

October 27, 2011

To Our Clients:

The Good News: The 3rd Quarter 2011 was an even better time to be a bondholder than 2nd quarter 2011.

We were pretty excited about last quarter's Barclays' Aggregate Bond Index return of 2.29%. We are downright giddy about the index's return of 3.82% during the 3rd quarter. Of course, it is not enough to offset the dismal equity returns, but we choose to focus on the positive first in these letters.

In light of recent bond value increases resulting from extremely low interest rates (discussed in greater detail in the later section titled "**Why do Bond Values go up when Interest Rates go down?**") our investment committee made the decision to reduce duration risk in all client portfolios. This is an unprecedented move for our firm. Usually, we let bonds ride out whatever interest rate movement there is, but considering the fact that rates will have to go up (I know we've been saying this for a little while now), we think it is best to protect our clients' bond portfolios by reducing their interest rate sensitivity. Nearly all of our clients saw trimming sales of some bond mutual funds and purchases of Vanguard's Short-Term Bond ETF (BSV). This fund is an aggregate holding (meaning it holds a diversified group of bonds) that has a shorter duration than we usually hold.

What is duration? Duration is a bond measurement of risk. Morningstar's Investment Glossary defines Duration as follows:

Average effective duration provides a measure of a fund's interest-rate sensitivity. The longer a fund's duration, the more sensitive the fund is to shifts in interest rates. The relationship among funds with different durations is straightforward: A fund with duration of 10 years is expected to be twice as volatile as a fund with a five-year duration.

We reduced all bond mutual fund holdings with a duration higher than 4.0 for individual investors and replaced those holdings with Vanguard's Short-Term Bond Index (BSV), which has a duration of 2.6 (data provided by Vanguard's website 10/17/11). This move will lower your dividend income for the bond portion of your portfolio, but we think it will reduce your risk when interest rates move up and better maintain the value of your bond investments during a tough spell in the bond market. BSV is an inexpensive index fund, which only charges 0.22%, or 22 basis points, per year. You pay a trade fee of between \$8.95 and \$19.95 to buy or sell this fund. (If your accounts are at Charles Schwab, we kindly remind you to sign up for electronic service if you have not already done so to lower your trade fee for this fund to \$8.95. Contact us if you need assistance.)

In general, we do not purchase bond mutual funds or ETFs with durations higher than 5 or 6. This is not as high as we could go, but a 1% rise in interest rates could result in unrealized losses of 6% in some cases. Since bonds have been doing so well, we felt it was time to take some profits in that area and reduce your interest rate sensitivity for the future bond market environment.

It is worth mentioning that Vanguard's Short-Term Bond ETF (BSV) will lag the Baird Aggregate Index when rates are declining.

What happened in the Markets in the Third Quarter of 2011?

Equities around the world were hit hard this quarter by continuing concerns over Europe's economic problems. The S&P 500 was the one to beat this quarter with a negative return of 13.87%. Some of our active funds did beat that dreary target: Appleseed Fund (APPLX) was only down 8.88%, Columbia Dividend Fund (GSFTX – a recent purchase for many clients over the past couple of quarters) was only down 10.46%, and Wisdom Tree Large Cap ETF (DLN) was down 9.81%.

We also manage a dividend stock portfolio for some of our institutional clients and some individual clients with larger portfolios. This portfolio consists of roughly 30 individual stocks that we choose ourselves. While every client's individual stock portfolio is slightly different from one another, these accounts have consistently beat the S&P 500, including the 3rd quarter of 2011. We invested additional money in this stock portfolio alongside Columbia's Dividend Fund over the last couple of quarters.

