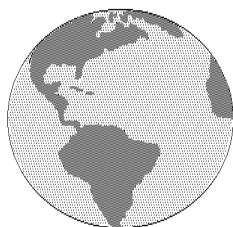


Summary

- U.S. stocks enjoyed their best September since 1939 and the major indices gained 11% for the quarter.
- Large company stocks outperformed small company stocks, in the U.S. and globally.
- International stocks benefitted from the falling value of the dollar and thus outperformed U.S. stocks.
- The best performing bonds were those with the most risk (Emerging Market Debt and High Yield Bonds) while “safer” bonds still produced positive returns.
- Real estate funds produced over 4% returns for the quarter but lead all major U.S. equity categories for the year.
- Most alternatives added positive benefits to portfolios this quarter.
- Although the “Great Recession” ended last June and jobs are being added and housing prices are beginning to stabilize, economic growth still faces several headwinds.



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Strong 3rd Quarter Gains

The third quarter posted strong gains buoyed by the strongest September rally since 1939. In September alone, the Dow surged over 8% with gains in all of its 30 components. For the quarter, the S&P 500 Index, representing the largest U.S. companies, rose more than 11% while the NASDAQ gained almost 13%.

As can be seen in the adjacent charts, September's surge brought the benchmark indexes back into positive territory for the year. At quarter end, the S&P 500 index was up almost 4% year to date and is now up 74% from the market low on March 9th, 2009. While this is a strong recovery, the index is still down nearly 22% from the market's all-time peak in October 2007.

While U.S. market results were good, international market returns were even better. The MSCI EAFE Index (the mostly widely used index to track non-U.S. stocks in developed countries) increased by 16.5%. This rise was attributable to moderating concerns about the European sovereign debt crisis, the stabilization of the European banking system and the weakening dollar.



Source: J.P. Morgan Asset Management

While problems continue to confront the global economy, the economy is improving, albeit slowly.

U.S. Economy

End of the “Great Recession”

It's official: The longest U.S. recession since World War II ended in June 2009, according to The National Bureau of Economic Research (NBER). The recession started in December 2007 and lasted 18 months, outlasting the longest previous postwar downturns in 1973-1975 and in 1981-1982, both of which lasted 16 months.

This recovery has been far from normal. While strong corporate profits have driven increased capital investment, this investment has not yet resulted in significant job creation. Factory capacity utilization is still well

below the trough levels of four of the five past recessions. Companies appear reluctant to hire given the uncertain regulatory environment. We can hope for movement as the laws become clearer.

Slow Progress on Employment and Housing

The U.S. economy needs to create more than 200,000 jobs each month to make any significant impact on reducing unemployment. Unfortunately, job growth in this recovery has been anemic. The unemployment rate remained unchanged at 9.6% in September and initial jobless claims remained high. The September employment report showed private payrolls increased by a mere 64,000 jobs, while government payrolls fell 95,000 as temporary census workers were let go and state and local governments cut back.

Housing also remains a mixed picture. Housing starts are still depressed. Existing home sales rose a robust 7.6%, and new sales contracts grew 4.3%, but actual sales numbers are still far below normalized levels. According to the S&P/Case-Shiller 20-city home-price index, home prices rose 3.2% last year but are still 25% below the July 2007 levels, restrained by a glut of distressed properties and reluctant homebuyers.

Economic Growth, the Consumer and Inflation

Consumer spending accounts for about 70% of the U.S. economy, so consumer attitudes directly impact economic activity. As measured by the Conference Board, consumer confidence fell to 48.5 in September, after being as high as 62.7 in May and 53.2 in August. While the recession may have officially ended, the confidence data reflect consumers' increasing uncertainty and apprehension about the state of the U.S. economy. This has continued to slow consumer spending.

The national savings rate edged up to nearly 6% in August, as Americans put more of their income into savings and paid off debt. With consumer spending still low, other economic sectors (exports and business spending) need to rise to boost overall growth.

Manufacturing has been a relative bright spot. September was the 14th consecutive month in which manufacturing activity has grown. The services sector has also been improving, having grown for the ninth-straight month.

Inflation remains minimal. The August Headline CPI, the most watched inflation indicator, was 1.2%

on an annualized basis. This compares to the most recent five year average of 1.9%.

World Economy

Global economic growth continues to be slow, as the impact of fiscal stimulus in the U.S. begins to fade and austerity measures are implemented in Europe. Emerging economies, while not immune to the global growth slowdown, have experienced higher growth rates. We believe emerging markets will continue to act as a stimulus for global growth.

In Europe, officials sought to restore stability and jumpstart economic momentum through the financial stability package created in May and with bank stress tests released in July, 2010. These efforts have eased the sense of emergency, but the Eurozone's underlying problems are not so easily fixed. Most EU countries still have to reduce their budget deficits and initiate changes in social programs. These will be sources of real conflict in the months ahead. It will not be easy.

