APPLETON GROUP
WEALTH MANAGEMENT, LLC

The Compass™

October 2011

Appleton Group Wealth Management LLC is an independent Registered Investment Advisor (RIA) located in Downtown Appleton, Wisconsin. Our firm provides wealth management and investment advisory services, using time-tested asset management strategies that prepare for 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.

Appleton Group Wealth Management, LLC currently manages approximately $133.2 million, serving individuals, families, corporations, endowments, foundations, trusts, company sponsored retirement plans and third-party investment advisors.

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

Inside this issue:

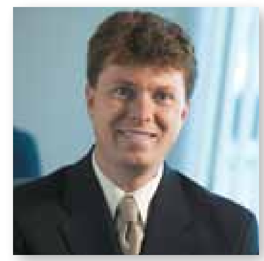
Short and Sweet

From the desk of Mark C. Scheffler

When I was a kid, I remember enjoying the short stories and brief humorous snippets that appeared in my parents' copy of the *Reader's Digest*. You probably enjoyed them too.

It was kind of a neat magazine, especially for someone who wasn't all that interested in sitting down and reading an entire novel at a time. While I devour books today, I still consider myself more of a "doer" than a reader. Like so many boys, my mind just has a tendency to think about things and will often be led astray unless I really concentrate. The *Reader's Digest* was perfect for me because I could easily absorb the short snippets of information and humor and musings that made this magazine so popular.

There's a nostalgia that I'm drawn to as well, because it evokes in me memories of a time that was much less complicated and less harrowing than today. The client letter that I penned during the first week of September was over three pages long, and I knew that most readers would struggle with the length. The content was as short as I could make it without leaving out important details. But I know that the advice "keep it simple" is sound. With that in mind, I've collected a few thoughts that may be helpful in understanding today's markets, the significant economic issues facing the world today, and our approach to navigating them as smoothly as possible…



Mark C. Scheffler
Senior Portfolio Manager,
Founder

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Our global economic system is wholly dependent on

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Do You See What I See?

As I visit with our clients every quarter, there's one common thread that runs through all of our conversations: the strong desire to make sense of the markets, investing, and the economy in general. Not an easy task, because today's global economy is more complicated, intertwined and dynamic than ever. But a trend-following discipline like ours can make even the most complicated issues seem really simple. For the last few years, we've been showing our investors the price trends that we analyze to determine when to be invested, and when it makes sense to take action (either to increase or decrease positions). The response I've received time and time again is "This makes so much sense! Show me more!"

As a former teacher, I recognize that there are three primary ways of learning: by seeing (visually), by hearing (aurally), and by doing (kinesthetically). And I also recognize that there's a great satisfaction in having something click, having it make sense. With that in mind, we're launching an innovative research and communication tool that I believe will knock your socks off. It's called clearTREND and is available only through Appleton Group Wealth Management. Here's how it works: any client will be able to easily set up their own portfolio that will track the different investments that we use in their portfolio (in most cases ETFs). Once set up, we will provide you the combination of simple moving averages we use to determine the best exit and entry points for each security.

You'll then be able to see in real time the adjustments that we're making to your portfolio, as well as the historic outcome of making that adjustment at the time prescribed. In other words, you'll see exactly what we see in our daily market research process. You'll get a simple email that details the adjustment we're making, the historic outcome of that adjustment, how likely that adjustment will have a positive outcome, the average historic gain and loss for the adjustment, and the best and worst historic outcome. From an education and communication standpoint,

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Retirement Plan Corner…

Moving to 'ModelxChange'…A Better Tool

Appleton Group Wealth Management's Retirement Plan Services is in the final stages of converting its managed, risk-based asset allocation models to the 'ModelxChange' platform. This new platform has been made available to us by our plan partner, Pension Inc., who provides recordkeeping and administration services to our plans and uses the Mid Atlantic Trust Co. as the custodian.

What does this mean to the plan Sponsors and Participants?

With the availability of the ModelxChange platform offered by the Mid Atlantic Trust Co., we are able to not only use Exchange Traded Funds (ETFs), but are able to realize lower annual operating expenses. This change also allows us to cap our trading costs – even during very active trading periods.

Additional benefits include the inherent performance improvement based on reduced costs and allows us to remove proprietary funds from the model, which is a fiduciary benefit.

Our friends at Pension Inc. have been working diligently behind the scenes to ensure that the conversion is a seamless one for plan participants. There is no notice required, as a participant in the 'moderate model' remains in the 'moderate model.' This is a 'back office' custodial and trading desk change that affords additional efficiencies to those processes.

Why use Exchange Traded Funds in a Retirement Plan?

