needs when determining their asset allocation. Rather than just seeking general equity exposure, the well-designed portfolio should address the appropriate risk/return profile based on each client's individual time horizon.

Clients often ask where we think the equity market is heading. Certainly we have a view, but our success and that of our clients does not depend upon market timing. Without question, the decline in equity prices over the past 20 months has created attractive opportunities and entry points for selected equity purchases. In the current environment, even following a 30% run-up from March 2009 lows, stocks are still down 37% since October 2007 and we believe they represent good opportunities.

That statement begs the question of whether the stock market will re-test the March 2009 lows, or build from here on the 'green shoots' of a recovering economy. The answer is: we don't know. Remember, we don't focus on predicting market movements. Instead, we employ what we

believe are sound and thoughtful investment strategies to garner upside potential while carefully protecting investors on the downside.

To achieve these goals, we rely on the broadest set of tools – from US equities to global investment strategies to fixed income and balanced portfolios – to address clients' unique and changing needs. We provide these investment options to clients in a highly personalized manner. This "wow" level of service for valued clients is what distinguishes our firm.

At Oakwood, we understand market pitfalls and exercise a consistent discipline. We don't allow the noise of the market to interfere with our judgment. We take time investing our portfolios. We don't just leap into markets or chase the latest fad or momentum investments. Yes, we are cautious, at the cost of perhaps lagging in a suddenly rising market. However, our ability to protect positions on the downside has served our clients well over the years. We can manage in any environment because of our ability to manage risk and to offer viable solutions.

The impact of our approach gets reflected back to us in client contacts on a regular basis. Just looking back over the last week ...

Approaching Retirement

Horace Higsbottom* ("HH") has invested his retirement savings with Oakwood for more than a decade. We met Horace for lunch on Monday at his golf club in the Valley. Now 60 years old, HH is overseeing the sale of his successful printing business to new and younger owners, so he's mostly focused on improving his golf game. In the early part of his career, HH put all available funds into his business. About 12 years ago he began to seriously prepare for retirement. Unfortunately for HH, the S&P 500 is now roughly where it was then, although corporate earnings in 1997 were higher than those projected for 2009! If HH had bought into the popular dogma of 'stocks for the long run', he would have ended up basically trading water for the entire period of his investing. And now, anticipating the proceeds from the sale of his business, HH wonders whether he should put any new money into equities.

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When we started working with HH, we structured his portfolio at 60% stocks, 40% bonds. As he approached age 60 (and began to implement his plan to sell the business) we readjusted his asset allocation to a more conservative 40% stocks, 60% bonds. As a result, HH outperformed the S&P 500 and achieved positive returns.

We told HH that at this stage of his life, it's perfectly appropriate to weight his portfolio toward fixed-income investments.

However, with equity prices declining by close to 50% from October 2007 through March 2009, equities became fairly and then attractively valued. While recommending that HH continue to direct a portion of his assets into equities, we did not suggest an equity index fund, because his time horizon wouldn't comfortably accommodate the overall market's expected volatility. Nor does he have the luxury of excess time to recover if there is another substantial, but unexpected, decline in equity values. We therefore designed a lower volatility (beta<1) equity basket for HH which effectively balances his higher allocation to fixed-income investments and provides enhanced returns. In order to preserve capital for later in his life, we can also shift the profits to rebalance from equities into more fixed income over time.

Within fixed income, we advised HH to buy tax-free bonds due to his current high-tax bracket. Other benefits include a stable stream of revenue and preservation of capital. Normally in retirement, income levels decline, but in HH's case, after selling his business he will continue to be in a high tax bracket.

At some point in the future we will discuss the blending of tax free and taxable bonds. On the taxable side, we advise against longer term US Treasuries, despite their attractive yields, because they are both expensive and vulnerable to declining prices as interest rates back up. Also, the ongoing drama of California's budget makes us similarly wary of state bonds.

We do find several very attractive local municipal issues associated with essential services that offer better returns based on the security of dedicated revenue streams where the revenue goes directly to the bondholder (e.g. tuition, ad valorem taxes) as well as pre-refunded municipal issues that are guaranteed by US Treasuries.

During our relationship with HH, we've explored ways to assist with tax management, estate planning, insurance and other means of sheltering and transferring his assets. We brought in experts to get the best advice.

Just Starting Out

On Wednesday we met with Brett Vapnik*, a 30-year-old software designer with a charming wife, Sarah and their two

kids at his favorite beach restaurant in Hermosa. Brett launched his freelance practice five years ago, and expects to be a disciplined saver for the next two to three decades that he intends to work. But with a mortgage on a modest South Bay bungalow, two cars, and the cost of child care, there isn't much to put aside. Even more perplexing to Brett is how to approach investing intelligently following the worst market cataclysm since his grandparents were youngsters.

