A Sensible Choice for Smart Investors

The Unconventional Investor, LLC

Approach to Investment Management

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Executive Summary

Thoughtful investors face an overwhelming array of choices. In the US alone, there are over 6000 stocks, more than 8000 mutual funds, and innumerable investment advisors. It's hard for the average investor -- or even the above-average one -- to know which approach provides the best chance for financial security and long-term growth. This paper details the strategic asset allocation approach offered by Unconventional Investor, LLC. Our combination of careful portfolio construction and low costs offers peace of mind to individuals who want to know that their money is well-managed.

The current economic crisis provides a sober reminder of the hazards of assuming one's assets are safe. Just as with the dot-com boom, many well-educated and highly competent individuals invested in real estate, the financial sector, and many other parts of the economy that were growing and offering very attractive returns. When the market was going ever-upward, everybody was a winner (or so it seemed). But once the market started to turn sour, most investors did not know what to do: whether to cash out, and if so, where to put their money instead of the stock market or real estate. Very few survived without suffering significant losses.

The Unconventional Investor approach described in this white paper cannot help investors avoid the fluctuations of the market. It can, however, help protect them from wasteful overspending on expenses, inertia, and their own unhelpful buy/sell reactions. For rational, competent people who want to know that their money is well-invested, but who do not want to actively manage it themselves, Unconventional Investor offers a safe, sensible, simple yet sophisticated approach for maximizing returns and carefully managing risk. Blending market-tested principles and a highly-customized approach to suit each client's financial profile, the Unconventional Investor model takes much of the worry out of financial planning.

A Proven Track Record

David F. Swensen[1] is the Chief Investment Officer for the Yale University endowment and an institutional investing legend. His enormously successful approach is now called “The Yale Model” and has been widely copied. As a large university endowment, Yale enjoys tax-free status and a team of experts befitting their massive $16 billion portfolio. But understanding that individual investors lack these advantages, Swensen adapted his institutional approach to fit their reality. In his 2005 book, *Unconventional Success: A Fundamental Approach to Personal Investment,* he details the strategy at the heart of this investment management offering.

1 Although he is held in the highest possible esteem and is owed a significant intellectual debt, Mr. Swensen is not affiliated with Unconventional Investor, LLC.

At Yale, Swensen has demonstrated the power of strategic asset allocation, where an investor establishes a target asset allocation and strictly maintains the target over time by rebalancing. Because the different elements of a portfolio earn different returns, the actual allocation changes over time. Investors with the discipline and time to rebalance and restore the target allocation increase their chance of optimizing long-term portfolio performance.

Paul P. O'Leary, the principal of Unconventional Investor, LLC, has more than 20 years financial experience and a lifelong passion for investing.[2] He has extended the power of Swensen's model in two ways: by (1) providing sensible portfolios customized for each client and (2) minimizing money management fees. The former increases top-line returns, as explored in detail below, and the latter helps the bottom-line results. Together, the combination provides a superior return to the investor, worth about 1.5 percent annually over the most recent 10-year time frame.[3]

This sophisticated, yet simple investment approach ensures that investors receive their share of market returns. The strategy is elucidated in further detail in this paper, which is organized as follows:

1. A brief review of investment principles relevant to all investors
2. A more detailed articulation of the asset allocation strategy and its impressive results as compared to alternative investment approaches, and
3. A description of the Unconventional Investor model's advantages over other money management firms.

In sum, smart investors can reap better-than-average returns by relying on the Unconventional Investor approach: setting and maintaining an asset allocation target that's right for their needs, investing only in the strongest assets and minimizing taxes, fees and expenses. Together, these elements create a compelling and effective strategy to build wealth and achieve financial security.

2 Disappointed with the returns on his savings account, O'Leary used his paper route money to buy his first share of stock at age 9.
3 Period ending June 30, 2009. See more in Historical Performance section.

General Investment Principles

We begin with the fundamental principle that money should be put to work on its owner's behalf. Investors hope to receive back more money than they put in, not simply the same amount and certainly not a lesser amount. If the only goal is to retain what one has acquired, and not worry about erosion due to inflation, one could stash funds under the proverbial mattress or in a simple savings account. But if the goal is to have the money grow enough to beat inflation and meet future financial needs, one must enter the world of investments.

Consider the Whole

When reviewing investment options, the investor should consider all assets broadly: savings, investments, physical property (e.g. real estate, cars, boats, art, jewelry, collections), and sources of projected future income (e.g. anticipated salary and expected inheritances). Determining how to invest available funds should be done in the context of a complete financial picture, with the intention of strengthening the investor's overall financial stability and health.

Suitability

A portfolio should reflect the investor's individual risk tolerance and time horizon. It should consider the investor's age, projected expenses (retirement, college tuition, home remodeling) and possible changes in circumstance (job loss, decline in the value of home and/or savings). The basic building blocks of equity, bonds and cash can be combined in proportions that account for these factors, as well as the investor's ability to bear the risk of loss.

Diversification

Most people understand the need to hold different types of assets to minimize the risk from any single one. Failure to do so can be catastrophic, as with Enron employees whose 401(k) accounts were loaded with company stock. When the energy company failed suddenly in 2001, the dual loss of jobs and retirement savings left many employees financially bereft, despite a lifetime of hard work. Such double-exposure is an unnecessary risk that can easily be avoided with thoughtful planning.

More generally, the investor should diversify financial investments to reduce overall risk and balance long-term, short-term and liquidity needs. This is accomplished by selecting a broad range of equities, bonds and cash in appropriate proportions. Further, careful consideration of a portfolio's geographic exposure is also very important. The choice of international assets (e.g. does one use foreign stocks or foreign bonds?) is a vital element of a sensibly diversified portfolio.

Portfolio Elements

The three core elements of any portfolio are equity, bonds and cash or cash equivalents.

Equity

Data from the past few hundred years indicate that owners, not lenders, earn the greatest long-term rewards in a capitalist system.[4]

Equities reflect partial ownership of an enterprise or physical asset, and their intended function in a portfolio is to drive long-term growth. Long-term investors should have a significant proportion of their investments in equity.

