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To: Interested Parties

Date: February 12, 2010

From: Richard W. Greene

Re: *Intelligent Index* 4<sup>th</sup> Quarter Update

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**Fourth Quarter Review:**

Capping off one of the most volatile years in history, the financial markets extended their remarkable recovery during the fourth quarter of 2009. After falling over 20% the first 10 weeks of the year, the Standard and Poor's 500 Index closed the year with a 26.47% gain. The Intelligent Index Model Portfolio improved approximately 5.20% net of fees for the quarter and finished the year up 30.13% net of fees.

Below are the fourth quarter results for the relevant indices.

**Quarterly and Annualized Returns for Intelligent Index Model Portfolio and Indices as of 12/31/2009**

	<u>Q4 2009</u>	<u>1-Year</u>	<u>3-Year</u>	<u>5-Year</u>	<u>10-Year</u>
Intelligent Index (Gross)	5.53%	31.77%	-2.65%	2.48%	5.44%
Intelligent Index (Net)	5.20%	30.13%	-3.86%	1.20%	4.12%
S&P 500 Index	6.04%	26.47%	-5.62%	0.42%	-0.95%
S&P Citi Large-Cap Value Index	4.22%	21.18%	-9.10%	-0.81%	0.89%
S&P Citi Large-Cap Growth Index	7.76%	31.57%	-2.24%	1.53%	-2.94%
S&P Citi Mid-Cap Value Index	5.46%	33.73%	-3.67%	2.70%	8.89%
S&P Citi Mid-Cap Growth Index	5.63%	41.08%	-0.03%	3.72%	3.82%
S&P Citi Small-Cap Value Index	4.42%	22.85%	-6.48%	0.76%	7.68%
S&P Citi Small-Cap Growth Index	5.81%	28.35%	-3.14%	1.87%	4.46%

Source: Bloomberg, wilshire.com, iShares.com

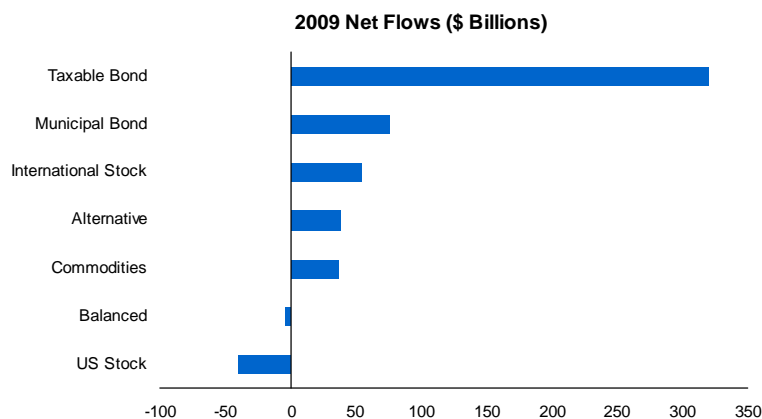
As a result of all six indices as well as the benchmark S&P 500 Index being positive for the quarter, the Intelligent Index Model Portfolio remains in a neutral equal weight allocation of 50% value and 50% growth for the current quarter.

## Market Commentary:

The unprecedented amount of stimulus combined with the Federal Reserve's policy to keep interest rates low for an "extended period"<sup>1</sup> allowed the economy to stabilize and demonstrate some initial signs of growth in 2009. Many of the companies who suffered the most in 2008, such as banks, had some of the largest rebounds of all, as the government committed to essentially "backstop" the banks and the economy in general. The bond and credit markets were also resurrected, as historically low money market rates drove record amounts of money into the fixed income markets. Here, investors who had previously shunned risk bought record amounts of bonds and high yield paper in the hopes of securing some sort of yield in their cash and bond holdings.

In trying to determine one's investment strategy going forward, it's hard not to simultaneously consider the past. The last 10 years produced two large scale bubbles that erased a decade's worth of returns for most long-term equity investors. The internet and technology bubbles of the early 2000s were followed by the credit and leverage bubble, where mountains of debt were met with complacency. In fact, the last 50 years have been witness to several bubbles of various degrees. In the 1960s it was the "nifty 50", where big was beautiful and multiples for some of America's largest companies at the time such as ITT, IBM, Xerox, and Polaroid exceeded 50 times earnings. The 1980s witnessed bubbles in the commodity and energy markets, with gold and silver at prices that we didn't see again for twenty-five years. The early 1990s saw the break up of a biotech bubble, followed by a real estate bubble which left hundreds of savings and loans insolvent.