Strategy - To understand the benefits of using ETFs in a plan such as a 401(k) plan, it helps to know the differences between ETFs and actively managed mutual funds. From a design standpoint, ETFs seek to track a market index, before fees and expenses – much like an indexed mutual fund.

Actively managed mutual funds seek to outperform market indexes - through better 'stock picking' for example. Active funds typically charge higher fees than index-linked products due to increased trading and research expenses. The ETFs provide access to many broad indexes in a cost efficient manner and with a high level of liquidity as well.

Ease of use and Transparency – ETFs trade on exchanges intraday at market price, which may be greater or less than its Net Asset Value (NAV). This offers additional benefits compared to mutual funds which must be accessed directly through the fund company and which are generally priced only once at close of day NAV.

ETFs are more transparent in that most provide daily holdings disclosures, although in accordance with MSCI licensing, holdings for MSCI-indexed funds are updated monthly. Generally, mutual funds provide quarterly holdings disclosure.

Unlocking ETF Potential

With their array of unique benefits, ETFs are an increasingly popular portfolio construction vehicle. But here at Appleton

Wendy Hoeft
Advisor to Private Clients
& Retirement Plans

Group Wealth Management, we have been using this tool for more than eleven years now. That's why a number of national conferences have invited our founder and senior portfolio manager, Mark Scheffler, to sit on a panel of experts, including Morningstar's invitation to their 1st Annual ETF Conference held in Chicago.

We were ahead of the curve in gaining insight and the knowledge to leverage this precision investment tool effectively. And we will continue to be a proactive steward of our Plans' resources by continuing to find efficient ways to decrease costs and improve fiduciary care.

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Short and Sweet… continued

unending growth, expansion, and consumption. The issue that is most difficult today is that when growth is slow or nonexistent – as it is today – the value of all assets tied to growth must come down.

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Economic growth is not the same thing as human advancement.

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The growth problems we face today are not symptoms of our failings, but of our successes. Our largest global banks created their own instability by successfully extending credit until there was no one left who needed it. No need for more credit, no need for global banks.

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During the great depression, deflation was a double-edged sword. It caused the value of stocks to plummet by more than 85% from peak to trough, but it also made the prices of goods much more reasonable (which allowed the vast majority of consumers to purchase goods at deep discounts). Today's Fed has stated in no uncertain terms that deflation is a grave threat that will be fought at every turn. So despite most consumers having less to spend, the Fed's goal is to make prices go up. This is a high-risk proposition that could potentially backfire.

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If there is an Achilles heel to trend-following (what we do at Appleton Group Wealth Management) is that without the presence of a clear sustainable trend, progress will be limited from time to time and short-term uncertainty will increase. August, 2011 was an excellent example of this as the week-to-week volatility was extreme: out of the twelve weeks in the quarter, ten saw the markets move by more than +/- 1.00%, with the average move being more than +/- 3.15%. Of those weeks, seven were negative (averaging a loss of -3.97%)[1], but amazingly three weeks were hugely positive (with the average weekly advance being higher: 4.10%). That's volatility without rationality, which isn't helpful at all.

To sustain the current American standard of living, we estimate that every household and pension plan and endowment fund in America must achieve a positive return on investment of between 7-9% per year. Over the past eleven years, the average return for the S&P 500 has been negative, and factoring in a typical allocation to bonds and the total return has been only around 3% per year. With interest rates now at 200-year lows (!), the likelihood of getting 7-9% by investing in bonds alone is highly unlikely. To have any chance of making it work requires accepting some short-term uncertainty along the way by investing in other assets, such as equities and real estate and commodities.

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The Federal Reserve is working feverishly to fix a problem that has really been inside the global economic system since the early 1980s: under the Reagan administration, the cold war solution to dealing with the Soviets wasn't solely a military strategy, it was an economic strategy. Reagan's advisors rightly believed that an escalation of military spending, if massive enough, would force the Soviets to do the same and would eventually bankrupt them. They were right. But the effort had two unintended consequences: 1) American businesses became addicted to the positive effects of government stimulus (mainly defense spending and infrastructure), and 2) Congress failed to rein in spending after the Soviet Union disintegrated. Both issues continue today.

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During the last week of September, retiring Fed Governor Thomas Hoenig stated that the Federal Reserve is not now nor is it ever out of ammunition to deal with economic weakness. Possibly, but the truth of economic warfare is much like that of conventional warfare: the most powerful weapons have no benefits to humanity whatsoever and are best left unused.

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Since the turn of the millennium, a $100,000 investment in the S&P 500 Index, with all dividends reinvested was, at the end of September 2011, worth $94,166[1]. Ten years, eight months, thirty days of no progress. John Bogle, the famed founder of Vanguard Investments stated last month that while the market was certainly rigged, "buy and hold" investing is still the best strategy. Is waiting eleven years to break even really the best strategy?