Bonds

Bonds have a different role: they reduce portfolio volatility and generate modest but predictable income. The bond market offers many options: US Treasury, Fannie Mae, Freddie Mac, Ginnie Mae, corporate, mortgage-backed, high-yield (i.e. junk), municipal and the more exotic, less traditional ones invented in the past decade.

Cash

Cash and cash equivalents (usually money market accounts) provide liquidity, or easy access to one's funds. The return on such holdings is usually minimal, but they serve an important function in case of an emergency such as uncovered medical bills or unexpected job loss. Inflation aside, cash poses no risk of loss.

Compounding

Even small investments can grow large over time through appreciation and reinvestment of income. As the sum invested increases, subsequent earnings are produced on the larger base. In the same way, an investment grows faster and larger when even small increases in performance are measured over multiple years.

Consider three hypothetical investors, each making a one-time investment of $100,000 and choosing to reinvest earnings. The first investor earns 7.5 percent each year. The second investor holds the same general portfolio, but pays 1 percent less in expenses by using lower cost mutual funds, and thus earns 8.5 percent annually. The third investor similarly reduces costs by 1 percent, and also improves portfolio selections to generate an extra 1 percent each year, for a total return of 9.5 percent annually.

4 William N. Goetzmann & Roger G. Ibbotson, "History And The Equity Risk Premium," Yale ICF Working Paper No. 05-04 (April 2005), Yale School of Management.

In this scenario, the $100,000 initial investment grows considerably over 25 years. The first investor accumulates $610,000, the second accrues $769,000 (26 percent more!) and the third amasses $967,000, a full 59 percent more than the first investor! (See Table 1.)

Table 1: The Power of Compounding

Initial Investment $100,000

	VALUE AFTER:					
Annual Return	5 Years	10 Years	15 Years	20 Years	25 Years	30 Years
6.0%	$134,000	$179,000	$240,000	$321,000	$429,000	$574,000
6.5%	$137,000	$188,000	$257,000	$352,000	$483,000	$661,000
7.0%	$140,000	$197,000	$276,000	$387,000	$543,000	$761,000
7.5%	$144,000	$206,000	$296,000	$425,000	$610,000	$875,000
8.0%	$147,000	$216,000	$317,000	$466,000	$685,000	$1,006,000
8.5%	$150,000	$226,000	$340,000	$511,000	$769,000	$1,156,000
9.0%	$154,000	$237,000	$364,000	$560,000	$862,000	$1,327,000
9.5%	$157,000	$248,000	$390,000	$614,000	$967,000	$1,522,000
10.0%	$161,000	$259,000	$418,000	$673,000	$1,083,000	$1,745,000
10.5%	$165,000	$271,000	$447,000	$737,000	$1,214,000	$1,999,000
11.0%	$169,000	$284,000	$478,000	$806,000	$1,359,000	$2,289,000

Reflects compounding. All returns are reinvested. No taxes. No new investments. Results are rounded.

Applying this mathematical model to the real world, a series of seemingly small improvements can make an enormous long-term difference to an investor's financial well-being. Accordingly, it's essential to plan investments wisely and manage expenses closely.

Portfolio Design at Unconventional Investor

Strategic Asset Allocation

In the world of institutional investors, David Swensen is a rock star. During the more than 20 years he has managed the Yale endowment, the fund grew from $1.3 billion to its current $16 billion at June 30, 2009. His track record demonstrates the effectiveness of strategic asset allocation -- the practice of establishing a target asset allocation and strictly maintaining the target over time with periodic rebalancing. Even though the Yale fund lost 25 percent in the year ending June 30, 2009, its 10-year numbers still outperformed the competition by a mile. “Yale... produced an average annualized gain of 11.8 percent over the last 10 years. According to Wilshire, the average return during that period was 4.3 percent for endowments with more than $1 billion in assets.”[5]

Swensen's success rests on his adherence to the bedrock principles of diversification, equity orientation, tax sensitivity and careful attention to expenses. Two other factors in the strategy receive less attention, but are equally critical: (1) the use of non-correlated assets in the portfolio, e.g. ones that, to the greatest extent possible, are mutually exclusive and comprehensively exhaustive (MECE), and (2) rigorous analysis to ensure that all assets are of the highest quality.[6]

The same principles can be applied to individual investors, regardless of portfolio size, but the choice of assets and allocations will differ significantly.[7] Swensen translated his institutional investment philosophy and principles into an approach suitable for individual investors in his 2005 book, *Unconventional Success: A Fundamental Approach to Personal Investment.* In it, he recommends low-cost mutual funds from The Vanguard Group, an investor-owned financial institution. Swensen encourages individuals to choose a limited number of funds to represent the three major asset classes of equities, bonds and cash. The funds should have mutually exclusive holdings, which will ensure maximum diversification and match the investor's risk profile.

Risk and Return

Different asset classes offer a range of possible outcomes, including loss of some or all of an initial investment. The wider the range of outcomes, the higher the risk. Investors demand a higher return as compensation for bearing additional risk. This risk/reward ratio is not linear, meaning some risks are not as well-compensated as others. Most importantly, rather than evaluate an asset class is isolation, risk and return is evaluated by the asset's contribution to the risk and return of the portfolio as a whole. This seemingly subtle distinction has important implications in portfolio construction.

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5 Geraldine Fabrikant, "University Funds Report Steep Investment Losses," *New York Times*, 23 Sept. 2009.

6 David F. Swensen. *Pioneering Portfolio Management* (New York, New York,; The Free Press, 2000). Pages 53-99.

7 Because Yale is tax-exempt, expects to operate in perpetuity and has a staff of expert financial analysts able to research specific securities or sectors, it can invest in risky or illiquid assets such as timber and hedge funds. These choices are a poor fit for the average investor's risk profile and time horizon.

