The Compass™

The Appleton Group, LLC
100 W. Lawrence Street, Third Floor
Appleton, WI 54911

AMONG THE NATION'S TOP 75 SEPARATE ACCOUNT MANAGERS

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The Appleton Group LLC is an independent, Registered Investment Advisor (RIA) located in Downtown Appleton Wisconsin. We solely provide wealth management services for investors, building and managing portfolios that prepare for both cooperative and uncooperative markets. Since our founding in 2002, our firm has been recognized both locally and nationally as a leader in the wealth management community.

The Appleton Group serves 80 families & institutions, and manages $59 million of investable assets. We serve individuals, families, corporations, institutions, endowments, trusts and company sponsored retirement plans.

The Compass™ is published quarterly, and is produced by The Appleton Group which is solely responsible for its content.

Fat Tails and Possibilities

From the Desk of Mark Scheffler

It's really hard to believe that it's already been five years since I founded The Appleton Group. Back in 2002 the market was really quite shaky, what with a mild recession, the aftermath of 9/11, corporate scandals, the Enron and WorldCom fallouts, pension plans defaulting – just about as much bad news as you could imagine. Not exactly the time to start a wealth management firm. Or was it?

Five years later we've grown to serve approximately 80 clients, our assets under management have grown to just under $60 million (up over 32% last year alone!), and I believe we've just scratched the surface of our potential.

I guess I wasn't really thinking much about the risk of being an entrepreneur at the time – I was just focused on working to serve as many people as I could. When I first started in the investment business, you could practically throw a dart at anything and make money. You remember those days, right? I started in 1995, the first year of a really strong bull market, and I have to say that the environment at the time made it a great entry point. But I also remember a thought going through my head every day as I parked in the ramp next to my office: Is this the day it all ends?

Mark C. Scheffler
Senior Portfolio Manager, Founder

What a crazy question, especially in the midst of such a great time to be a capitalist! Couldn't I just be grateful for the favorable market?

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The Results Are In....

As part of The Appleton Group's effort to become one of Wisconsin's first Certified Fiduciary Advisors under the 2006 Pension Protection Act, the firm participated in an in-depth survey, conducted by DALBAR, Inc., to determine overall client satisfaction. The results are in, and they are truly humbling.

52 out of 80 active clients completed the survey, which asked participants to rate their satisfaction with The Appleton Group in four key areas: Trust of Professional, Financial Performance, Satisfaction with Services, and Quality of Advice. The results were then tabulated and compared to those of 2,545 other investment professionals across the country.

In every category, overall client satisfaction was sharply higher than the other professionals that participated in the survey (see data on page 3). The firm received ratings of "Very Good" or "Excellent" in every category, with the biggest difference among our peers coming in the areas of Quality of Advice and Trust of Professional.

96% or more of responses indicated that clients were satisfied with every area of the firm's performance.

"To say that we are humbled by the overwhelming positive response from this survey is an understatement," said Mark Scheffler, Senior Portfolio Manager and Founder of The Appleton Group. "Asking our clients for feedback in this kind of a format was something we'd never done before, and it was so great to know that the services we offer are valued to this degree."

He added, "We'd like to thank the clients that participated in the survey for taking the time to share their thoughts. It is our goal to meet or exceed their expectations every day, and knowing what's working well and what's not working is so important."

The full data from the survey is available on page 3 of this newsletter.

Inside this issue:

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Those who truly know me understand that The Appleton Group has never been about me. I mean, my wife Karen and I are comfortable, we have a good life, but the thing that gets me riled up literally every day (weekends included) is that there is so much work left to do. There are many people that vastly underestimate the importance of a solid financial foundation, one not built on hope but one built on reality. History tells us a great deal about the ups and downs of life, and I like to think that we take those lessons to heart . Yet I see so much needless anxiety among investors, I see such complacency among many investment experts, I see the future fortunes of families pinned to outcomes that are largely the pervue of chance. Maybe I see things that aren't really there, or I consider possibilities that simply don't require as much thought as we give them. In any event, history is replete with winners and losers, and The Appleton Group was formed to create as many wins as possible, and to make loss merely an inconvenience.

I have to say that five years down this path, I'm really proud of what we've accomplished. Helping others (especially those in my industry) see the possibility of managing wealth in a way that makes the most of uncooperative markets is a challenge, but there is no more important calling right now. Our story is really a simple one: working to produce higher returns than other disciplines with less risk over a reasonable period of time. Performance, risk management, results.

Fat Tails

With the exception of the first year of our existence, the market has been on a roll. Did you know that since November of 2002, the market hasn't had as much as a 10% correction? That's very unusual, especially with all of the turmoil we've had in oil prices, the ongoing war on terror, not to mention the AFC winning several Superbowls during that span. Very suspicious indeed! During those years the S&P 500 has leapt its way back to breakeven a full six years and four months after its previous high (that's with all dividends reinvested, mind you). In all, it's been another great run for the bulls, proof that the markets really do trend, that they do have momentum, and that being on the wrong side of the market for an extended time can lead to returns that might be disappointing, or worse.