Given his longer time horizon, Brett has the ability to absorb the inevitable volatility of share prices. He benefits from the fact that current prices offer much more reasonable valuation, as well as potential for attractive returns, than we have seen since the mid-1990s. However, there is no guarantee that equities will deliver those returns over the short run (less than five years). So we recommended a customized portfolio for Brett that is weighted more toward selected equity investments, e.g., developed and emerging international markets, which are likely to generate attractive returns over the long run. Our DFA Global strategies are a perfect vehicle for Brett and we encouraged him to begin to invest, at a minimum, his annual retirement allocation into these strategies.

Underlying this investment plan we also encouraged Brett to establish Section 529 savings plans to ensure his kids' college education, and as sole proprietor in his business to establish a 401(k)-like program such as a SEP-IRA account. Finally, we suggested a term-life insurance policy for Brett and his wife to insure that their family could have additional financial security should either die prematurely.

High Earning Years

On Friday, we had breakfast with Alyssa Abramson* at the club that sits atop her law firm's Century City office tower. Alyssa is celebrating twenty years as one of the top litigators in her firm, where she's been a partner for ten years. Alyssa is 45 years old, single, and has worked relentlessly to excel in her profession. Her dream is to retire in France. She is a new client who was perilously overexposed to equities and took a hard hit in the last year. After that experience, she decided to become more systematic and disciplined in her investing, and asked to meet with us.

Alyssa was ready to throw in the towel and sell all her shares earlier in the year. We counseled her against this plan, and in a more expansive discussion about investing, we noted that retail investors are notorious for selling at market bottoms while we as professionals are much more focused on relative

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* *fictitious name to preserve privacy*



An Emerging Opportunity

Stocks enjoyed a big bounce in the second quarter of 2009, from developed countries to emerging markets, with the latter strongly outperforming established markets. In addition, REIT's (Real Estate Investment Trusts) had a strong quarter.

Despite the financial crisis and continuing dislocation in the credit markets, the world has not ended. That underlying force drove the market stabilization and recovery. While

economies continue to struggle around the world, markets were clearly oversold at the end of 2008 and beginning of 2009. We are witnessing a rebound from the most dire days of the financial crisis.

Japan did the best among the developed markets, with the Nikkei gaining 23% during the quarter. Even so, many analysts regard Japanese companies as still attractively priced, with more than 60% of the Nikkei 225 trading below book value. Coinci-

dently, the Japanese market declined the least last year of any developed market.

France's CAC-40 index increased 12%, and Germany's DAX index gained 18%, breaking five consecutive losing quarters. The US also did well, as the S&P 500 managed an impressive 16% gain for the quarter. The laggard among the developed countries was the United Kingdom, with the FTSE 100 rising only 8%.

In Europe there was a notable move towards higher risk companies with weaker balance sheets which had underperformed in the previous quarters. This left stocks in defensive sectors like telecoms, utilities and consumer staples looking more attractive.

But the real action this quarter was in emerging markets. India led the charge, surging 49%. This rise reflected investors increasing optimism following the Congress Party's better than expected victory in mid-May elections.

Eastern European markets similarly delivered outsized gains. Poland's WIG-20 rose 23% and the Hungarian market gained 38%. These results may be difficult to sustain, however, due to a continuing banking sector crises. Credit problems are unlikely to be resolved quickly since much of the distressed debt is denominated in global currencies (Euros or Swiss Francs), and borrowers are struggling with depreciating local currencies. Ongoing credit weakness could well impact Western European to Eastern European lenders as well.

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Oakwood Conservative Global Equity

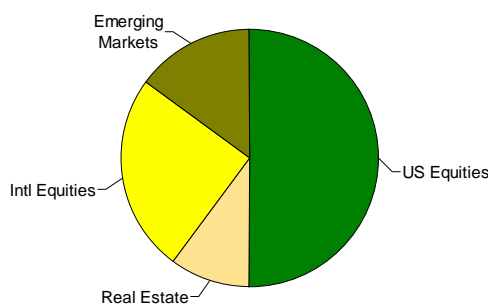
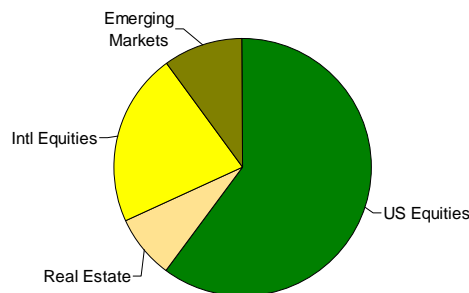
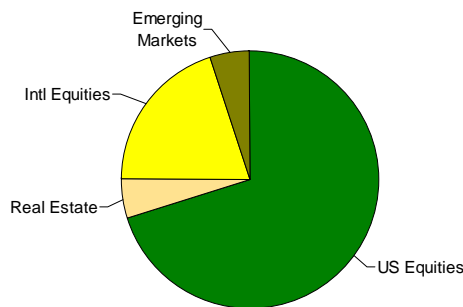
- Balance of value and growth as well as large, medium and small capitalization stocks
- Suitable for investors seeking income and long term capital appreciation