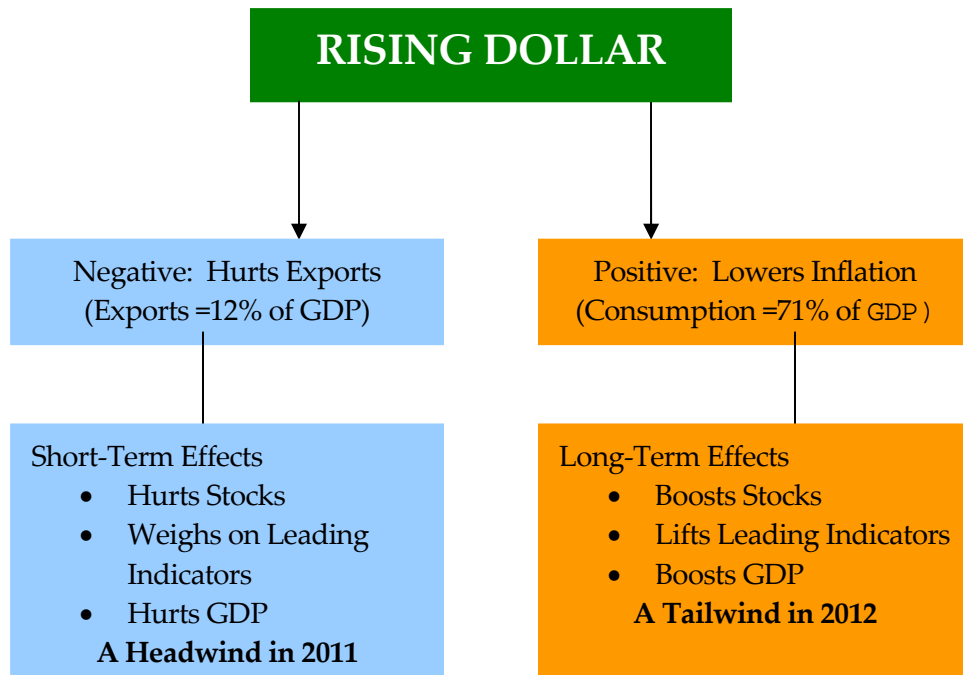
However, we can't blame it all on Europe. It seems like ages ago, but at the end of July, the United States Treasury was facing default and political stalling over the issue of whether or not to raise the debt ceiling on August 2nd (for further discussion and review of the debt ceiling, please review last quarter's letter). The Congress finally agreed to do it, but Standard and Poor's downgraded US debt to AA+ from its usual post at AAA. This doesn't make much difference in practical terms, but the emotional backlash on the market was very real. General concerns of political instability in this country are hurting the confidence of the US consumer and investor. As the presidential election and an end to the political mud-slinging are still several months away, it's doubtful that this will change in the near future. We are seeing stagnant growth in the economy with lackluster employment numbers, very little positive movement in housing, and some weakness in the previously improving manufacturing sector. On the other hand, corporations are showing good earnings numbers and consumer spending is up while inflation remains in check. There is some hope on the horizon.

European markets were generally worse off than US markets with the MSCI EAFE International Index down 18.95%. Only Artisan's International Value fund (ARTKX) and Wisdom Tree Intl Value ETF (DOL) did slightly better. Most of the other active managers were slightly worse than the index. European leaders are saying a lot of positive things to try to mitigate the damage, but no clear plan is yet in place. This will continue to depress international numbers. The EAFE index is now negative by more than 14% for the year through September 30th.

Even Real Estate via our REIT funds did poorly this quarter. The Wilshire REIT Index was down 14.64%. It was still slightly positive for the year through September.

Natural Resources took the worst beating with unrealized losses of more than 25%. Commodities, like natural gas, oil, energy, etc., have been pummeled while the US Dollar rallies. A stronger US Dollar is good for us long-term, but it makes a bit of mess in the short-term. If you look at the chart below, you can see a breakdown of what you can expect to see from the immediate onset of the rising US Dollar and the longer-term benefits of having a stronger US Dollar.

The first negative impact you can expect to see is on the stock market and our domestic imports. That has been very evident in commodities prices as previously mentioned. But long-term, a healthy US Dollar means lower inflation, which has a profound effect on consumer spending, which makes up 71% of GDP (Gross Domestic Product: the monetary value of all finished goods and services produced within a country's borders in a specific time period, www.investopedia.com).