I'll put it in writing: I think one of the brightest investment minds in our business is Simone Favola of Wealth Management LLC right here in Appleton. I've only spoken with him a handful of times, and I guess Simone is a competitor of ours, but I call 'em like I see 'em. Simone is a thinker, he's not afraid to tell you like it is, and he recognizes the importance of skepticism. Like me, Simone believes in the importance of consistent investment returns regardless of whether the market is cooperative or not, he recognizes the value of true diversification, and a recognition that you have to pick your battles in order to be successful.

Anyway, he put in writing what I had believed to be true, but had never sat down to actually graph it out. He is a believer in "fat tails," a concept that mathematically demonstrates that the two most common (and important) market environments to prepare for are 1) large gains and 2) market losses. In other words, market extremes. These extremes are normal, they reoccur throughout history again and again, and they certainly need to be considered when building a well-crafted investment plan. I've included the mathematics, just for the sake of proper citation:

$$\Pr[X > x] \sim x^{-a} \text{ as } x \to \infty, \; a > 0$$

Got it?

By far, the most common environment is one in which the market goes up by 10% or more in any given calendar year. Wonderful news! I like gains of 10% or more, especially since bonds and cash are both producing much lower rates of return right now, and probably will for quite some time. I'll take more if I can get it, certainly, but 10% per year is quite nice. If history tends to repeat itself, how often should I expect this to occur? The data says that it occurs almost 56% of the time. Great guns, sign me up!

So what else do I need to know? Well, the next most common market environment is one in which I lose money.

What!!?? (Insert long, awkward silence here…)

That's right. The next most common outcome is that the markets will retreat. "Retreat" sounds so orderly, doesn't it? Other words used to describe this phenomenon are declines, losses, corrections, bear markets, and crashes (if it happens all at once). Once I accept that this is normal and that it happens again and again, all I have to do is to determine how much of this unpredictability I can stand. In other words, what is an acceptable tradeoff in order to get these wonderful advances we've been promised?

Always one to consider the big picture, Wendy Hoeft in our office is fond of asking, "Is the juice worth the squeeze?" In other words, knowing that some risk in today's world is required to produce useful returns, how much loss potential is reasonable in order to get those returns? Is

the juice (positive returns) worth the squeeze (potential for loss)?

Accepting Risk versus Managing Risk

The latest, greatest inventions hitting the 401(k) marketplace right now are asset allocation funds, something that we know more than a little bit about. These are portfolios that invest in a preset mix of stocks, bonds, and cash and are designed for investors who simply don't want to build a portfolio by themselves. What a great idea and just in time! The trend has been so hot that they have found their way into practically every well-run retirement plan in America. And they are definitely a step in the right direction. With one click of a mouse, participants choose their appropriate risk level, and the portfolio manager does the rest. These portfolios are supposed to be efficient, easy to use, and the end of the line when it comes to old-fashioned picking of mutual funds. In large part, this is true, but there are certainly good asset allocation funds and there are those that are mere shenanigans.

The overwhelming majority of asset allocation funds in retirement plans today do one thing that must be clearly understood: they accept risk with all of their underlying investments rather then managing risk. What's the difference? Earlier we discussed the fact that the most common market environment is one in which stocks went up by 10% or more, and that the next most common environment is one in

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which stocks lose money. Most asset allocation funds have no way of adjusting their investment mix to account for these types of swings. For example, a fund that always has 60% of its assets in equities can be exposed to the risk that this chunk of the portfolio will incur significant losses from time to time, and that nothing will ever be done to change this fact. The assumption is that over time, simply accepting this risk will result in positive returns. On the other hand, the other 40% of the fund is invested in bonds at all times, and that during a strong equity market your performance could be much less than you'd like (a risk of significant underperformance over time). No flexibility, no adjustments, no meaningful management.

In my estimation, if you're going to pay for portfolio management, you should be getting some benefit aside from just simply being exposed to the whims of the markets at all times. Portfolio management should lead to returns over a full market cycle (both favorable and unfavorable environments) that are positive, useful, that allow investors to achieve their personal goals on their schedule, and that mitigate the risk of large losses. Merely accepting risk (especially with today's momentum markets) is dangerous, as it leads an investor down a path that could quickly change, and with no method for adjustment the portfolio could suffer mightily.

The Appleton Group Wealth Management Discipline™ is like no other process of portfolio management in that it automatically adjusts a portfolio's exposure to whatever part of the market is the strongest. Equally important, it automatically steers the portfolio away from the weakest (and most dangerous) parts of the market. Over the last full market cycle (2000-2005), The Appleton Group Wealth Management Discipline™ has demonstrated the ability to produce portfolio gains which are larger than practically any single part of the market alone, including equities, bonds, and cash (the lone exception being real estate). More gain, less pain, in a nutshell. Much has been written about our discipline, and I'm certain that it will benefit so many more investors over the many years to come.

Seeing Possibilities

If the two most common outcomes in investing in the U.S. equity markets are double-digit gains followed by market losses, wouldn't it make sense to have a wealth management process that prepared for both possible outcomes? The past seven years have resulted in prime examples of both: solid gains most of the last four years, and solid losses the previous three that have left the markets largely where they were at the start. Is it possible that this trend of big swings could continue? Certainly, and it is very possible that in seven years we could be exactly where we are today! In this environment, making the most of big market moves (preparing for and potentially profiting from both) is critical. Standing still and accepting risk in a long-term flat market makes little sense. The bigger value lies in taking advantage of the moves themselves.

