FAIRPORT ASSET MANAGEMENT
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The Compass

Wealth management tips, trends and articles that provide confident navigation for high net worth clients.

November 22, 2011

Thank you for your continued confidence and feedback. As always, we encourage you to share this newsletter with friends, family members and colleagues.

From all of your friends at Fairport, best wishes for a happy and healthy holiday season!

Mid-Quarter Outlook

By John M. Silvis, CFA
Director of Investments

As we are all aware by now, the S&P 500 Index recorded its worst decline, dropping nearly 14% in the third quarter, since the fourth quarter of 2008 which was near the height of the credit crisis. Historically, declines of this magnitude are followed by better than average returns over the next 12 months. According to Ned Davis Research, if you go back to 1929, the median return for the benchmark index one year later has been over 12%. If you shorten that time frame to post WWII, and the median return climbs to over 23% one year out.

Through the end of October, the market bounced back registering a return of 10.92% setting a better tone for the current quarter. As we approach year end, history would suggest that we are entering a more favorable timeframe as the period from the beginning of November through the end of January has the best three month return characteristics.

The headline risks of the summer remain, lead by the ongoing debt ceiling debate here at home coupled with the contagion fears of the ever-expanding European sovereign debt crisis. On the domestic front, not much has happened as of yet with the November 23rd deadline looming. It again shows how polarized the country is and how little political will there is in Washington to compromise. Both sides have made slight concessions, but the two parties remain far apart on any real progress making any "grand bargain" less likely in the next few days, but time will tell. In Europe, the leaders of the European Union have taken the first steps and admitted they have a problem, outlining steps to recapitalize the banks and agreeing to an outline that would "voluntarily" restructure Greek debt. However, as has been the case, the capital markets still believe that more concessions will be needed as yields for Spanish and Italian bonds are climbing towards unsustainable levels. This likely indicates that more structural changes are needed in the near future. Stay tuned.

It is still our base case that the economy will not fall into another recession anytime soon. GDP growth for the recently completed third quarter came in at 2.5%, elevating the fear that the economy was grinding to a halt. Indicators for the fourth quarter are trending up led by falling weekly unemployment claims, a positive yield curve and productivity numbers pointing to an expanding economy. Economists surveyed by Bloomberg have revised up their view on the economy with the average now forecasting 2.2% GDP growth in 2012.

As third quarter earnings reports wind down, it's apparent that corporations continue to turn in strong results with earnings growth approximately 18% over the same period last year. The top line, or revenues, also continues to report strong numbers as sales for the companies within the S&P 500 Index are coming in at 10% ahead of last year. More importantly, balance sheets are in great shape and payout ratios remain low indicating more companies will look to return capital to shareholders through dividends and share buybacks in the future. Earnings for the S&P 500 should top $100 next year, indicating that the market should have room to advance in 2012.

Fairport Global Asset Allocation
Europe continues to struggle as sovereign debt yields continue to rise and the ability to fund these debts into the future becomes less certain. Australia and Canada, areas removed from the sovereign debt issues plaguing Europe, are countries we continue to favor. Both have benefited in the current quarter, after a rough third quarter, due mainly to a rebound in oil and other raw material prices. Japan, where we remain underweighted, has seen some economic improvement due to the need to rebuild after the devastating earthquake; however, their equity markets have underperformed the benchmark MSCI EAFE Index so far this year. Emerging Markets may be poised for a comeback as monetary policy is shifting towards the next easing cycle and China seems to be executing another "soft landing" with inflation becoming less of a concern.

Fairport Large Cap
After coming out of the gate strong in the fourth quarter, the financial sector continues to be plagued by concerns over exposure to Europe and any contagion that may happen if the crisis deepens in the next few months. We remain underweight Financials but are looking to add quality franchises as we see opportunities. We continue to take a bar-belled approach, remaining overweight in Consumer Staples due to their lower volatility and consistent and stable yield. We do however think that the market is undervalued and the economy is showing some improvement leading us to remain tilted towards cyclical sectors. We continue to weight toward the Industrial and Technology sectors to capture what we believe will be a cyclical basis going forward.