Data Source: Wolfe Trahan and Company (Schwab Market Snapshot with Liz Ann Sonders, October 2011 (webcast))

The only uptick in the sector markets during the 3rd quarter was in utilities. Everyone uses their utilities, no matter the market environment.

Bonds were the place to be this quarter, specifically US Bonds as rates dipped to historical lows. Corporate bonds did not fair well, and we saw negative returns for usual strong performers like Pioneer Strategic Income (PSRAX). The clear winner this quarter was TIPS. The Barclays Treasury Inflation Protected Securities Index returned 4.51%, bringing its year-to-date return to 11.51%. If you have a larger portfolio with a significant bond allocation, you likely own TIPS, either in individual bonds or with an ETF or mutual fund like I-shares Barclays TIPS Bond (TIP) or Vanguard's Inflation Protected Securities Fund (VIPSX). Long-term, we think they offer the protection a conservative portion of a portfolio requires.

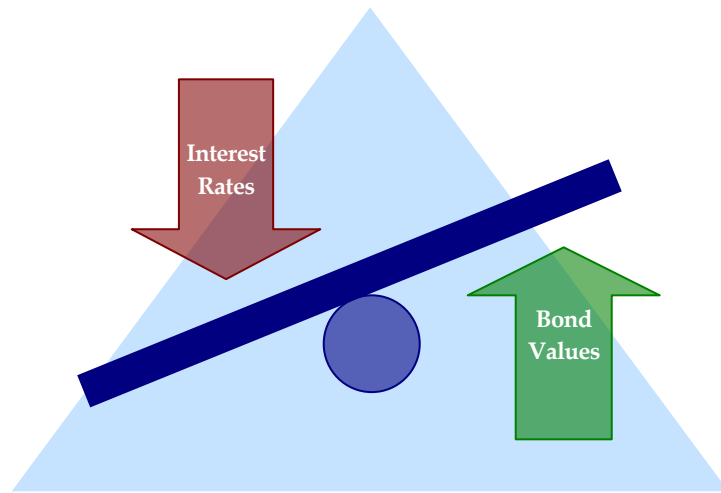
Why do Bond Values go up when Interest Rates go down?

You may have heard, hopefully from your helpful investment advisors, that interest rates have an effect on bond values. Specifically, bond rates and their values are inversely proportionate. This means that when interest rates rise, values go down and vice versa. During the 3rd quarter of this year, the 10-year U.S. Treasury Yield (which is sort of the one to watch as it falls in the near-middle of the yield curve and is directly affected by the U.S. Federal Reserve) hit historic lows, falling to a mere 1.6714% on September 23rd (it recovered a bit and closed at 1.84, thankfully).

An interest rate of 1.67% is usually paired with a short-term bond – something with a 2-year maturity, not a 10-year maturity. This directly affects investors because they tend to purchase debt securities, i.e. bonds, in order to gain a return on their investment, the interest. Tying your money up in a bond for 10 years with a mere 1.67% annual interest payment is not very enticing.

So why would that make the value of a bond go up? It defies logic. True, but only if you look at it from a newly issued bond purchaser's perspective. There are lots of bonds out there available for purchase that existed before interest rates fell. Many of those bonds have fixed interest rates, which are likely significantly higher than a paltry 1.67% for a 10-year Treasury. Those older bonds with higher interest rates are now much more valuable because you can't get that interest rate on a brand new bond. So now investors are more willing to pay higher prices for a 10-year bond paying a 4% annual yield.

This is good for investors who hold a portion of their portfolio in bonds, either as a diversifier against equities or because they are older investors taking less risk. Nearly all of our clients hold bonds. The Barclays



Aggregate Bond Index, a grouping of bonds that fall in the intermediate maturity bucket (4-6 years) and include a variety of bonds from the various sectors - U.S. Treasury bonds, corporate bonds, mortgages and foreign bonds, had a positive return this quarter of 3.82%. That is an unusually high return for bonds in such a short period, but it can almost entirely be credited to the plunge in interest rates.

