The Compass™

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

April 2008

Appleton Group Wealth Management LLC is an independent, Registered Investment Advisor (RIA) located in Downtown Appleton Wisconsin. We solely provide wealth management services for investors, 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 currently manages $111.46 million, serving advisors, private individuals, families, corporations, institutions, endowments, foundations, trusts and company sponsored retirement plans.

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

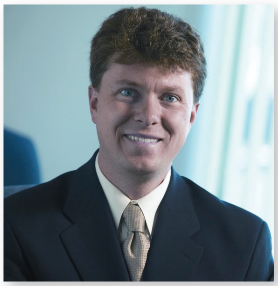
Beautiful Balance

From the desk of Mark C. Scheffler

I was hooked the moment I saw it. While spending a longer than planned weekend up in Door County back in February, my wife Karen, my son Will and I looked out of our car window at the beautiful harbor in Ephraim, and there it was. A power kite fully inflated by a steady south wind pulling some brave soul strapped to a pair of downhill skis across the frozen landscape. We just had to stop and see this amazing sight for ourselves. Here was this guy, all alone on the ice, strapped to a kite easily the length of our car tacking along as if he were on some sort of a tow rope. But the rope was really just a pair of strings, the machine was merely a piece of fabric, and his chosen path was nothing more than the still section of a bay on Lake Michigan. I couldn't believe my eyes.

Over the next six weeks I visited every website I could find, downloaded dozens of You-Tube video clips, raved to friends (well, even to the gal at the dry-cleaners) about this amazing sport as if begging someone to say "Hey that sounds like fun, let's give it a try!" Most people agreed that it sounded like a lot of fun, and my closest friends even came out to try their hand at a small trainer kite that I bought. But the real fun happened on Good Friday when I took a lesson out on Lake Winnebago with a local pro.

Kevin (the pro) told me to meet him and his buddies on the west shore of the lake between Fond du Lac and Oshkosh and we'd give it a go. He'd even bring along a big kite to try if I got the hang of the trainer quickly enough. After two hours or so of refining



Mark C. Scheffler
Senior Portfolio Manager,
Founder

continued on page 3...

Appleton Group Wealth Management's Assets Soar During Recent Quarter

Principals of Appleton Group Wealth Management LLC announced that the firm's assets under management have exceeded $111 million, an increase of over 27% since the start of 2008. "While many firms are struggling during this difficult market environment, our firm continues to shine," said Mark Scheffler, Senior Portfolio Manager and Founder. "Investors are increasingly interested in our proactive approach to wealth management, which has resulted in the sharp increase in the assets that we are asked to manage."

"The Appleton Group Wealth Management Discipline™ prepares for both good and bad markets, and we believe it is one of the best ways to manage an investment portfolio," said Scheffler. "Fact is, our wealth management offerings continue to be among the most efficient in the marketplace, working to produce positive returns over time with as little risk as necessary along the way."

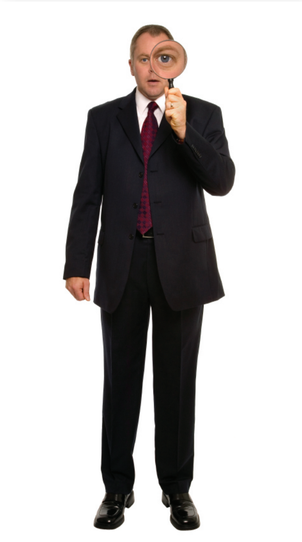
Please visit www.appletongrouponline.com to learn more about Appleton Group Wealth Management.

Inside this issue:

Beautiful Balance	1
Appleton Group Wealth Management's Assets Soar During Recent Quater	1
Retirement Plan Corner	2
Balance in The Appleton Group Wealth Management Discipline™	3

Retirement Plan Corner

Fiduciary Responsibility for Plan Sponsors - Looking Beyond the Style Box



In "Beautiful Balance" on page 1, Mr. Scheffler states, "For investors on 'the right side of the market,' the rewards can be substantial. But for those on 'the wrong side of the market,' investors can be left holding an asset that is quickly and severely deflated, which can require many years to repair."

