

Greetings Clients & Friends,

While the volatility in global capital markets continued during August, the stage is being set for a significant move higher in global stock markets over the next six months. This is my general conclusion about the direction in which the current intense tug-of-war in the stock and bond markets will get resolved over the intermediate-term. But, before I go onto to provide a quick update on my current outlook for the investment landscape and how I am positioning client portfolios, let me first share some Smith Capital news.

We are in the process of updating and improving our website to better reflect the full extent of the Smith Capital process, methodology and various investment strategies. This redesign will also entail an improved Commentary section that should make it easier for clients to stay updated on my latest views and portfolio updates. We will be going live with the new site sometime during September.

Back to the investment landscape discussion . . . August ended on a sour note, with the net result being another drab month for stock markets, while another strong month for the bond markets. You may recall in my last Quick Update from August 11<sup>th</sup> that we were positioning client portfolios for such a scenario, but looking for an opportunity to buy back into select areas of the stock market once a pull-back occurred. As the first leg of the August pullback unfolded I began adding a little more equity exposure within various Smith Capital model portfolios. However, we elected to keep higher levels of cash reserves throughout the rest of August to see how the stock market's technical weakness got resolved. During this recent round of investor fear, which has pushed stocks lower and bond prices higher, the Smith Capital model portfolios continue to perform well versus their associated benchmarks.

With August ending with much weakness in the stock markets and with continued strength in the bond markets, be aware that your account statements for the month of August will reflect these trends to a certain extent. For accounts that are more tied to the stock market, we ended the month on a weak note. However, for client accounts that are more conservatively and / or balanced focused we have benefitted from the strong trends in the bond market. In general, our elevated cash levels and slight hedge positions have been very good portfolio stabilizers for most of the year.

Despite this weakness during August, my outlook for a much improved stock market and fading strength in the bond market has grown stronger. In fact, after the close of the markets on August 31<sup>st</sup> several key market indicators within the Smith Capital Allocation Engine model were giving strong short-term buy signals. Indeed, September has started off well, as global stocks have rallied strongly the first three days of the month last week. While volatility will likely persist into the fall, I believe we are near the beginning of a sustained rally in global stocks that should last through the end of 2010 and into the beginning of 2011. Ultimately, over the next six months I project the S&P 500 Index could advance back to the 1,200 level, which would produce a gain of nearly 10% from current market levels.

Along with this move in the stock market, I expect the bond market's strength to wane as capital flows back out of bonds and into stocks. While these capital flows should slow the momentum in the bond market, I don't expect a massive decline in bond prices to unfold until firm evidence of inflation

within the domestic economy clearly appears in the data. At that point, I do expect a significant decline in bond prices to unfold. Therefore, within client accounts where we have maintained more bond exposure I have been gradually selling certain bond positions and slightly adding to positions that act as a hedge against inflation and / or a bond market sell-off.

For much of this year I have been discussing prevailing levels of investor sentiment at various times when I expected short-term market inflection points. While there are multiple factors and indicators I evaluate and analyze that go into the Smith Capital Allocation Engine and our Tactical Allocation Decision Process, market psychology has played a greater role recently. Hence, I have been watching the trends and extreme levels in market psychology more closely this year for keys as to when we should overweight or underweight specific asset classes.

Investor sentiment is particularly influential in our modeling process currently because many of the other factors in our model are giving firmly bullish signals for the stock market. Key leading indicators, relative valuation of stocks versus other asset classes, and monetary policy conditions are all very positive and supportive of a strong stock market. However, investor sentiment has been vacillating a lot over the last year and a half, as the investing public has gyrated from extreme fear to slight exuberance back to extreme fear again.

While much of this psychology volatility is understandable given the times we are in, most of you know by now I am a very contrarian investor. I have discussed with many of our clients through the years, and written extensively about the necessity to have a contrarian view with regard to overall investor sentiment. In other words, when the broad investing public is overly negative and selling reaches a climax, we get bullish and begin buying cheap. In contrast, when the broad investing public is excited and buying with exuberance, we become concerned and begin selling. The key to successful investing is buying low and selling high, but the difficulty is actually doing so when it is un-popular. Indeed, true value investing requires fortitude, patience, and the confidence to take the road less traveled. Today, that road appears to be the one leading to the stock market, but with vigilance!

To conclude, we are still sitting on moderately higher levels of cash reserves across each of the Smith Capital model portfolios, awaiting some clarity on the market's technical direction. We have been gradually reducing bond exposure in income and moderate portfolios given our concern about overvaluation and excess investor optimism within the bond market. Concurrently, we are gradually putting cash to work in attractive values within stocks, depending on the model portfolio, based on very attractive relative valuations, excess investor negativity within the stock market, and an overall positive outlook for the economic landscape looking forward. Our propensity to buy the dips within the stock market will continue only as long as the Smith Capital Allocation Engine (our proprietary multivariate econometric model) is saying to stay more weighted toward stocks, which remains the case.

As always, we will remain diligent in striving to manage risk and keep client accounts prudently allocated. Thanks for the continued privilege of serving you and your families.

Sincerely,

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