Example: Rising Rates

You purchase a US Treasury Bond in June of 2011 with an interest rate of 2.0% that matures in June of 2016 for \$1000 at par (Par

means that you buy the bond for 100 cents on the dollar, no premium and no discount). You will receive interest payments totaling \$20/year for the next 5 years, and you will receive your full \$1000 investment back in June of 2016.

However, you go crazy buying Christmas gifts in December of 2013 and need your money back. You try to sell your bond. In December of 2013, interest rates are now higher than they were in 2011. A newly issued 5-year bond is paying interest of 3% or \$30/year for the next 5 years. That's \$10 more per year than your bond is paying. Therefore, purchasers are not going to pay \$1000 for your bond at only 2% when they could buy a new bond paying 3%. You will have to sell your bond for less than \$1000. A purchaser is not going to pay more than \$950 for your bond in order to get the same return on his investment as he would if he just purchased the new bond at 3%.

Example: Declining Rates

You purchased a US Treasury Bond in June of 2008 with an interest rate of 3% that matures in June of 2013 for \$1000 at par. You are receiving annual interest payments of \$30/year.

In September of 2011, you lose your job and decide to go back to school. You need your money back to pay for tuition. A newly issued 5-year bond is now only paying 2%. Your bond is now more valuable, and you will be able to sell it for more than \$1000.

As you can see from the following index list, bonds in your portfolio helped considerably in protecting your principal from the downturn in the equity market.

Indices

The following is a list of indices and returns for the 3rd quarter 2011 and twelve months ending 09/30/2011. Indices are used as a target for us when managing your money and they demonstrate how diversified segments of portfolios can be uncorrelated and perform differently.

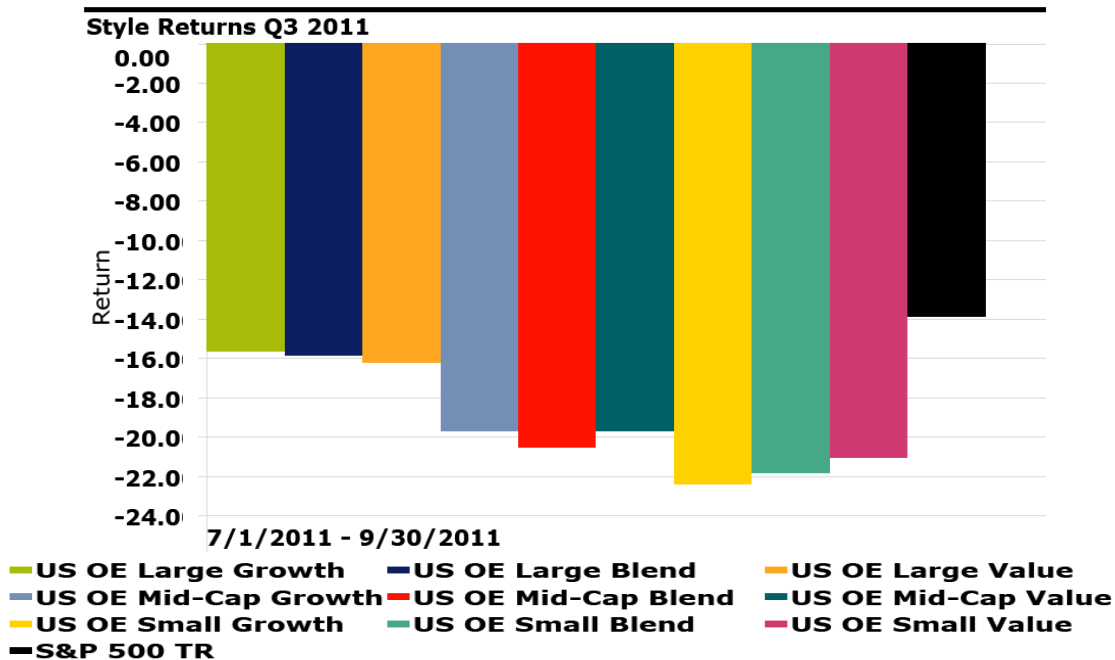
<u>Index</u>	<u>3rd Quarter Return</u>	<u>Last 12 Months Return</u>
<u>Fixed Income Indices:</u>		
Barclays Mortgage Index:	2.36	5.63
Barclays Treasury Inflation Protected Index:	4.51	11.51
Barclays U S Aggregate Bond Index:	3.82	5.62
Citigroup World Dollar Bond:	0.95	4.25
<u>Equity Indices:</u>		
S&P 500 Index with Dividends	-13.87	1.49
Wilshire REIT Index	-14.64	1.85
MSCI All Country World	-17.33	-7.02
MSCI EAFE International Index (Gross)	-18.95	-14.34