What do we mean by "the right" or "wrong side of the market"? In the worldwide bestseller, **Against The Gods, The Remarkable Story of Risk**, Peter L. Bernstein helps us to understand the uncertainties that every investor must face. In the last chapter he states, "The classical models of rationality—the model on which game theory and most of Markowitz's concepts are based—specifies how people *should* make decisions in the face of risk and what the world would be like if people did in fact behave as specified. Extensive research and experimentation, however, reveal that departures from that model occur more frequently than most of us admit."

You may recall that Markowitz won the Nobel Peace Prize for developing the concept of Modern Portfolio Theory. You know, the Efficient Frontier, non-correlating assets and all that stuff to which we owe the all powerful style box.

But sometimes we just can't see the forest for the trees. Why do we embrace the all powerful style box as gospel? Because it showed us a way to reduce our market risk through improved diversification, right? Remember the matrix of asset classes showing the negative correlation? The moral of the story was that we shouldn't put all our eggs into one basket or chase the hot dot or try to time the market. And it was a good lesson.

Just a couple of flaws with the premise: First of all, it's only supposed to work if we stand firm…stay the course. And we know that participants do not – will not. Based on the review of the S&P 500's performance (see Zero Day on page 4) we know that an unfavorable market, or being on the "wrong side" of the market, can dig a pretty deep trough. Even those investors who stay the course might wait a long time to be rewarded for their patience. And those who don't – the majority who sell low and buy high at the "I can't take it anymore points" – perform dismally.

Secondly, most of the asset classes are correlating these days. Aside from maybe gold, oil and hedge funds – everything is moving in the same direction. How does that provide diversification? How does that reduce risk?

The point is that Markowitz's concepts, "model… how people *should* (his emphasis but I'll add an "Amen" to that!) make decisions in the face of risk…" But do participants make decisions the way they "should" based on rational models? Or do they almost invariably make knee-jerk, emotional reaction decisions based on fear and greed? Bernstein continues to describe, "…what the world would be like *if* (my emphasis) people did in fact behave as specified." That's a pretty big IF. Huge!

In the past you have often heard us talk about the performance gap demonstarted by the DALBAR study[1] which tracks investors' behavior in chasing market returns over a rolling twenty year period. The average investor only earned 4.3 percent while the S&P 500 yielded 11.8 percent per year. The fact is, the data clearly demonstrates that most participants hit the "I can't take it anymore point" and do exactly the wrong thing at exactly the wrong time.

> *"The study determined that 84.2 percent of do-it-yourselfers would have fared better in a single professionally managed portfolio than by selecting their own investments."*
>
> *-Burgess Study[2]*

Wendy Hoeft
Director - Retirement Plan Relations

Similarly, the Burgess study[2] tracking the performance of 14,487 plan participants from 1997-2006 compared the results of those participants who built their own portfolios to those who selected a professionally managed approach. The study determined that 84.2 percent of do-it-yourselfers would have fared better in a single professionally managed portfolio than by selecting their own investments. So, we're not surprised to learn that participants don't behave the way they should. Like I said…a pretty big IF!

continued on page 4...

[1] Source: DALBAR, 2007, Quantitative Analysis of Investor Behavior.

[2] The Burgess study was a commissioned study by John Hancock. The study examined the performance of 14,487 retirement plan participants from 1997-2006 contributing to their employer's defined contribution plans through an ARA group annuity contract issued by John Hancock USA. The Lifestyle group (i.e. professionally managed approach) represents those participants that invested only in a single Lifestyle Portfolio throughout the period. The Non-Lifestyle group (i.e. do-it-yourselfers) represents those participants who chose their own portfolio mix throughout the period. Burgess + Associates and John Hancock USA are not affiliated.

Beautiful Balance... continued from page 1

my work with the training kite (and even managing to get pulled along on my skis a bit), Kevin said I was ready for the big kite.

"Really? Are you sure?" I asked. He told me that I was the first "newbie" of his to have not flown face first into the ice, which made me beam more than just a little bit. He pulled the kite out of the back of his van, looped the handle of the kite to the trailer hitch (can you feel the excitement?) and started to pump it up. Pump it up? You mean this thing would get even bigger? When he was done it looked like a giant kind of dinosaur / bat / octopus that was just itching to take flight. And so was I.