Overall, economic data has been better than expected, resulting in smaller budget deficits than originally projected—even for Greece. However, the economic recovery has been uneven. Most of Europe, along with Japan, trail well behind the few brighter economic lights (Germany, China, India and Brazil). According to the *Economist*, China's GDP is forecasted to jump by nearly 10% this year and more than 8% in 2011. It has passed Japan as the world's second largest economy.

Fixed Income

As any experienced investor knows, bonds play an important role in portfolio management, and should be a component of any well-diversified portfolio.

The chart on the next page denotes the various sectors of the bond market and ranks the total return from highest to lowest for the years 2008 and 2009. As you can see, different sectors of the bond market can react differently to changes in the economy or interest rates. Interestingly, those bond categories which performed well in the difficult period of 2008 were among the worst performers in the calmer environment of 2009. This points to the advantages of having diversification within bonds, as with equities. Similarly, in a global environment, exposure to a broad array of

2008	2009
Long Treasuries 24.03%	High Yield 57.51%
Unhedged Foreign 12.00%	Emerging Markets 28.18%
Int. Treasuries 11.35%	Inv. Grade Corp. 16.04%
Mortgages 8.52%	Municipals 12.91%
Short Treasuries 6.61%	U.S. TPS 11.41%
BCAG 5.24%	BCAG 5.93%
T-Bills 1.80%	Mortgages 5.75%
U.S. TPS -2.35%	Unhedged Foreign 1.90%
Municipals -2.47%	Short Treasuries 0.78%
Inv. Grade Corp. -3.08%	T-Bills 0.10%
Emerging Markets -10.91%	Int. Treasuries -1.41%
High Yield -26.39%	Long Treasuries -12.92%

Source: JP Morgan

and the Yen—and about 57% of the global bond market is denominated in non-dollar currencies. On a sector basis more than half of the world's outstanding bonds are debt issued by sovereign governments. Government agency bonds and corporate bonds represent another 15% each, and the remaining 19% of outstanding bonds are in securitized bonds such as mortgage-backed or asset-backed securities.

In any given year, some foreign bond markets are likely to outperform the U.S. bond market. In fact, although the U.S. bond market recently has been attractive for investors, only twice in the last 10 years—in 2001 and 2005 did the U.S. bond market lead the way. The Asian region led the way just once, in 2008. European bonds had the highest return for U.S. investors in seven out of ten years. Diversifying bonds with a foreign component improves the chance that you will be able to enjoy the best-performing bond markets.

Emerging Markets

Goldman Sachs estimates that emerging markets could represent nearly half of global stock market capitalization in 20 years, as illustrated at the right. Currently, emerging market stocks represent a relatively small portion of the world's equity market value at about 14%, up from around 1% a decade earlier. However, when you consider that emerging markets gener-

currencies and yield curves has the potential to deliver portfolio benefits.

Global Bond Market Overview

The global bond market is highly diverse, whether viewed by country, currency or sector. The United States is the leading issuer with \$14 trillion in market value representing more than 38% of the total bond market. The U.S. total is greater than the next four issuers combined—Japan, Germany, France, and the United Kingdom.

On a currency basis, more than 86% of the world's bonds are denominated in just three currencies—the U.S. Dollar, the Euro,

ate nearly half of the world's GDP and harbor roughly 70% of the world's population, even 14% is low.

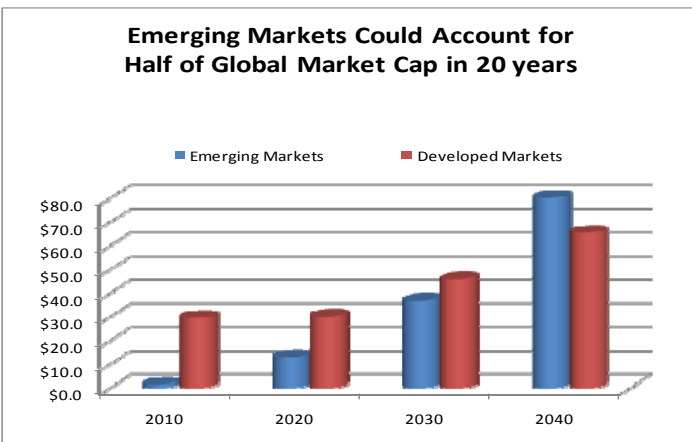
Most emerging market economies are relatively healthy today. By and large the emerging countries did not get caught in the real estate and debt problems that impaired the developed parts of the world. Partly as a result, government debt levels in the emerging countries are much lower than is true in the developed world. While U.S. government debt is approximately 71% of GDP and Japan's is 196%, China's debt is only 16% of GDP and Brazil is at 39%. Given relatively strong balance sheets, many emerging market countries have been able to create stimulus programs to boost their economies and to offset the restricted spending among the developed world's consumers. The emerging countries have also benefited from the rebound in demand for commodities.