Equity: Index Funds

A core element of the Swensen strategy is to rely on index funds for the equity component of the portfolio. Index funds are recognized as a superb choice for individual investors by financial legends such as Warren Buffett, David Swensen, Benjamin Graham,[8] and John Bogle[9]. Buffett, perhaps the world's greatest investor, has declared:

> *A low-cost index fund is the most sensible equity investment for the great majority of investors...[10]By periodically investing in an index fund, the know-nothing investor can actually out-perform most investment professionals. Paradoxically, when 'dumb' money acknowledges its limitations, it ceases to be dumb... Those index funds that are very low cost...are investor-friendly by definition and are the best selection for most of those who wish to own equities.[11]*

Research supports this conclusion. Bogle compared the S&P 500 index to actively-managed large-cap mutual funds for the years 1968-2006.[12] The index outperformed 58 percent of the large-cap funds on average for each of those years, 8 percent better than the arithmetic mean. During the latter half of the period (1987 to 2006), the index outperformed an average of 63 percent of funds each year.[13]

Consistently better-than-average performance of the index fund pays off handsomely for investors, thanks to the power of compounding. A fund that is good or very good every year provides greater overall yields than one that has a great year followed by a terrible one.[14]

Citing another study, Swensen notes that most actively-managed mutual funds fail to achieve the investor's ultimate objective: growth.

> *The fifteen year after-tax results provide the most powerful case against actively managed mutual funds. A minuscule 4 percent of funds produce market-beating after-tax results with a scant 0.6 percent (annual) margin of gain. The 96 percent of funds that fail to meet or beat the Vanguard 500 Index Fund lose by a wealth-destroying 4.8 percent per annum.[15]*

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8 Benjamin Graham is Buffett's teacher and mentor. He wrote the first great books on investing, *Security Analysis*, (with David Dodd), first published by McGraw Hill in 1934, and *The Intelligent Investor,* first published by Harper & Brothers, New York, in 1949.

9 John Bogle is the founder of The Vanguard Group and the author of several books, including *The Little Book of Common Sense Investin*g (Hoboken, New Jersey: John Wiley & Sons, Inc., 2007).

10 John C. Bogle. *The Little Book of Common Sense Investin*g (Hoboken, New Jersey: John Wiley & Sons, Inc., 2007). Page 186

11 Ibid, p. 199

12 "Large-cap" refers to the largest publicly traded organizations, generally those stocks represented in the S&P 500.

13 Bogle, p. 30.

14 Ibid, p. 30.

15 David F. Swensen, *Unconventional Success: A Fundamental Approach to Personal Investment* (New York, New York; The Free Press, 2005, p. 217.

The ability of an index fund that passively tracks the market to consistently beat the majority of actively managed funds surprises many investors. They have been led to believe that celebrity money managers deliver premium results, thanks to their Wall Street inside knowledge and legions of financial analysts looking for the next hot stock.

Instead, all too often, investors are simply paying a premium - for the salaries, transaction costs and taxes associated with an actively-managed fund. An index fund that passively mimics the market can be managed by relatively few people and avoids the taxes and expenses associated with frequent trading. Lower expenses + lower taxes = an ongoing cost advantage that helps index funds outperform other types of mutual funds, year after year.

Unconventional Investor recommends three specific equity index funds to its clients: one for US stocks, another for foreign stocks and the third for real estate[16] ensuring that the client will participate in growth wherever it happens globally, and be cushioned from any localized market softening. Unlike many investment strategies, no attempt is made to favor specific sectors (e.g. financial services, energy), nor is there any attempt to pick the winners or losers within a sector. Instead, the investor relies on market returns. The individual client's needs are met through the allocation among the three types of equity, as well as by the chosen ratio of equity, bonds and cash. Additionally, the advisor will consider the impact of taxes when allocating the different funds between tax-deferred and taxable accounts.

US Stocks

The Vanguard Total Stock Market Index Fund contains the stocks of more than 3300 companies and represents the entire US market.[17] This index is capitalization weighted, so that as a company grows in size (e.g. Google), its proportion of the fund increases. Similarly, even as a firm fades (e.g. General Motors) or collapses (e.g. Enron), its impact on the fund is minimal. Within the portfolio, this fund ensures that the investor captures the benefits of US market growth.

Foreign Stocks

Almost 59 percent of the world's total market capitalization now exists outside the US.[18] Exposure to these markets is essential to achieve meaningful diversification, and to allow an investor to participate in worldwide economic growth. The Vanguard Total International Stock Index holds 52 percent European stocks, 27 percent in companies located in developed Asian countries, and the remaining 21 percent in enterprises based in emerging markets[19] (notably China, Brazil, Korea, Taiwan, South Africa and India[20]). In effect, this fund holds the S&P 500 equivalent in markets around the world.[21]

16 A real estate investment trust (REIT) index fund is used for significantly improved liquidity.
17 Semi Annual Report, June 30, 2009. Vanguard Total Stock Market Index Fund (VTSMX),p. 60.
18 Derived from holdings, August 31, 2009. Vanguard Total US Stock Market Index Fund (VTSMX).
19 Semi Annual Report, April 30, 2009. Vanguard Total International Stock Market Index Fund (VGTSX), p. 8 .
20 Semi Annual Report, April 30, 2009. Vanguard Emerging Market Index Fund (VEIEX), p 60 .

Real Estate

A real estate investment trust (REIT) index fund may be less familiar to individual investors than domestic or foreign stock funds, and usually receives the smallest allocation of the three equity classes.[22] A REIT purchases or manages real property assets and must by law distribute 90 percent of its net income each year to shareholders. Accordingly, REITs generate higher income than traditional stock dividends, since companies may retain the vast majority of their earnings. Despite the recent sharp decline in valuations, physical property is a high quality asset class that complements common stocks.

Bonds: US Treasuries

Bonds are included in a portfolio to provide stability and predictable returns. In contrast with equity, however, exposure to the broad market is not an advantage. Given that the recent financial catastrophe was caused in part by the issuance of highly complex, risky and poorly-understood classes of bonds (credit default swaps and mortgage-backed securities) careful investors want to *avoid* exposure to such assets.

Accordingly, Unconventional Investor only recommends bonds backed by an explicit United States government guarantee, known as Treasuries.[23] These debt obligations have lower interest (i.e. coupon) rates than other bonds, but their superior performance and stability offer unique advantages in good times and bad.

Benefits

Treasuries are favored by savvy investors for the following reasons:

Simplicity and Trading Costs: US Treasury bonds are straightforward and consistent, varying only in their different interest rates and maturity dates. The government sells bonds directly into the massive Treasury bond market, eliminating Wall Street underwriting fees. As a result, bonds are very liquid, and both spreads and transaction costs are low – all good things for investors.