I strapped on a harness, helmet and skis, and away I went, pulled across the frozen lake powered by nothing more than the wind. The trick to staying in control is balancing the potential power of the kite and the wind with my own desire to safely have fun. And fun it was! Upwind, downwind, crosswind – it was a blast no matter which way I went. I can't wait to try it again, especially this summer when Lake Winnebago warms up.

I've seen a whole bunch of "kiters" who make it look easy, flying through the air as they spin around, grab the bottom of their board, and land back on the top of the water as if they'd been doing it all their lives. They need incredible balance just to get up on the water, balance to skim the surface, balance to change direction at a moment's notice, balance to avoid obstacles, not to mention the balance in their personal lives to find the time to go. Balance is a beautiful thing!

Balance in Life

I'm figuring out a lot about life as I go along. As I quickly approach what should be the halfway point of my life, I think I've got one thing pretty well pegged: balance is important. I'm not talking about the normal everyday balancing act that keeps me from falling over (although that's pretty useful too, especially in kiteboarding). I'm talking about the vast amount of choices we make every day that either gets us out of balance (on purpose or by accident) or brings us closer to being in balance. We often balance elements of our lives that are fairly straightforward, yet require us to be aware: work vs. play, spend vs. save, lead vs. follow, etc. But other balances have been so ingrained in us that we really don't even think about them: behave vs. rebel, share vs. hoard, cure vs. injure. For many of us, the challenge of balancing our lives is a constant struggle, and we can easily feel when things are out of balance: we feel stress.

> *"Balance in investements is no new idea, but the need to equally weight certain aspects of our investment activities today is becoming more and more important."*

The first tendency is to identify what is out of balance in the hope that we can cure it. I think that's why vacations are so useful and necessary. It's probably also why our relationships with others can wax and wane, falling in and out of balance as we work to keep our lives so finely tuned.

Balance in investments is no new idea, but the need to equally weight certain aspects of our investment activities today is becoming more and more important. The reality of today's investment climate is that we live in a world of long-term price imbalances. Just over the past ten years or so (a mere instant in the history of economics) we've witnessed a phenomenal number of asset bubbles occur. Bubbles are nothing more than an imbalance in a particular asset created by too much capital (money) chasing too few resources (such as shares of stock, barrels of oil or bushels of wheat). In other words, bubbles are created when a whole lot of money flows into one particular asset, pushing

continued on page 4...

Balance in The Appleton Group Wealth Management Discipline™

The Appleton Group Wealth Management Discipline™ is special for many reasons, but many of its key benefits result from its focus on balance. Here's how…

Balancing **WHAT** we invest in: Our discipline utilizes many different market segments, including equities (stocks), fixed income (bonds), cash, and real estate. All common types of investments - nothing exotic.

Balancing **WHEN** we are invested: Not only do we have the ability to own any of the vehicles mentioned above, but we also have the flexibility to reduce and even eliminate our investment in each as market conditions become less cooperative. That's such a big advantage, especially in the kind of market we're in right now!

Balancing **WHERE** we invest: Many of our investment vehicles have exposure not only to the U.S. economy, but to the global economy as well. While our investments tend to focus on U.S.-based companies, many have operations overseas that generate profits in both developed and developing countries.

Balancing **HOW** we invest: Many of our portfolios position two distinctly different wealth management strategies inside of the same portfolio. One discipline (strategic) typically profits during both rising and flat markets, while the other (tactical) can profit during both rising and falling markets. Most portfolios only use one of these, but we believe that combining these together is so much more effective!

Balancing **NEW with OLD**: Our investment selection process balances companies that are growing (growth stocks) with companies that are already well established (value stocks).

Balancing **UP with DOWN**: Fact is, markets go up and markets go down. That's why we will often pair positions that can profit from market advances (bull market investments) along with positions that can profit from market declines (bear market investments).

Balancing **OFFENSE with DEFENSE**: The key to being efficient, we believe, is in doing both, but not at the same time. To us, playing offense and defense simultaneously is a lot like driving your car with one foot on the brake and one on the accelerator.