Investments – U.S. Equities

All equity categories posted strong gains during the 3rd quarter. The S&P 500 rose over 11%, while the NASDAQ increased nearly 13%. Large cap growth stocks rose 13% for the quarter while large value stocks increased by 10%. The 3rd quarter saw small company stocks generate slightly lower returns than large stocks.

Year to date, Small Cap has outperformed Large Cap, which is typical during the early phase of economic recoveries. Historically, as a recovery matures, stock leadership shifts to more stable, consumer-oriented securities. It's not yet clear if this pattern will be repeated this time.

From a stock valuation perspective, using current stock prices and analysts' forecasts of future earnings over the next twelve months, the S&P 500 is now



Source: Goldman Sachs; Financial Post

priced at 12.3 times forecasted earnings, versus a 15 year average of 17.2. This would imply significant room for appreciation, and even more so if earnings continue to improve. Stocks also appear to be historically cheap when looking at corporate book values.

Investments – International Stocks

International broad market indices posted strong gains during the 3rd quarter, enhanced by favorable currency valuations. Generally, the weaker the dollar, the more attractive international investments become. The MSCI EAFE index, the most widely used international index, gained 7.1% (in local currency) for the third quarter; however, due to a weak dollar, the index returned 16.5% to U.S. investors.

Emerging markets posted stellar third quarter returns with 13% (in local currency) and over 18% to U.S. investors. The best performing developing countries this quarter were Brazil and India with returns to U.S. investors of 22% and 15%, respectively.

Investments – Fixed Income

The overall bond market, as represented by the U.S. Aggregate Bond Index, gained 2.5% for the quarter and 8.2% for the year. There were notable differences between the top and bottom bond segments. At one extreme Emerging Market Debts and High Yield both enjoyed a strong quarter at 8% and 7%, respectively. At the other end of the spectrum, Mortgage Backed Securities (MBS) and 2 year Treasuries produced returns of only 0.6% each.

Inflation has not been a factor since the summer of 2008. If the U.S. government continues its current level of budgetary deficits, U.S. interest rates will almost certainly need to rise (to attract investors to buy government bonds needed to finance our deficits). Should this occur, we believe inflation will follow. To address this risk, we allocate a significant portion of clients' intermediate bond allocation to Treasury Inflation Protected Securities (TIPS). These bonds tie their coupon payments to inflation, producing returns over time of inflation plus a real interest rate. TIPS returned 2.5% last quarter and 8.9% for the year.

Investments – Alternative investments

Our alternative investment selections are intended to help dampen the overall volatility of the portfolio while still contributing to portfolio returns. Overall,

our alternatives performed well during the third quarter with their performance driven by a declining dollar and the rebound in commodity prices.

- The Alerian Master Limited Partnerships ETN that was recently introduced to most portfolios gained 10.7% this quarter, with a year to date gain of 23%.
- The Merger Fund invests in arbitrage situations involving the changing price of companies which are merging or being acquired. It was up 2.2% during the 3rd quarter and is up 4.4% for the year.
- Plum Creek Timber closed out the quarter with a return of 3.5% and has a 12 month gain of 20.8%.

Commodity prices rose during the third quarter, due, in part, to a weaker dollar. Oil prices ended the quarter at almost \$80 per barrel. Meanwhile, gold prices hit new highs, ending the quarter at \$1,307 per ounce. The rise in gold's price comes amid growing concerns that the Federal Reserve (along with other central banks) will embark on another round of monetary easing leading to higher inflation, against which gold is often considered a hedge.

- The Dow Jones Commodity Index finished the quarter up 12% and is up 10% for the 12 month period. The PIMCO Commodity Real Return Institutional Fund, outperformed the index (14.6% for the quarter, 20.0% for the year) due to the relative performance of TIPS, which it holds, versus the treasuries that are represented in the index.

Summary

The third quarter posted strong gains across U.S. and international markets. The announcement that the "Great Recession" is behind us has reduced fears over a possible double-dip recession and fueled double digit September gains in the U.S.. International markets outperformed their U.S. counterparts and experienced healthy gains, partly attributable to the easing of concerns over the European sovereign debt crisis, stabilization of the European banking system and the weaker dollar.

We look forward to your questions and comments and to continuing our work with you.

Sources: Morningstar, JP Morgan, Financial Post, Bureau of Labor Statistics, Ibbotson, The Federal Reserve, Reuters, Forbes, Bloomberg, Standard & Poors, The Economist