I reference these phenomena because as we know, all bubbles end disastrously. We also know that there will be more bubbles ahead. In fact, some suggest that a bubble of significant proportions has and continues to develop in the bond market. The once in a lifetime 2009 returns of 50% or more in some bond categories such as "junk" bonds and leveraged loans have only served to attract more capital despite the fact that, as one Barclay Capital analyst puts it, "you clearly, mathematically, can't repeat that."<sup>2</sup> The chart below summarizes net mutual fund and ETF asset flows for 2009, with taxable and municipal bonds receiving a huge share of investors' money.



Source: Morningstar, as of 12/31/09.

The appeal of great performing or popular investments is compelling for sure, but without discipline, investors are exposing significant amounts of their net worth to oftentimes unrecoverable losses. Although at the early stages it is very difficult to distinguish good performance from a bubble, below are several points that may help lessen the likelihood of being victimized by market frenzy.

- Spectacular returns in any asset class are unsustainable over a long period of time and are often the result of a bubble. Be wary of buying into securities or sectors that have experienced sharp appreciation.
- By the time an investment theme or product is being heavily marketed or advertised in the media, the opportunity for excellent returns has likely passed.
- Be careful to avoid investing where the majority of money is flowing. Assets that are the beneficiaries of large money flows are often appreciating in price because of money being invested rather than fundamentals.

<sup>1</sup> Lauricella, Tom. "For Rebuilt Markets, a Test in 2010." The Wall Street Journal. January 5, 2010. <http://online.wsj.com/article/SB10001424052748704162104574630242432745528.html>

<sup>2</sup> Rappaport, Liz. "U.S. Resuscitated the Credit Markets, but Work Remains." The Wall Street Journal. January 3, 2010. <http://online.wsj.com/article/SB10001424052748704234304574626283642332604.html>

- Be disciplined about rebalancing. Your best performing investment by definition will likely become overweighted within your portfolio. It's not always a good idea to just let your profit "ride" and not trim back to your original core allocation.
- Don't let the tax tail wag the investment dog. Investors are often unwilling to sell or trim successful investments to avoid paying taxes. One's "winners" may actually just be the beneficiaries of short-term enthusiasm rather than being good long-term investments.

**Looking Forward:**

The prognosis for the economy and stock market, although much improved from last year at this time, is still very much up for debate. Despite corporate America's ability to deliver earnings that pleased investors, the list of macro concerns continues to grow. Despite unprecedented amount of money spent to date, little progress has been made in areas that have the most direct financial effect on Americans, namely unemployment and real estate. Taxes, the other large contributor to one's sense of wealth, look poised to be the next shoe to drop and further impair people's sense of financial well-being.

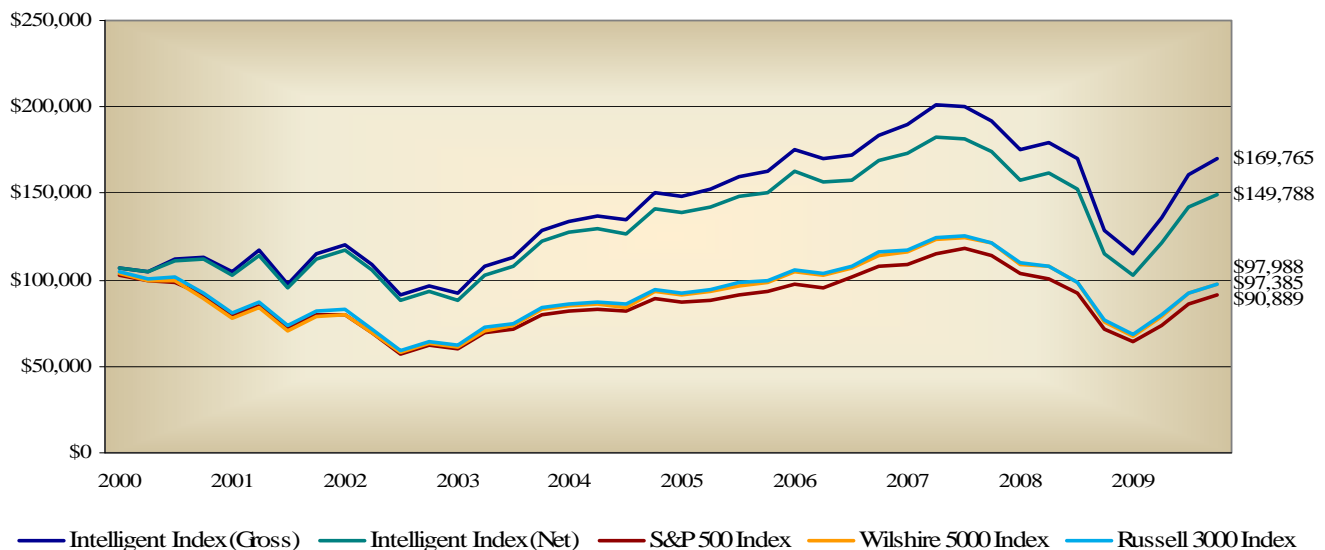
We continue to advocate a healthy allocation to bonds and fixed income given the magnitude of current uncertainties such as record and rising national deficits, the near-insolvency of municipalities and states, a consumer who is about to become further impaired through tax policy, and likelihood of higher interest rates.