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:

- Emerging Markets
- Int'l Small Cap
- Int'l Core Equity
- US REIT's

What Hurt Global Strategies in the Quarter:

- Cash



Is the Recession Nearing an End?

What a quarter! The second quarter of 2009 closed with both the Dow Jones and S&P 500 indices up 12% and 16% and for the year -1.9% and +3.2%, respectively. Financials, basic materials and technology sectors led the quarter, as they did in March.

As economic surveys and data were released over the quarter, we saw the economy slowly recede from its disastrous fourth quarter 2008 Gross Domestic Product (GDP) drop of 6.3%. Some statistics give indications that the recession is abating as captured by the following quarter-end 2009 snapshot of the economy:

Average weekly hours	manufacturing hours down but flattening
Initial jobless claims	remains elevated; peaked in March
New consumer orders	down only 0.4% annualized - best since August 2007
New cap goods orders	up 1.1% in May but down 2.5% for the quarter
Building permits	up 4% in May but down 5.8% for the quarter
S&P 500	up 16% in the quarter
Real M2 money supply	9% year over year
Yield curve	steepest level since 2004

Another important economic indicator showing improvement is the Chicago Fed's National Activity Index, a weighted average of 85 monthly indicators of economic activity drawn from five broad categories: i) output and income, ii) employment, unemployment and hours, iii) personal consumption, housing starts and sales, iv) manufacturing, and v) inventories and orders. This number has risen for the last four months. Typically this Index bottoms two to three months before the end of a recession.

FRB Chicago National Activity Index: 3 Mo. Moving Average



Source: Haver Analytics, Banc of America Securities-Merrill Lynch, Oakwood Capital Management LLC

Based on these and other statistics, economists are now looking for the real GDP to turn positive in the latter half of 2009 with a possibility that the third quarter will be slightly positive. However, many questions remain concerning the economy's vitality in the beginning of 2010 as the initial effects of the stimulus package start to wear off. Our read on this is that the recovery will not be as vigorous as previous

economic upturns — meaning, the rebound will not be V-shaped. A long litany of ongoing economic challenges will impact the GDP growth rate or may even cause another pullback (W-shaped recovery). These problems include a lack of disposable personal income, higher savings rate, higher mortgage rates, higher gasoline prices, heavy consumer debt, diminished housing equity, labor market pressures, inventory cycle, Fed's monetary policy, and the slowing of the government stimulus package. But for now, the positives still outweigh the negatives, and the equities market is reflecting that the worst may be behind us. Thus we believe that the pending recovery for 2010 will be slower than previous economic recoveries and will be selective across economic sectors.

Our earnings expectations for the S&P 500 are more cautious than the consensus for 2009 and 2010. For that reason we will continue to be conservative and selective for the foreseeable future, preferring to be underweighted in most economic sectors and overweighted only in energy. Although oil prices are above our expectation on a short term basis, we remain bullish long term. We continue to believe that until investment in oil production is significantly increased there will be serious supply shortages during the next few years as the world economy picks up.

For Oakwood's Equity Income portfolios we continue to be conservative, preferring to invest in high quality companies and maintain an above-average cash position. We increased our technology weighting, buying a provider of relational database management systems used in network-based client/server computing. In addition we purchased a leading supplier of virus protection, help-desk, network security, and encryption software. To offset these purchases we sold a provider of computerized payroll-accounting services, since we prefer companies with higher growth potential. In the Consumer Discretionary sector we purchased a company that operates a chain of retail building supply/home improvement stores, as we believe the home repair market will improve next year. We also purchased a company in Consumer Staples that specializes in technology-based agricultural product solutions for growers.