Fairport Fixed Income
The financial crisis in the Eurozone continues to unfold, as 10-year Italian bond yields surged north of 7%, the same level that prompted bailouts for both Portugal and Ireland. Spain also came dangerously close to joining the party, setting a record yield of 6.975% in a recent 10-year auction. Given this backdrop, investors continue to seek the quality and safety of U.S. Treasuries. Despite several weeks of surprisingly strong U.S. economic reports, 10-year yields continue to hover around 75 basis points below fair value, at 2%. While a substantial allocation, 65%, to U.S. government securities has served our clients well, we continue to tactically underweight this sector in favor of both investment grade and high yield corporate bonds.

Municipal bonds also look relatively attractive, yielding more than Treasuries on a pre-tax basis throughout the entire length of the curve. For instance, a 5-year AAA-rated municipal bond is currently yielding 144% of its comparable Treasury. This would amount to a yield pick-up of approximately 100 basis points for an investor in the 35% tax bracket.

Celebrating a Legacy of Success: Fairport's 10th Anniversary
Nearly 200 clients and friends were greeted with the message of *Happy Birthday Fairport* on the House of Blues marquee on Euclid Avenue on September 27th. Guests donned "backstage passes" and helped us celebrate our 10th anniversary as Fairport with drinks, dinner and lively conversation. As part of the festivities, we premiered a short video reflecting on our roots and founding principles dating back to the early 1960s. If you haven't seen the video, we invite you to view it here: http://www.fairportasset.com/insights.aspx?nid=33.

As we near the end of 2011, we want to again thank you for being a special part of our history. We understand that our longevity is due to the support of our loyal clients. Whether you're a long-time client or you've joined us this year, it's our privilege and honor to serve as your trusted financial advisor. From our partners and the entire Fairport team, sincere thanks and cheers to the next decade!

Client Question
Each quarter, one of our professionals will answer a question asked by a Fairport client(s).

"The ups and downs of the market have been maddening. How is Fairport addressing this volatility in my portfolio?"
By Andrew R. Connors, CFP®
Vice President & Advisor

The Chinese use two brush strokes to write the word crisis. One brush stroke stands for danger; the other for opportunity. The lesson is that in periods of risk where obstacles seem to abound, one should be aware of the danger but recognize the opportunity.

With what seems to be a continued ebb and flow of euphoric run-ups followed by despair driven downturns, understanding how to balance the short term risks against the longer term opportunities, while still maintaining a strategic focus, is critical. Diversification, not only among asset classes, but also asset strategies is one of the most constructive approaches that Fairport has employed to address this issue. Diversification, which is a highly overused term, is often incorrectly implemented and one-dimensional in nature. Successful diversification is not driven by the number of holdings in a portfolio, but rather by the correlation of those holdings. At Fairport, we see three dimensions to diversification: preservation, opportunity and alternative.

Preservation-focused assets can help maintain capital, reduce volatility and/or generate income regardless of the market environment. These investments often hold up well during sharp drops in the equity markets, but will also experience little upside during periods of expansion. For individuals in or nearing retirement, holding the equivalent of five years of required income in this preservation “pool” helps provide peace of mind by ensuring that there will be stable funds available to cover expenses even in market cycles where volatility can be excessive. Having this stable pool of funds also means you do not have to liquidate longer term, opportunity-focused assets during volatile periods thereby allowing them a shorter time to recover.

Opportunity-focused assets are those more moderate to aggressive investments that focus on appreciation and the ability to drive growth over long time horizons. These assets have a higher risk profile, will be more volatile and will generally follow the overall direction of the broad markets.