Indices are passive investment measures, which cannot be purchased without a fee. Your account(s) may include aspects of any one or all of these indices in their allocation, and the different performance of various indices demonstrates how diversification works. We use an active approach to investing, meaning most of the equity managers in your portfolios are actively involved in the allocation and purchase and sale of securities in their respective funds. Our overall goal is not just to beat the indices but also to generate positive total returns.

Returns in the Domestic Stock Market by Style and Sector

Equity managers usually have a certain "style" and we try to find very competent managers among Value, Growth and Core managers. As the chart below indicates, large cap companies held up better during this market's downturn than mid- and small-cap companies. Most of your assets were consistent with the market returns as illustrated.

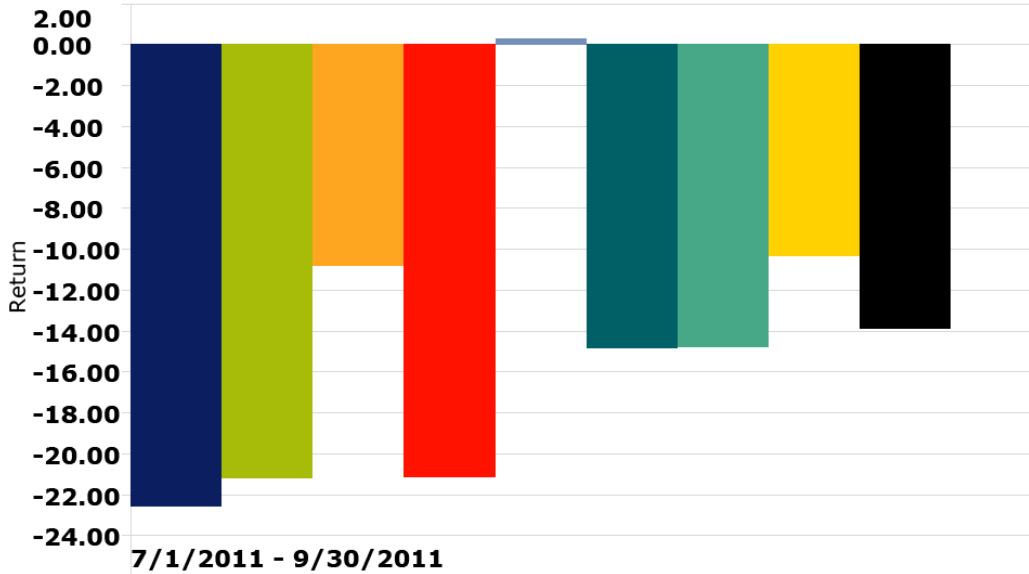
Chart Source: Morningstar



Commentators on the economy often divide the stocks of domestic companies into several sectors reflecting certain segments of the economy. During the Third Quarter, all sectors were down between 10 and 22%, with Financials, Energy and Industrials hit the hardest. The one shining spot here is Utilities, which eked out a positive return this quarter.