Credit Quality: The US government has never defaulted on its bond obligations and can be expected to take extraordinary steps to prevent such an occurrence; the US Government recognizes that repaying its bond obligations is essential to maintaining its good standing in the global financial marketplace.

21 The fund holds the roughly 20% of stocks that make up approximately 80% of the country's aggregate market capitalization. Small-cap stocks in Japan, for example, are not included until they become larger.

22 The Vanguard REIT Index Fund holds only US properties. Semi Annual Report, July 31, 2009. Vanguard REIT Index Fund (VGSIX), p. 9.

23 The bonds of government sponsored entities (GSEs), such as Fannie Mae, Freddie Mac and Sallie Mae (respectively Federal National Mortgage Association; Federal Home Loan Mortgage Corporation; Student Loan Marketing Association) are not considered Treasuries. Their government backing is implicit, not explicit.

No Prepayment Risk: Treasury obligations cannot be repaid early. This means that when rates fall, the US government cannot pre-pay high interest rate debt, leaving the investor's agreed-to interest rate locked in. This is in contrast to other types of bond obligations, such as municipal, state or corporate bonds. Those may be "called" early, resulting in an early repayment of principal, denying the investor the higher returns they otherwise would have earned.

Best Choices

Treasuries are issued with maturities ranging from 90 days to 30 years. To ensure maximum yield and provide an inflation hedge, two are recommended for Unconventional Investor portfolios.

Intermediate-Term: These bonds mature 5 to 10 years in the future, generally considered the "sweet spot" on the yield curve, where it starts to flatten out.[24] This time horizon, as opposed to shorter or longer time horizons, provides reasonable returns without committing funds for decades.

Inflation Protected (TIPS): TIPS are inflation-indexed bonds issued by the US government. In addition to their unique credit quality, TIPS eliminate the risk that inflation will erode the income anticipated from this portion of a portfolio. TIPS are the only meaningful variant of regular Treasuries, and thus merit their own allocation. The Vanguard TIPS fund currently holds 99 percent inflation-linked bonds with an average maturity of 9 years.[25]

Cash: Money Market Fund

Setting aside a cash emergency fund that can cover 6 to 12 months of expenses is generally recommended for investors of all ages.[26] Additionally, investors who are no longer accumulating assets (and are spending them down in retirement) may choose to have part of their portfolio allocation in cash, to reduce overall portfolio volatility. Vanguard's Prime Money Market Fund provides liquidity and low costs, along with very competitive returns.

Peace of Mind

By relying on the strategic asset allocation model and carefully-selected Vanguard Group funds, an Unconventional Investor client can face any set of market conditions with confidence that her interests are protected. Simply going through the process of identifying major financial milestones and risks can reduce anxiety and prevent possible missteps. Having a portfolio

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24 According to a Wikipedia, the yield curve is the relation between the interest rate (or cost of borrowing) and the time to maturity of the debt Yield curves are usually upward sloping asymptotically: the longer the maturity, the higher the yield, with diminishing marginal increases (that is, as one moves to the right, the curve flattens out). The sweet spot is where the curve starts to flatten out. As economic conditions change, the yield curve will change as well.

25 The remaining 1% is non-inflation linked securities (e.g. cash), used for fund operations and redemptions. VIPSX Semi Annual Report. June 30, 2009, p. 13.

26 Some people in the early part of their careers and a stable job situation may choose not to hold cash in their investment portfolio.

tailored to one's individual needs makes it easier to stay focused on the long term, rather than reacting to the latest market conditions and media coverage. The disciplined, long-term approach of Unconventional Investor helps clients through turbulent times as well as calmer ones.

The recent crisis has tested all investors. Some have questioned Swensen's strategy, noting that individual investors would have been better off holding cash than the assets he recommends. Yet history tells us that sitting in cash is not an acceptable long-term investment strategy; investors need to engage in the market to meet their financial and life goals. When challenged, Swensen is unapologetic:

> *...a time of market turmoil is more challenging than it is when markets are more settled...But the basic principles, having an equity orientation and having diversification, haven't changed....*[27]

27 Isaac Arnsdorf, "Swensen defends 'Yale Model'," Yale Daily News; 26 Jan. 2009.

The Unconventional Investor Difference

Unconventional Investor, LLC is a small, privately-held financial investment firm registered with the California Department of Corporations. Our clientèle consists primarily of individuals and families who have accrued at least $250,000 in investable assets and who wish to ensure that their money is wisely managed. Most are well-educated professionals who understand investment principles, but have neither the time nor inclination to actively manage their money.

The cornerstone of the Unconventional Investor approach is the strategic asset allocation model, optimized through careful portfolio construction and value-based pricing. Unlike some larger financial firms, every aspect of Unconventional Investor is designed to meet the *client's* needs, not our own.

The Process

Each engagement starts with an inventory of the client's significant assets and liabilities, including real property, retirement accounts, salary and bonuses, mortgages, outstanding loans and credit card debt. It continues with a more detailed analysis of the client's financial holdings -- stocks, bonds, mutual funds, money markets, CDs and cash, whether held solely, jointly, in trust, or in a variety of IRA and 401(k) accounts. This analysis will reveal whether and to what extent the client is over-invested in some arenas and underrepresented elsewhere. Unconventional Investor will also evaluate recent performance history and calculate the fees being paid for each account. Many new clients are surprised to learn just how much they have been paying in fees.

Next, the client outlines financial goals in addition to retirement, both short-and long-term. This might include starting a business, taking a dream vacation, buying a second home, paying a child's tuition, enjoying early retirement and/or helping adult children purchase their first home. Understanding the financial impact of such major milestones is a key part of financial planning. The Unconventional Investor advisor will ask additional questions to determine the client's tolerance for risk, and to assess the likelihood of disruptions to the status quo, such as a sudden job loss or the need to take unpaid leave to care for a relative. All these factors, taken together, will determine which ratio of equity, bonds and cash will best meet the client's needs.

If the client agrees with the recommendations, she is encouraged to move as many accounts as feasible to Vanguard. Although assets held elsewhere can be managed by Unconventional Investor, there are structural advantages to having as much as possible in a central repository, specifically Vanguard. First, it permits an integrated view of the client's holdings on a single statement. Anyone who has tried to calculate their net worth or complete their tax forms after reviewing a half dozen statements will appreciate the simplicity of receiving a single, consolidated account statement.