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International markets can play rough. For example, Japan is now in the 21st year of their bear market. The Nikkei 225 (their equivalent of our S&P 500 Index) topped out in late 1989 at around 39,000. At the end of September, 2011 it closed at 8,700, a decline of over 77% from its peak[1]. In an effort to boost their economy along the way, Japan devalued its currency to boost exports, it cut interest rates to near zero, and it engineered a housing bubble that eventually burst. Everything Japan has tried has been mimicked by the United States; if our government's response to our economic woes are identical to Japan's and the root causes are the same (which I believe they are), why should we rationally expect a different outcome here in the U.S.?

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At the end of September, the U.S. 10-year Treasury Bond was yielding a paltry 1.92%[1]. To put that low rate in context, to find rates that were ever lower you'd have to go all the way back to the early 1800s! And that's exactly the way the Fed wants it. Their grand plan is to force investors into other assets (such as equities and real estate) to spur growth. And with their accompanying strategy to create a high inflation environment as a way of spurring demand, the risk tradeoff is massive. In a normal world, higher interest rates would follow inflation (just like it did in the 1970s). But Bernanke is attempting a maneuver that has never worked in the history of free market economics: high inflation with low interest rates. He's had three years to make it work, but it may be impossible. If it fails, it risks spinning the global economy into a deflationary tailspin in which cash and other defensive instruments would be

[1] *Source: Yahoo Finance*

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Short and Sweet… concluded

most advantageous.

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I continue to believe that the best values in today's investment environment are the bear market securities that we use in our PLUS strategy and in our Tax Managed Growth strategy. Because of the massive interventions that have been in place for the past three years, these assets are trading significantly off of where they should be given the current state of the market. How much? Would you believe as much as 80%? That's the case for real estate and for commodities, with deep discounts for the Dow and the NASDAQ and for emerging markets as well. The only issue is that they're quite unpredictable, especially when the Fed promises additional stimulus. If a sustained downtrend does emerge, the upside for these securities could be large.

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Perfection is elusive.

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When this current downtrend does run its course (and that could be anywhere from a couple of weeks to a couple of months or more from now), the discounted values could be great. Coming out of the last bear market we've played it cautiously, and for good reason. But as a result we left far too much potential gain on the table. It is my intention to never miss another buying opportunity when the prevailing trend once again turns.

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I hope that I've convinced all of our clients that I continue to be skeptical about the current state of the markets, and that we've built our firm on the belief that the end of the twenty-year high growth environment (1980-2000) could end badly. It has. But so many institutions that we've come to know and love and count on could simply vanish if the current economic contraction continues. State-run pension funds would become significantly underfunded, community foundations would see existing asset pools considerably smaller, college endowment funds would shrink mightily. The worst part of it is that each of these institutions (and so many more) have had years to prepare and have literally wasted that time. The overwhelming majority continue to invest their endowment funds exactly as they did in 2000 and in 2007 with no regard to the possibility that markets could contract severely once again. This is something that we could certainly look back on in the coming years and simply ask "Why?"

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Nothing lasts forever. In music, every masterpiece comes to an end. So does every piece of music that you just don't care for. The same is true in the markets. Every market advance eventually runs its course, every market decline eventually comes to an end. The only unknown is how long the intermission will be between the end of one market move and the beginning of the next.

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My book, *On the Right Side of the Market* (2009) is more relevant today than ever. All of the major market and economic issues and the benefits of trend-following strategies are exactly the same today. But I understand that our lives are busy and that time is precious. For those who just don't have the time, we've put most of the chapters in an on-demand summary format on our website. Simply visit www.appletongrouponline.com, click Research and then click on the image of the book. Hard copies are available at no cost to current clients.

-MCS

Do You See What I See?…concluded

clearTREND will run circles around our competitors, and give you access that no other advisor has ever offered!

One important feature that our portfolio management team is particularly excited about is the ability to further optimize each security we use to give all of our investors an added edge. Through a partnership with Microsoft and Skyline Technologies, we've been able to leverage technology and computing power like never before. clearTREND utilized cloud-based computing services from Microsoft to consider over 8,000 combinations of simple moving averages per second in an effort to determine which is likely to give us the best future result. With 2.8 billion possible combinations, the computing power necessary was out of reach – until now. Additionally, clearTREND uses a cutting edge user interface that will enable you to identify trend changes as they unfold, just like we can. The view is spectacular, the ease of use is unprecedented, and the time is now.

There are a host of additional features that we're eager to introduce you to, but suffice it to say we're really excited. We'll start the rollout in late October (clients first, as always). If your interest is piqued, let us know right away that you'd like to be in the first rollout phase and we'll be sure to include you.

-MCS