We are generally more aggressive in Oakwood's Capital Appreciation portfolios where we increased our weighting in technology by purchasing a company that develops and supplies custom-designed user interface products and solutions that enable interaction with various mobile computing, communications, entertainment, and other electronic devices. We also purchased a company that makes electronic design automation software for the global electronics industry. In addition we sold one energy company to add to another we already owned, believing that it has better reserves and the potential to grow those reserves at a faster pace. ■



Clash of the Titans: Monetary Policy versus Fiscal Policy

Monetary Policy Impact

The Federal Reserve, through its use of monetary policy, strives to maximize economic growth while maintaining price stability. To achieve this goal, the Fed has the authority to increase or decrease the amount of liquidity available for lending in the banking system. This helps set consumer and business lending rates. In an effort to stimulate our ailing economy, the Fed has pulled out all stops to enhance banking system and capital market liquidity by injecting huge amounts of cash.

The Federal Reserve also recognizes the vital role housing plays throughout the economy. Through large and ongoing intervention (buying) of Treasury securities, it seeks to shrink supply of Treasuries and stabilize mortgage rates. This process is normally effective as Treasury yields fall and mortgage rates typically follow. However, mortgage rates are now struggling to remain low under the weight of a seemingly endless supply of new Treasury securities. The following chart shows the correlation between a fixed home mortgage rate and 10-year Treasury yields.

Ten Year Treasury Yield vs. Fixed Home MTG Rate



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

Recently, as Treasury yields moved up, mortgage rates followed. If the Fed does not find a way to halt this situation, it may be harder to dig out of recession. What is causing this decoupling to happen?

Fiscal Policy Impact

Bond investors are increasingly fearful that multiple Government stimulus programs will produce out-of-control budget deficits. Funding these programs will require enormous borrowing in the Treasury markets for the foreseeable future. Over time, this could prompt a precipitous drop in the dollar and propel inflation higher. This would be the kiss of death to the Fed's other role,

which is to seek price stability. Adding to this problem are Government retirement promises and sponsored health care programs (Medicare and Medicaid).

We believe this dilemma has put the Federal Reserve's role at odds with the Government's need to stimulate. To resolve this, we urge Congress and the Administration to put forth a plan to deal with the potential ramifications caused by unprecedented borrowing to pay for economic stimulus. If they do not, the Fed may be unable to stop the recent rise in Treasury and mortgage rates as it is forced to restrict monetary policy.

We will handle this situation by adopting a barbell strategy in client portfolios. This entails the sale of 4-to-6 year holdings, in favor of shorter 1-to-2 year alternatives. To achieve our target duration of 3.5 years for intermediate maturity clients, we invest a portion of the remaining proceeds in high coupon 10-year Treasuries. This completes the long end of the barbell structure, and positions our clients to earn attractive returns from the flattening yield curve.

In addition, we begin to shorten select 5 to 10 year corporate bond positions. This provides protection against unforeseen earnings shocks which would result in yield spreads widening. However, we plan to continue to maintain an overweighting in corporate bonds.

We intend to remain highly conservative until such time as the Federal Reserve and Administration dispel inflation concerns. We are confident that the Fed, if needed, will act aggressively by raising short-term rates and draining excess reserves from the banking system. We look forward to the time when we can again extend portfolio durations. Until then, we emphasize above market income, security selection and yield curve positioning to aid us in preserving capital. ■



Continue with the Best of the Best

At Oakwood, we believe a well-structured municipal bond portfolio should contain two basic features, dependable tax-free cash flow from coupon payments and market growth in excess of inflation. This is especially important to heavily taxed individuals who at some point may depend on tax-free cash flow to meet expenses. To reach this objective, all investments must be first and foremost safe – return *of* capital is more important than return *on* capital. As many of you are all too aware, California, like many states throughout the nation is suffering deterioration in credit quality. The rating service Fitch recently cut the state's general obligation rating, already the lowest in the nation, to BBB. Unfortunately, lawmakers remain gridlocked on how to exactly deal with the \$24 billion budget shortfall. Consequently, a difficult challenge now appears almost destined to turn into a catastrophe.

For more than two years, we have avoided all purchases of insured and non-insured State level bonds. While most market experts say it is unlikely that California will default on its debt, we still feel it imperative to steer clear of the state's general obligations. However, even during the Great Depression, municipal investors lost less than one-half of one percent of their portfolio to defaults. In addition, we continue to maintain stringent quality standards on all holdings. This includes local municipality general obligations that are secured by dedicated property taxes, collected separately; or essential service type bonds carved out specifically for the payment of interest and principal. In most cases, to include the State, payments to bond holders are prioritized over other services by the State constitution and court rulings. States are not able to file for bankruptcy under the existing bankruptcy code. As a sovereign entity, there is no established way for states to seek court protection as other local governments can under Chapter 9. Unlike a corporation, a municipality cannot simply go out business and disappear.