Second, money can be moved easily between Vanguard funds. This greatly facilitates portfolio rebalancing. Similarly, when it is time to update the target allocation to reflect a shift in priorities (e.g. upcoming college tuition or approaching retirement) or sudden life change, the advisor can adjust the portfolio quickly and without disruption.

Finally, using Vanguard as the custodian for the client accounts offers significant cost advantages compared to full-service financial investment firms. Unconventional Investor clients will receive their statements and IRS documentation from Vanguard, which also provides asset security, online access to account information and performance reports. Vanguard mutual fund expenses cover these services.

Once assets are transferred to Vanguard, the client executes a Limited Agent Authorization agreement in favor of Unconventional Investor. This enables the advisor to move money between accounts to establish the target allocation, rebalance when necessary and review the client statements for anomalies. And annually, the Unconventional Investor advisor and client will review the portfolio, discuss any major life changes (e.g. a new baby, new business venture), so that the portfolio continues to meet current and projected needs. Of course, a client may contact the advisor at any time as changes occur or to ask questions.

Simple (But Not Simplistic)

The relative simplicity of the Unconventional Investor portfolio strategy makes it easy for investors to understand where their money is going and what they can expect to happen as a result. It also makes it easier to adjust holdings when the client's needs shift because of life changes, expected or unforeseen. The same core holdings will continue to be part of the client's portfolio, with only the relative proportions changing over time.

Because many investors have objectives in addition to retirement (e.g. college, saving for a house) that reflect different time horizons, they may wish to establish multiple sub-portfolios. Others may wish to have a parent's portfolio or a child's trust fund professionally managed, to remove that burden from the family.

Sophisticated

Although the strategy is simple enough for most individual investors to understand easily, it is complex enough to require sophisticated tools to manage and maintain the appropriate allocations. A typical portfolio usually consists of at least five or six accounts, each holding some number of the five asset classes. Tracking and rebalancing this array of holdings across all of a household's accounts, would be time-consuming and tedious for most people. Unconventional Investor uses a proprietary money management system to automate the process. This system receives the client account information directly from Vanguard (pursuant to the Limited Agent

Authorization), evaluates the client's current allocations as compared to the target, and identifies the necessary rebalancing transactions.

High Value, Low Cost

Unconventional Investor charges a percentage-based fee based on dollar value of non-cash managed assets, billed quarterly. Fees are billed at the end of the quarter with a one-quarter lag, meaning that the June invoice reflects end of March holdings. Unlike financial advisors that receive commissions or charge transaction fees, Unconventional Investor keeps as much money as possible in our client's hands.

Table 2: Unconventional Investor, LLC Fee Structure

Assets Under Management	(paid in quarterly installments) Annual Charge
First $250,000	0.30% ($300 per $100,000)
From $250,000.01 to $500,000	0.25%
From $500,000.01 to $750,000	0.20%
Amounts over $750,000	0.15%

To give an example, a portfolio of $525,000 would pay a quarterly fee of $356.25.

First $250,000 times 0.003 = ...$750.00
Next $250,000 times 0.0025 = ...$625.00
Next $25,000 times 0.002 = ...$50.00
Total annual fee = ...$1,425.00
1/4 annual fee = ...$356.25

Secure

Unconventional Investor, LLC is a non-custodial advisor, working via Limited Agent Authorization at Vanguard. This provides trading authority to maintain client portfolios, yet protects investors from advisor malfeasance. That means the advisor cannot:

- Change any name or address information on the account
- Add or delete bank accounts linked to the account
- Change beneficiary information on the account
- Move money in or out of the account

Advisors who hold custody can deduct their fees directly from client accounts;[28] instead, Unconventional Investor sends an invoice, leaving clients in control.

28 In addition to Unconventional Investor's fees, clients also incur normal mutual fund expenses from the underlying mutual funds. The average expense ratio for the five relevant Vanguard funds is 0.22% and ranges from 0.30% (international stock index) to 0.15% (US stock index). Like all mutual fund expenses, these are deducted directly from the fund. For large investments, even lower cost share classes are available.

Historical Performance Compared to Benchmarks

Long-term growth and security are at the top of every investor's wish list. To demonstrate the power of the Unconventional Investor model, the performance of almost 100 combinations of the recommended asset classes[29] and Vanguard funds were compared to two benchmarks -- the S&P 500 index, and target date retirement funds offered by three large firms[30] -- over three time periods. The following three pages contain graphs which demonstrate the benefits of Unconventional Investor's powerful combination of diverse equity holdings[31], high-quality bonds[32] and value-oriented fee structure.

Specifically:

- Over the last 10 years, ending June 30, 2009, on a risk-adjusted basis,[33] Unconventional Investor portfolios outperformed the comparable alternatives by approximately 1.5 percent annually. The portfolios performed nearly 4 percent better per annum than the S&P 500. The effect of the extra earnings, compounded annually, is dramatic.[34]
- Over a five-year time frame, also ending June 30, 2009, the Unconventional Investor portfolios again trumped the target retirement funds, this time by anywhere from one-half percent to 2.5 percent, and returned a full 5 percent annually more than the S&P 500.
- In the last three years, again ending June 30, 2009, virtually no portfolio has performed well, compared to the returns of earlier years. But again, the Unconventional Investor portfolios handily outperformed the S&P 500 and either exceeded or matched the target retirement funds.

The longer the time horizon, the more compelling the case for the Unconventional Investor approach. A thoughtfully designed portfolio can help an investor meet long-term financial needs better than relying on “safe” solutions like the S&P 500 index alone or even target date retirement funds.

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29 In all, 96 variants of Unconventional Investor portfolios were evaluated over a 10-year, five-year and three-year time frame, all time periods ending June 30, 2009. The combinations reflect the wide range of risk tolerance and time horizons of investors. Eight different allocation models of equity/bonds/cash were used, ranging from an aggressive, long-term option (94% equity, 6% bonds, no cash) to a highly conservative one (25% equity, 40% bonds, 35% cash). Within each allocation model, four different ratios of US stocks, foreign stocks and REITs were tested. Within each of those variants, the proportion of TIPS and Treasuries were varied three ways. See Appendix 1 for more details. The Vanguard funds evaluated are the same ones used in Unconventional Investor client portfolios.