Although we continue to always advocate "the case for equities", we think the extent of equity exposure needs to be managed closely. The notion that just because interest rates are near zero, one has to be exposed to more stocks in order to have the potential to earn a yield is analogous to owning a home for the sole purpose of the mortgage interest tax deduction. We believe how one makes allocation decisions has to make sense in a larger context.

**Intelligent Index Portfolio Update:**

The end of 2009 marked the 10-Year anniversary of actively managed index portfolios. When we were doing the research and analysis of a tactically managed index strategy in 1999, we had no idea that it would evolve into the central component of our long-term growth strategy for clients. We also did not know if the returns demonstrated through 22 years of hypothetical backtesting would really stand the test of time once put to work in an actual portfolio going forward. Needless to say, we are very pleased that the Intelligent Index Strategy has been and continues to be validated as a prudent, tax and cost-efficient strategy for investors seeking equity exposure and long-term growth. In fact, through its first 10 years, our actively managed index outperformed the Standard and Poor's 500 Index and the Wilshire 5000 Index in 8 of those years, even though outperformance is not the sole driver of the strategy. And while an average annualized return of 4.12% net of fees may not spark investors to do cartwheels, as the chart below illustrates, a \$100,000 investment in the Intelligent Index fared significantly better than would have been the case in other popular indices.

**Growth of \$100,000**  
2000-2009



At this milestone, we would also like to reiterate a word of thanks to our former research assistant, Keith Dalrymple, who did a considerable amount of the original analysis. We are also extremely grateful to several institutional money managers who so generously spent time with us reviewing the data and strategy, and provided us with the encouragement to implement the strategy for our clients. Lastly, we would very much like to thank our early Intelligent Index investors, who took a leap of faith of sorts, and allowed us to initiate the strategy on their behalf based strictly on our research and their confidence in us.

We look forward to updating you again after the 1<sup>st</sup> quarter, and as always, please do not hesitate to contact us with any questions or thoughts in the meantime.

Sincerely,

Richard W. Greene  
Managing Principal

Jennifer M. Wolfsberg  
Principal

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Adviser's fee schedules are available in Form ADV Part II or upon request. Performance results reflect expense in effect during the relevant period. The performance data quoted represents past performance. Past performance does not guarantee future results. The investment return and principal value of an investment will fluctuate so that an investor's shares, when redeemed, may be worth more or less than the original cost. Current performance may be lower or higher than the performance quoted. The performance information assumes reinvestment of all dividends and capital gains. An investor will indirectly bear the expenses of the ETF's underlying investments. Investing involves risk, including possible loss of principal. Diversification does not protect against loss. Index returns are for illustrative purposes only and do not represent actual fund performance. Index performance returns do not reflect any management fees, transaction costs or expenses. Indices are unmanaged and one cannot invest directly in an index. The DJ Wilshire 5000: Measures the performance of all U.S. common equity securities, and so serves as an index of all stock trades in the United States. S&P 500 Index: Measures the performance of the largest 500 U.S. common equity securities. Russell 3000 Index: Measures the performance of the largest 3000 U.S. companies representing approximately 98% of the investable U.S. equity market. Intelligence Index figures reflect hypothetical returns for the "model portfolio" which is comprised of S&P/Barra indices that do not trade. Actual returns reflect the performance of Barclays Share Exchange Traded Funds, which are designed to track the S&P/Barra indices. Increments of Return sourced from the model portfolio. The information contained herein is compiled independently by Richard Greene. Though considered to be reliable, these materials have not been verified by any third-party, and are not guaranteed as to their accuracy or completeness. All quantitative analysis illustrated herein is done using market composites which best represent the overall investment strategy of the Intelligent Index. All annualized return figures consist of both capital appreciation and dividends reinvested. Risk: The Intelligent Index Strategy allocates its investments among Barclays iShares ETF indexes invested in growth and value style equities of small, mid, and large capitalizations. The Intelligent Index Strategy systematically rebalances its allocations in these assets to maintain their target weightings. There can be no guarantee that rebalancing will achieve its intended result. The risks, both systematic and unsystematic, associated with an investment in the Intelligent Index Strategy specifically and equities in general may not be suitable for all investors. 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