Chart Source: Morningstar

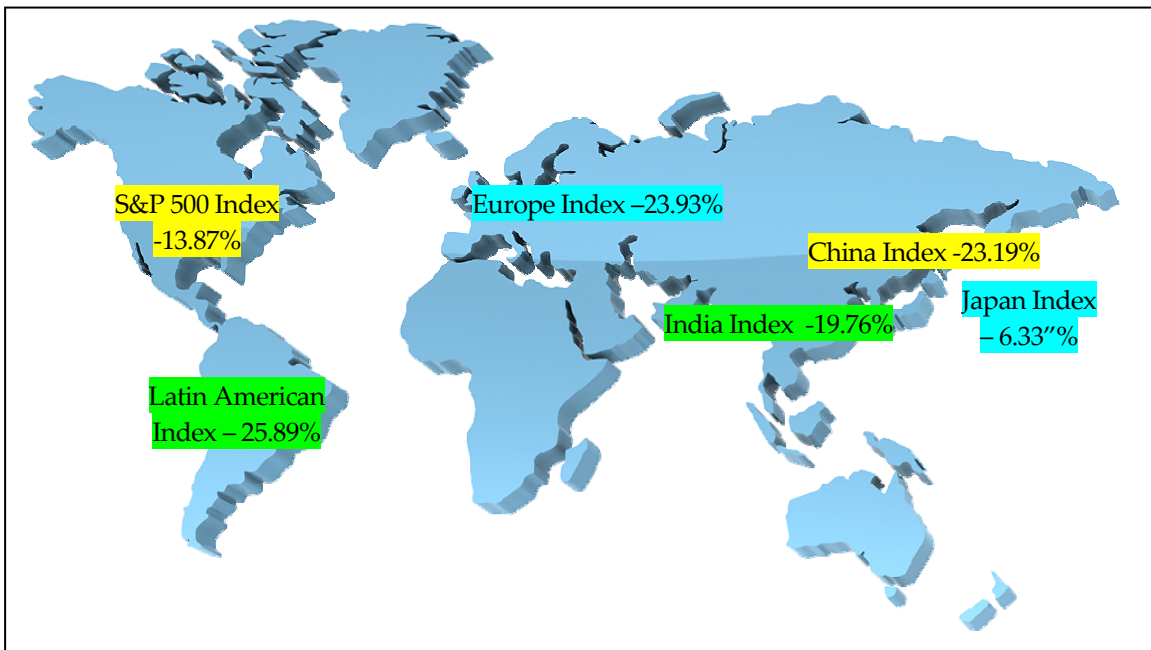
Sector Returns Q3 2011



- Morningstar SEC/Financial Svc TR USD
- Morningstar SEC/Energy TR USD
- Morningstar SEC/Healthcare TR USD
- Morningstar SEC/Industrials TR USD
- Morningstar SEC/Utilities TR USD
- Morningstar SEC/Communication Svc TR USD
- Morningstar SEC/Consumer Cyclical TR USD
- Morningstar SEC/Technology TR USD
- S&P 500 TR

International Investing

We thought we'd shake things up a bit and show you a world map of the international sectors for the quarter. All returns, except for the S&P 500, are reflective of a Morningstar-created index and are solely used for illustrative purposes. The chart reflects the significant effects that the current issues are having on Europe and in Latin America, where emerging markets are dominant. If there is any positive news, it is in Japan where they were barely scratched by the current quarter's economic concerns.



So far in the 4th Quarter: Equity Markets Rebounding

We think it is important to give you a positive ending to our letter. Thus far, through October 27th, the equity markets are experiencing a positive bounce up since September 30th. **The S&P 500 Index (Total Return) has come back 13.7%, and the MSCI EAFE International Index (gross, developed nations) has returned 13.16%.**

In bonds, as expected, interest rates have pushed back up slightly from historical lows which resulted in lower values for bonds. The 10-year Treasury was up at 2.42% on 10/27 from 1.92% on 9/30. Our firm's decision to shorten duration for our clients' accounts is paying off at present.

Aside from the bond duration shortening mentioned previously, you may have also noticed some trading in your equity assets. A positive of down markets is that they offer a good chance to rebalance accounts to prepare for recovery. We reviewed many individual accounts this quarter and took the opportunity to rebalance where we felt your account had fallen out of step with the allocation we prefer. If your international allocation was too low, we added to it at rock bottom prices. If you had too much growth tilt in your portfolio, we adjusted by reducing it or adding some value. In some cases, there was just too much cash built up in an account so we invested it. If you have any questions, just let us know.