30 See more on Target Date Retirement Funds in the Glossary.

31 Unconventional Investor favors a larger foreign country allocation than the target retirement date funds, better reflecting global capitalization rates. A REIT index fund, not present in target date funds, is also included for further equity diversification.

32 Only US Treasury bonds and inflation-protected Treasury bonds (TIPS) are used in Unconventional Investor portfolios. Target-date funds invest in a wide range of bonds, including high-yield (junk), corporate and mortgage-backed bonds. The recent credit market turmoil underscores the importance of high-quality bonds.

33 The risk-adjusted return of a portfolio is the return it provides relative to the risk absorbed. A portfolio with a superior risk-adjusted return is one that has the highest return for a given level of risk.

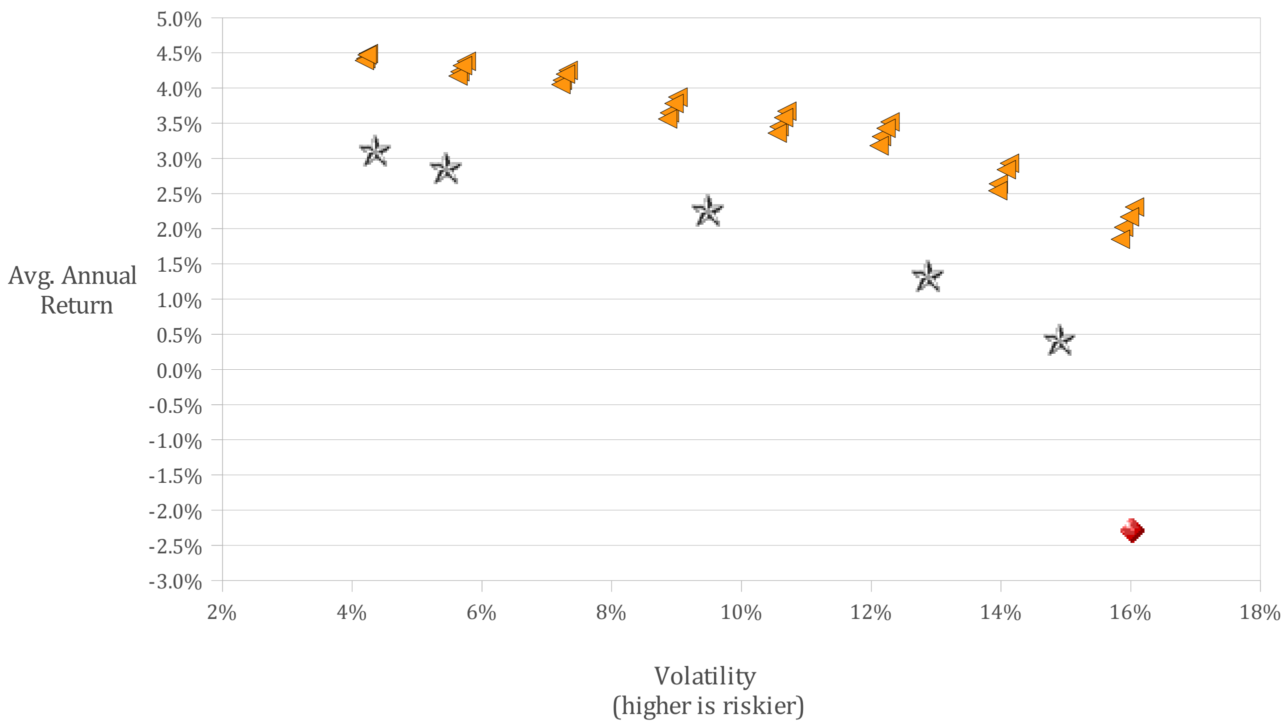
34 See compound interest example in Table 1.