Alternative assets create value through investments in traditional and nontraditional asset classes. Alternatives provide a good balance between the two aforementioned strategies, having noticeably lower volatility than opportunity-focused assets and greater volatility than pure preservation-focused assets. For more on alternatives, see our article here: http://www.fairportasset.com/insights.aspx?nid=29#clientq.

A wealth management approach that identifies your short and long term objectives and aligns each with the optimal mix of preservation, opportunity and alternative strategies has proven to be a great strategy to reduce volatility while still maintaining a consistent growth perspective.

Fairport News

Fairport believes in supporting the community as a company and through encouraging employees to participate and hold leadership positions in charitable, professional and community organizations. Read about our most recent community involvement.

Andrew Connors was accepted into Cleveland Bridge Builder’s 2012 class. The Cleveland Leadership Center’s program is a 10-month leadership development and civic engagement program for rising civic leaders. The program seeks to build relationships among civic leaders through experiential collaboration and civic education. Participants develop their civic leadership capacity through a highly interactive curriculum including individual leadership assessments, small group discussion, presentations from community leaders, engagement in team projects and review of best practices in leadership across sectors. Congratulations Andrew!

Laurel Lawrence coordinated an employee volunteer trip to the Bishop Cosgrove Hunger Center in October. Laurel, **Erin Fleming, Chris Isabella** and **Rachel Margulis** worked in the kitchen to help serve approximately 230 homeless or working poor individuals during the lunch hour. The Bishop Cosgrove Center is the largest day drop-in center in our community, serves approx. 500 meals in any given day (breakfast and lunch) and provides food bags through their pantry program. Laurel hopes to set up additional opportunities in the future for more employees to get involved.

J.T. Mullen was asked to serve as a judge for *Crain’s Cleveland Business*’ 2011 CFO of the Year Awards. The CFO of the Year program honors top financial officers in Northeast Ohio for their outstanding fiscal leadership and asset management. The award winners were announced at a reception at the end of October. Notably, J.T. was named “Chief Financial Officer of the Year” for charitable organizations by *Crain’s* in 2007 while at The Cleveland Foundation.

Emily Shacklett and **Joyce Zak** attended the Homes Sweet Homes Gala in September benefiting North Coast Community Homes, a nonprofit agency that develops and maintains customized housing for people with disabilities in Northeastern Ohio. Emily also hosted a Fairport-sponsored table at the Autism Family Foundation Third Annual Gala and Benefit Auction in October.

Fairport Continuing Education

Fairport employees frequently attend conferences, continuing education seminars and informational webinars to keep up-to-date with new strategies and industry trends relating to the wealth management needs of our clients. From investment management to client service to technology, read more about the conferences we've recently attended.

Ken Coleman, Andrew Connors and Heather Ettinger attended Schwab IMPACT in San Francisco during the first week of November. IMPACT is the premier industry conference for registered investment advisors. It features a dynamic lineup of keynote speakers, networking opportunities and education sessions covering a wide range of topics from investment strategies to market trends. A particular highlight of the conference was a Fairport mention during the opening general session. While urging advisors to focus on female investors, Bernie Clark, head of Charles Schwab's adviser custody unit, specifically praised Heather’s unique approach to serving women.

Peter DeVito, Chris Isabella, Tom Seifert and Emily Shacklett recently attended the 18^{th} annual Smith and Condeni Select Strategies for Insurance and Estate Planning Seminar.

J.T. Mullen recently spoke at the Annual Conference of Kansas Association of Community Foundations (KACF). He presented two breakout sessions: *Spending and Administrative Fee Policies in Turbulent Times* and *Community Foundations Investment Survey: Where Are We Now?* The goal of the two day conference was to increase the skills of community foundation board members, volunteers and staff as well as to build stronger sense of community.

Emily Shacklett attended the FPA Symposium and Northwestern Mutual Advanced Planning Seminar.

John Silvis kept current on investment and asset allocation strategies by attending the Morningstar ETF Invest conference in Chicago and the Goldman Sachs Asset Management Manager Research Conference in New York City.

Newsletter Disclosures

This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.