As I see it, the case can be made for either likely outcome at any time. In wrapping up my article for this quarter, I'd like to breakdown my view of why the market could either appreciate by 10% or more this year, or why the market could take a step backward. Here goes:

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The Results Are In... continued from page 1

	DALBAR Designation	Score* (Max is 4.00)	Percent of Clients Giving Top Score** (Perfect 4.00)	Percent of Satisfied Clients*** (3.00 or better)
Trust of Professional	Very Good	3.52	56%	96%
% of participants (financial professionals) with equal or better ratings	18%	16%	15%	23%
Financial Performance	Very Good	3.45	49%	96%
% of participants (financial professionals) with equal or better ratings	74%	36%	33%	46%
Satisfaction with Services	Very Good	3.63	65%	99%
% of participants (financial professionals) with equal or better ratings	58%	25%	26%	39%
Quality of Advice	Excellent	3.76	76%	100%
% of participants (financial professionals) with equal or better ratings	33%	28%	29%	51%

*"Score" is based on a 4-point scale, with 4.00 being the highest achievable score.
**"Percent of Clients Giving Top Score" shows the percentage of the professional's clients gave the professional the highest score (4.00 out of 4.00) in a category.
***"Percent of Satisfied Clients" shows the percentage of the professional's clients that indicated that they were either "Very Satisfied" or "Satisfied" with the professional's service in a category (gave the professional a score of 3.00 or higher).

DALBAR Certifications are issued to financial professionals who meet the criteria of having five years of experience, no disciplinary sanctions by certain regulators for five years, and are active practitioners. Financial professionals pay DALBAR a fee to obtain a rating of performance from clients. DALBAR, Inc. issued the ratings in 2007 after conducting surveys for 2,545 professionals. DALBAR ratings are not representative of any one client's experience and are not indicative of future performance.

The Appleton Group Composite performance data current to the most recent month end may be obtained by calling 866.993.7727 or by simply visiting www.appletongrouponline.com.

Fat Tails and Possibilities concluded

Our Top Ten Reasons for....

Double Digit Market Gains in 2007:	Market Losses in 2007:
1. The significant investments made in commercial property and housing over the past year continues and pays off handsomely;	1. The significant investment made in commercial property and housing leads to a saturated market;
2. New buildings create the need for continued maintenance, new furniture, and new equipment, bolstering the manufacturing and service sectors;	2. New buildings that have been created are left unsold, forcing developers to drop prices significantly;
3. Continued low interest rates make further corporate expansions possible;	3. Interest rates rise in response to accelerating inflation, making continued expansions too expensive;
4. Budget surpluses are created by the expanding economy, pushing our national debt back to levels seen in the mid 90s;	4. Budget surpluses are created by sharply curtailed government spending, resulting in continued weakness in the manufacturing sector;
5. Consumers continue their rapid pace of spending and borrowing to fund both wants and needs;	5. Consumer debt and mortgage foreclosures take a toll on consumer spending, leaving retailers with excess inventory;
6. Demographics remain favorable as a continued flood of immigrants continue to fill service jobs, buy houses, and contribute taxes;	6. The historic influx of immigrants is curtailed by fences, leaving important service jobs unfilled;
7. Corporate profits continue to grow at the double-digit rates of the past four years;	7. The unsustainable pace of corporate earnings growth returns to historic levels, leaving the stock market sharply overvalued;
8. Emerging economies around the globe continue their breakneck pace towards industrialization and development, which in turn creates new markets for American goods and services;	8. As the U.S. economy slows, emerging markets around the globe decline sharply as American investment is curtailed;
9. The price of oil declines over the next year as Iraq stabilizes and brings production back to pre-war levels; and	9. The price of oil continues to climb as Iran figures out that the more trouble they make the more it benefits them; and
10. Markets always go up;	10. Markets always go up, except when they don't.
Advantage: Stocks	**Advantage: Bonds, Money Market, Bear Market Funds**

Happy Birthday to The Appleton Group!

Happy birthday to The Appleton Group! Five years old, and you're growing up so fast. Can you believe it? It seems like just yesterday we got the slip of paper in the mail from the Wisconsin Department of Commerce that announced your arrival. I remember it as if it were yesterday.

We were so excited. We've never been entrepreneurs before. What if we dropped you, or forgot you somewhere? After all, it's a lot of responsibility starting a wealth management firm.

I'm so proud of you. You've got a lot of friends, a lot of people that cheer for you. I remember when you got your first custodial relationship. Mom and I were a bit nervous, but it was time. Oh, remember your first office? It was so cozy, you didn't even have an intercom (Can you say in-ter-com?), and your network was so tiny!

You're still so small, but you're just scratching the surface of your potential. I'm certain that you'll do great things for so many more people. After all, there is no "I" in The Appleton Group, LLC, is there?

Anyway, Happy Birthday! Now, back to work…

-MCS