Balancing **MULTIPLE** points of view: In The Appleton Group Assertive, Moderate, and Conservative Composites, we bring multiple money managers together in the same portfolio. This balances the portfolio among many different managers, research departments, and philosophies.

-MCS

Retirement Plan Corner... concluded

Yes, balance is important because we live in the real world where:

- participant behavior is not governed by theory but by emotional behavior,

-most retirees will not have pensions or even perhaps Social Security to fall back on,

-most participants are not contributing enough to reach their retirement goals…

It has been said that there is a special fiduciary science behind achieving optimal results in a retirement plan. Are you simply measuring the performance of your plan's funds against their respective style box benchmarks? Although that is certainly important, are you measuring your *actual* plan performance? If not, you should be.

What if there was a way to consistently manage risk and reduce the deep troughs…keep the participants from hitting the "I can't take it anymore point"… provide a whole new level of diversification through the marriage of an active management style to complement and work in concert with our existing strategic asset allocation style? Would we embrace it? Or, like Pavlov's dogs, are we so conditioned to live within the style box that we simply cannot look beyond it?

At Appleton Group Wealth Management, we engineer our 401(k) and other company-sponsored retirement plans to be more diversified and more balanced by providing the tools to balance a portfolio by not only <u>what</u> you own, but by <u>when</u> you own particular assets as well. Providing this balance – this additional level of diversification by management style – serves to reduce fiduciary risk for plan sponsors, increase benefits to plan participants, and improve the likelihood of an adequate retirement income stream for future retirees. We must look beyond the style box.

-WH

Performance Gap

<u>S&P 500</u>

+11.8%

Average Stock Mutual <u>Fund Investor</u>

+4.3%

Source: Dalbar
Returns for the period: 1986-2006

Beautiful Balance... concluded

prices up far beyond what is reasonable. If everyone suddenly wants Packer tickets, the price can go up sharply beyond what is reasonable (the face value of the ticket). Witness the 90's stock bubble, the 2003 bubble in bonds that pushed yields to historic lows, the real estate bubble, the credit bubble, the oil / gas bubble, and the list goes on and on. Inevitably, the imbalance gives way to reason and "can the last one out the door please turn off the lights?"

I believe we've entered a long-term period in history when asset bubbles are the norm. This is a direct result of a dramatic increase in investment packaging and liquidity (you can buy or sell large positions in practically everything, including the economies of whole countries in mere moments). For better or worse, bubbles are routinely being created and burst as large amounts of capital flow into and then out of investable assets, often just as individual investors flock to see what all of the excitement is about. For investors on "the right side of the market," the rewards can be substantial. But for those on "the wrong side of the market," investors can be left holding an asset that is quickly and severely deflated, which can require many years to repair.

Zero Day.

Monday, March 10 was a significant investment day for one very important reason: it marked the point in time at which the S&P 500 Index, including all dividends paid along the way, was worth exactly the same as it was on January 1, 2000. Eight years of holding what many consider to be a rock solid investment that rewarded the owner with "zippo" over an eight year period of time. Reality is what it is, but in almost anybody's book a "buy and hold" investment strategy isn't what it used to be.

Here's where balance becomes so important in my book: I believe that the investment approaches that stand the test of time and that really work through both good and bad markets are those that are not only ultra-efficient (as I've written a lot about) but those that are "ultrabalanced" as well. Balanced portfolios will often use both equities and fixed income sets (stocks and bonds) in the same account, and stop there. <u>Ultra</u>balanced portfolios use equities, fixed income, cash, real estate, bear market investments, perhaps even commodities – all ways of balancing a portfolio by <u>what</u> you own. But today's asset bubbles also require that you balance the portfolio by <u>when</u> you own any particular asset. That's balance, that's diversification, and without this extra step a portfolio could simply ride an asset all the way up and all the way right back down again without making any real progress.

On page 2 of *The Compass*, you'll find out more about the ways in which we engineer our 401(k) and other company-sponsored retirement plans to be more diversified and more balanced. And on page 3 you'll see the many ways in which our firm's most popular wealth management offerings use balance to help make returns more predictable, more lasting, and more meaningful over time.

-MCS