Performance Graph: 10 Years Ending June 30, 2009

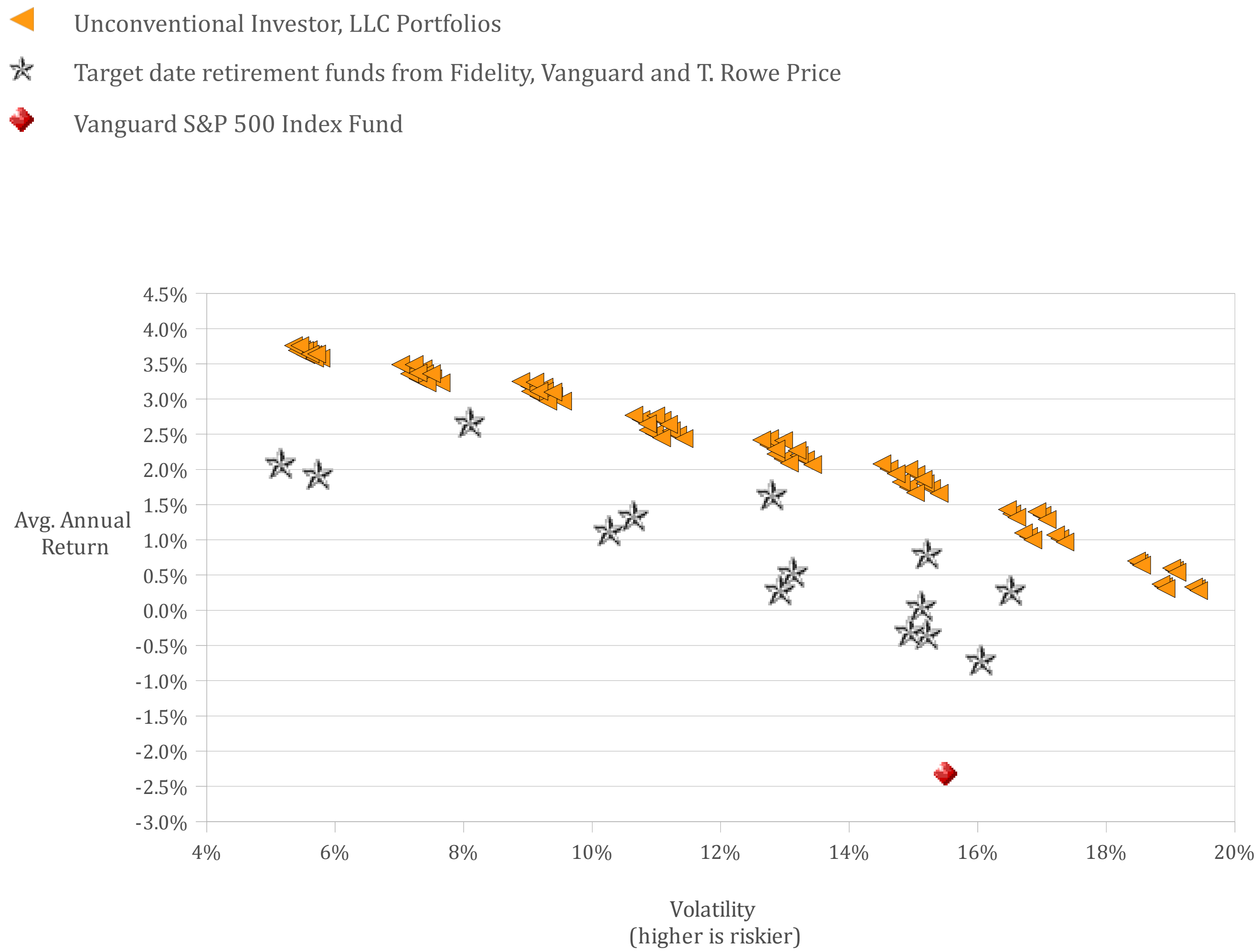
Unconventional Investor, LLC Portfolios

Target date retirement funds from Fidelity

Vanguard S&P 500 Index Fund



Performance Graph: 5 Years Ending June 30, 2009

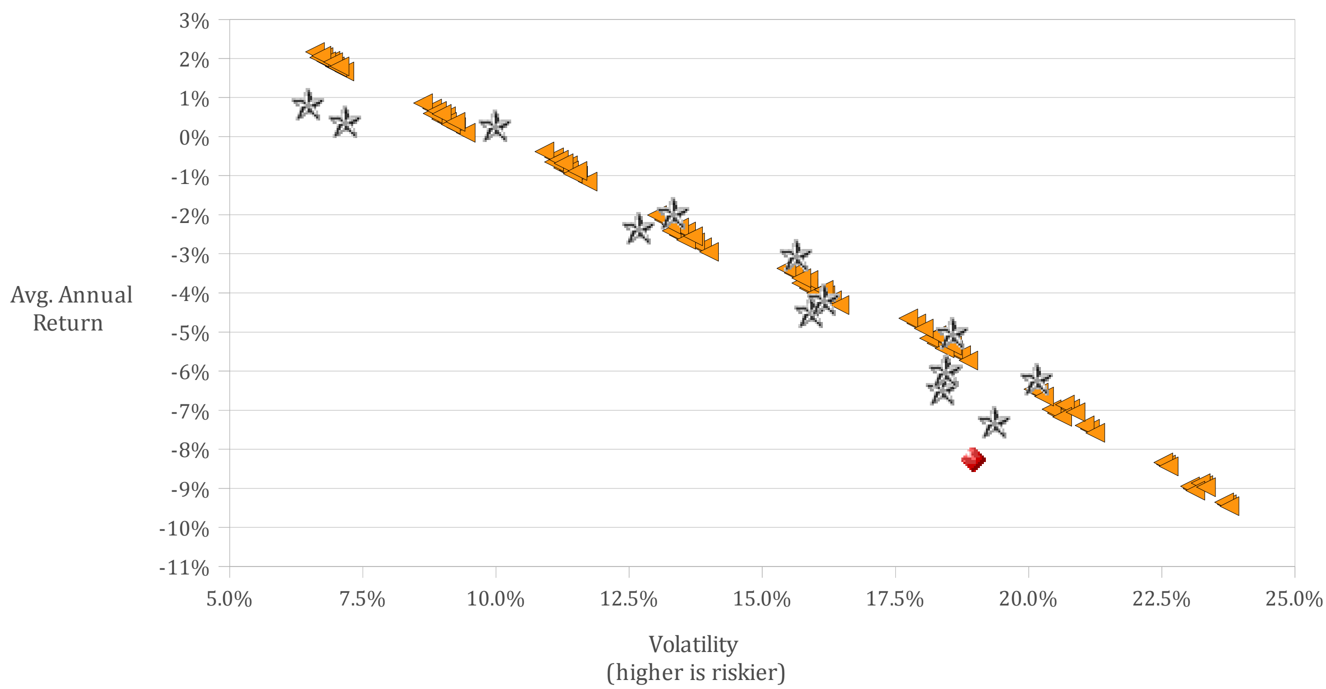


Performance Graph: 3 Years Ending June 30, 2009

Unconventional Investor, LLC Portfolios

Target date retirement funds from Fidelity, Vanguard and T. Rowe Price

Vanguard S&P 500 Index Fund



About the Author

Paul O'Leary has held senior level finance positions at several companies during his career. After business school, he worked for TRW in various finance capacities. From 1997-2002 he was Director of Finance, then Vice President of Finance for Score Educational Centers, a subsidiary of the Washington Post (WPO). He served as Director of Finance at Scientific Learning Corporation (SCIL) from 2004 through 2006. He left Scientific Learning at the end of 2006 to pursue his dream of helping individuals and families achieve their financial aspirations.

Mr. O'Leary has an MBA from the University of Michigan's Ross School of Business with a finance and accounting concentration and a BA in Economics from The Johns Hopkins University. He lives in Oakland, California and Boston, Massachusetts.

Definition of Terms

Several important investment principles are outlined briefly below to provide context for the more detailed aspects of the discussion.

Bond - The promise to repay money loaned to an entity (corporate or governmental) for a defined period of time, with an agreed-upon rate of interest. Bonds are commonly referred to as fixed-income securities, and are one of the three main asset classes (along with stocks and cash equivalents).

Compounding - The effect when earnings are reinvested and generate further earnings. "Compound return" refers to this multiplier effect.

Custodian - A financial institution that has legal responsibility for a customer's financial assets. The custodian handles the administration of customer accounts including statements, the safety of assets, Internal Revenue Service (IRS) reporting, and other such tasks.