Also, many municipal bonds have the ability to effect an early retirement or call of their outstanding bonds. Unfortunately, this untimely retirement of bonds can significantly alter the client's expectation of a dependable tax-free income stream. While details outlining that potential event are always described in a municipality's official statement, deciphering these complicated contingencies can be difficult and requires specialized expertise. With this in mind, we remain careful in our use of

callable bonds. When we do, we insist on a very narrow separation between a securities shorter call date and final maturity. This provides us the necessary income stability and helps to reduce market volatility.

The second ingredient to a well-structured municipal portfolio, market growth in excess of inflation, requires at a minimum that all securities retain full value in the marketplace. This is especially important during difficult market periods. We are pleased that Oakwood portfolios continue to see positive growth, as the stock market and economy search for direction.

Municipal bonds are more popular than ever. This could be the result of an aging population that demands an increasingly conservative asset allocation. It may also be that municipal bonds have proven through the years to be among the safest of investments, without incurring the cost of significantly diminished returns. ■





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value. In fact, the market was clearly oversold, and as the threat of financial system meltdown has dissipated, Alyssa's equity holdings have recovered nicely. We did take the opportunity to adjust her portfolio, positioning it away from growth stocks which we expect will lag the market in the near-mid term, and moved her more towards dividend paying stocks.

Finding the right fit

At Oakwood, we excel at delivering the best investment experience to our clients. We have the tools and expertise combined with a variety of strategies that are matched and suited to our clients' diverse needs; beyond that, clients tell us they enjoy the "wow" service.

While each of the three Oakwood investors described above (*fictitious names, of course, to preserve privacy*) has differing needs tied to distinct circumstances and stages of life, they all share a common desire for capital appreciation. When markets are tough, like today, our commitment to protecting clients on the downside truly distinguishes Oakwood.

Building and implementing a plan of action is a systematic, disciplined, and step-by-step process that readjusts as markets dictate and as goals are reviewed. Everyone is different and one size doesn't fit all; Oakwood finds the right fit for every client. ■

An Emerging Opportunity from page 3

China also did well in the second quarter, with the benchmark Shanghai index increasing 25%, just slightly less than Brazil's 26% gain.

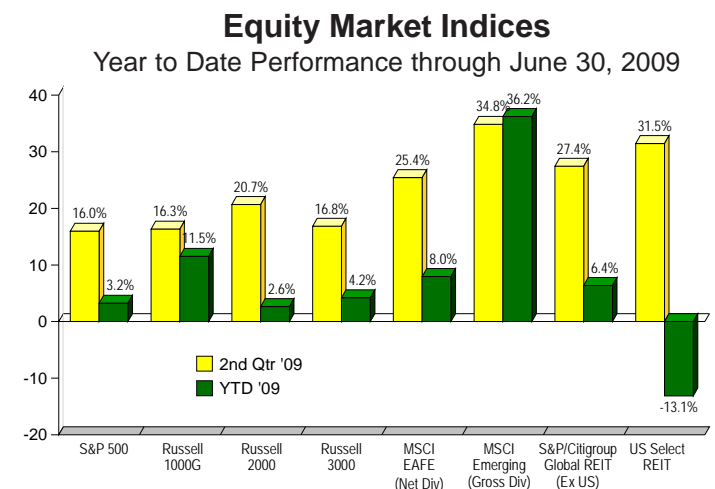
In total, all global markets performed well, but there was a distinct split between good performance from developed markets and great performance from emerging markets. This situation leads us to a few key questions:

- What drove this bifurcated result?
- Will emerging markets continue to outperform developed markets through the rest of the year?
- Will global stocks continue their rise, or is it time to take some money off the table?

As to the beginning questions, we note that the emerging market countries appear to be recovering from the financial crisis more quickly than developed countries. Citigroup forecasts 2009 economic growth of 5.8% in emerging markets, vs. a 4.9% decline among developed countries. Consequently, we do expect emerging markets to continue their outperformance, relative to developed markets, for the next two quarters.

The last question is a bit tougher, as the bounce we've experienced may not prove to be sustainable. The global economy has not yet recovered; it is only declining at a less precipitous pace than in earlier quarters. Corporate earnings remain weak, and 'green shoots' are still sparse. Several global markets gave back gains in June, as fears of a W-shaped recovery led investors to sell.

So, the world has not ended and markets are cheering. But we remain cautious that, despite some relief, global markets are not yet completely out of the woods. ■



Source: Frank Russell Company, Standard & Poor's Index Service Group, MSCI data copyright MSCI 2009, Dow Jones Indexes, Oakwood Capital Management LLC