Your Reports

Enclosed please find performance reports for your account(s) for the Third Quarter 2011 (July 1st through September 30th, 2011).

Please be aware that your performance is reported to you net of all fees, including our investment management fee, trading costs, etc. Please also be aware that market conditions will have an effect on your portfolio no matter its allocation. Past performance is absolutely no guarantee of future results.

We strive to create an allocation that is appropriate for the type of account you own and the time horizon for which we have to manage it, i.e., a taxable account for a retired individual will be managed very differently from a Roth IRA for a person in their 30's. Your Portfolio Statement will list all the assets in your account, their cost basis and their market value as of September 30, 2011. The assets are segregated by type in your statement, so you can see what type of investments you own.

Your Portfolio vs. Cumulative Net Investment is a report that emphasizes total return in dollars. There are no percentages on this report. When the blue bars are above the green bars, you are ahead in dollars. If the blue bars are disappearing behind the green bars, you have realized or unrealized losses. The columns below show the actual numbers. For each quarter, it shows what you added or withdrew and then adds or subtracts this amount from your initial amount invested to show a cumulative running number of what funds you have added to your account. This is then compared to the portfolio value after all income and gains and losses through that date, with the difference being your investment gain. At the bottom of the report you see your current results and whether your account has made money or lost money in dollars since it began with us.

The Transaction Ledger shows you any trades, income, and/or withdrawals that affected your portfolio for the period. The Performance vs. Benchmarks report shows you how your portfolio performed against the various indices listed at the beginning of this letter. Any performance data that is more than one year in duration is reported as annualized.

As always, we ask that individuals keep us up-to-date on cash needs, address changes, etc. We would also remind you to check your beneficiary designations on your retirement accounts to make sure they are accurate.

Our New Newsletter

We are taking another run at a quarterly client newsletter. It's been awhile since we tried to do this, but we like to send out an educational piece to you each quarter. It will include some similar and timely information regarding the market and specific types of investments, but it will also include some general educational information as well as more fun and personal items like MVT member interviews. If there is anything you'd

like to know more about, please send us an email and let us know. We always need some ideas for what you'd like to learn.

In closing, please feel free to call or write if you have any questions on your report or if we can be of any further service to you.

Sincerely,



A handwritten signature in cursive script that reads "Margie Mitchell Burke".

Margie Mitchell Burke
Portfolio Manager, Fixed Income
Mitchell, Vaught & Taylor, Inc.

Margie joined MVT, Inc. in 2007 after graduating *magna cum laude* from DePaul University with her bachelor's degree. Margie brings a fresh perspective to the firm where she is trading our fixed income accounts and also handles all of the day-to-day client account operations necessary to run an investment advisory firm. She works alongside the rest of the portfolio management team and with all of our client accounts in preparing client account documents, reports and communications.

Margie is a shareholder in the firm, a registered investment advisor representative and is currently studying to earn her Chartered Financial Analyst (CFA) designation.



A handwritten signature in cursive script that reads "Danielle Woods".

Danielle Taylor Woods, J.D.
Portfolio Manager
Mitchell, Vaught & Taylor, Inc.

Danielle began with the firm in 1998. She's played an active role in the firm's success over the years and has worn many hats, including a named shareholder, Director of Client Relations and Chief Compliance Officer, until October of 2008 when she took a break from the firm to focus on her family. During "the break," Danielle continued to provide investment advice to individual clients through the Knoxville, Tennessee-based firm, Patriot Investment Management, and handled client needs such as estate and tax planning as a self-employed attorney. As of May 2011, Danielle is back with the firm on a part-time basis and is primarily handling the portfolios and day-to-day needs of our individual clients as well as taking part in the firm's investment policy discussions, affecting all pension and individual accounts.

Danielle earned her Series 65 Investment Advisor Representative designation in September of 2001. In May of 2002, Danielle earned her J.D. from Northern Illinois University College of Law, where she took a number of courses that focused on issues pertinent to our client base including securities law, estate planning and taxation. Danielle has been a licensed attorney in Illinois since 2002 and in Tennessee since 2008.