Diversification - Including a wide variety of investments within a portfolio to minimize risk of overall loss or depreciation, and increase the opportunity to reap higher overall returns. Historically, a mix of investments performs better and more predictably than any individual asset.

Equity - A partial ownership interest in an asset or enterprise. Equity (commonly referred to simply as stocks) is one of the principal asset classes, along with bonds and cash.

Fees - The cost borne by investors for the management of their money, which vary widely. Fees directly offset return; a 0.5% reduction in fees is a 0.5% increase in return.

Index fund - A special type of mutual fund that tracks a specific market index, such as the Standard & Poor's 500 Index (S&P 500) or the Wilshire 5000. Since portfolio decisions are infrequent and automatic, the fund requires far less staff and rarely needs to purchase or sell its holdings. This results in lower operating costs, lower transaction costs and lower tax exposure.

Limited Agent Authorization - Allows an agent to place orders or make inquiries concerning a client's account, but not to disperse client funds.

Rebalancing - The process of buying and selling portions of a portfolio to restore the ratio of each asset class to its target allocation.

REIT / Real Estate Investment Trust - A legal entity that invests directly in real estate and sells partial ownership interests (comparable to shares of stock) on the major stock exchanges. REITs typically offer high yields, and are an easy, liquid way to invest in real estate. Equity REITs invest in and own properties; their revenues come principally from their properties' rents.

Return / Total Return / Rate of Return - The increase in value of an investment. Returns include income (interest and dividends) along with capital growth (price appreciation and distributions). Return is usually expressed annually, as the rate of return. In this paper, return and total return are synonymous. Returns can be negative, as investments can sometimes result in losses.

Risk - Reflects the range of possible outcomes, including loss of some or all of an initial investment. The wider the range, the higher the risk. Investors demand a higher return as compensation for bearing additional risk. The risk/reward ratio is not linear, meaning some risks are not as well-compensated as others.

S&P 500 - A group of 500 stocks chosen for their size, market value, strength (assets vs. liabilities), liquidity and industry sector, among other factors. The S&P 500 weights each stock proportionate to its market value; the index is designed to reflect the relative health of the largest publicly-traded companies in the US.

Strategic Asset Allocation - A strategy in which a target asset allocation of a portfolio is established, based on client risk tolerances and time horizons. As the value of assets changes due to market conditions, the portfolio is regularly rebalanced to return to the target allocation.

Target Date Retirement Fund - A fund that holds other mutual funds, often index funds. The equity / bond / cash allocation is appropriate for a typical investor retiring at or near the specified target date, such as Fidelity Freedom 2030 Fund. The further out the date, the higher the equity percentage in the portfolio.

Tax Efficiency - Describes how much return is received from an investment *after* taxes. Taxes are incurred only when assets are sold for more than their purchase price and gains are realized. Minimizing the purchase and sale of assets within the portfolio improves its tax efficiency.

TIPS / Inflation-Protected Treasuries - A special type of US Treasury bond that offers protection from inflation. TIPS coupon rate tends to be less than standard Treasuries because their underlying principal is automatically increased to compensate for inflation, as measured by the consumer price index (CPI).

Treasuries / Treasury bonds – Bonds issued by the US government that pay interest every six months and re-pay the principal when the security matures, typically 10, 20 or 30 years after issuance. Treasuries are backed by the explicit full faith and credit of the United States Treasury. The US government has never defaulted on its bond obligations.

Volatility - Unpredictability of earnings; large swings between highs and lows. Volatility can be measured by using the standard deviation (a statistical measure of the complete range of returns) or the difference between the highs and lows of a given asset. Volatility is usually an indicator of risk.

Appendix: More on Historical Performance Modeling

For the Unconventional Investor model portfolios, eight different allocations of equity / bond / cash percentages were tested, ranging from 94% equity to 25% equity.

Table 3: Equity / Bond / Cash Allocation

Allocation	Equity %	Bonds %	Cash %	Total
1	94%	6%	0%	100%
2	84%	16%	0%	100%
3	74%	26%	0%	100%
4	65%	26%	9%	100%
5	55%	26%	19%	100%
6	45%	36%	19%	100%
7	35%	36%	29%	100%
8	25%	40%	35%	100%

For each of the eight equity levels, the three equity classes were combined using four different blends, with US and foreign common stocks (70% to 80% of equity) dominating REITs (20% to 30%) in these blends.

Table 4: Equity Blends; Applied to Each Allocation (1-8)

Asset Class	Blend 1	Blend 2	Blend 3	Blend 4
US Stocks	35%	40%	40%	35%
Foreign Stocks	35%	35%	40%	40%
REIT	30%	25%	20%	25%

TIPS are relatively new and the Vanguard TIPS fund only began in June 2000. As a result, for the 10-year period, only US Treasuries were included in the model portfolios. For the 5- and 3-year periods, TIPS were included along with Treasuries, in three different blends:

Table 5: Bond Blends; Applied to Each Equity Blend

Asset Class	Blend 1	Blend 2	Blend 3
Treasuries	50%	60%	40%
TIPS	50%	40%	60%

Cash, in the form of a money market fund, is introduced as portfolios become more conservative.

Portfolio Composition and Results

For portfolio allocations and performance results on the 96 Unconventional Investor portfolios, see www.unconventionalinvestor\appendix1.pdf .

For benchmark portfolios description and detailed performance reports, see www.unconventionalinvestor\appendix2.pdf.

For detailed performance reports on the 96 Unconventional Investor portfolios, see www.unconventionalinvestor\appendix3.pdf.

Disclosures

- Vanguard's Create a Scenario tool was used to evaluate the historical performance. It is available only to professionals.
- The securities used in client portfolios are the same securities as those in the models.
- Results for the 10, 5 and 3 year analyses were for the periods ending June 30, 2009.
- Results are based upon an initial investment made at the beginning of the period; no further investments or withdrawals are made. All dividends and capital gains are reinvested.
- Results do not account for taxes.
- The performance results reflect payment of the mutual fund fees for all underlying funds.
- Unconventional Investor model portfolios:
    - also reflect payment of an annual fee of 0.3% (the maximum charged) for non-cash holdings
    - are rebalanced twice annually.
- Past performance is no indication of future results and investments can both increase and decrease in value.

