

Third Quarter 2010 Client Newsletter

Yanni & Associates Investment Advisors, LLC

Review of the Markets

Quarterly and year-to-date equity returns can be summarized below:

	<u>3rd Quarter 2010</u>	<u>Year-to-Date</u>
S&P 500	11.29%	3.89%
S&P Mid-Cap	13.12%	11.57%
S&P Small-Cap	9.62%	8.66%
Morgan Stanley's EAFE (International Stocks)	16.83%	1.46%

Investment Forecast

Economy – The economy has continued to slowly rebound with second quarter GDP recently being revised slightly upwards to 1.7%. The September unemployment rate was reported as 9.6%. Inflation remains tame with the year-over-year CPI remaining just above 1% (though some may argue it is not a true measure of inflation).

We have continued to witness companies reporting stronger earnings, which has also been a positive sign. Our main concern with the economy today is the lingering near 10% unemployment rate (which is not anticipated to substantially drop going forward). Throughout 2010, companies have reported record levels of cash positions on their balance sheets. These firms have been using this cash in multiple ways. For example, there have been a record number of businesses that have initiated or increased their dividends, share buy-backs, and mergers. What is missing – hiring employees! We do not believe the economy can sustainably recover from this past recession without companies re-hiring employees. In general, it does tend to be very expensive to hire & train employees; companies are perhaps not totally sure of their upcoming health care costs, and companies want to ensure their businesses are going to be stable for the long-term before making that commitment. As a result, we believe this is one reason why the stock market has been very volatile during 2010.

Equities – It was encouraging to witness the stock market have a positive return for this past quarter. In our previous newsletter, we did state “we do believe we are at or close to the bottom in the stock market”. However, given the volatility, YAIA chose not to shift to an “overweight stock” position.

Looking ahead, we continue to believe market volatility will remain with us for the foreseeable future. There is some speculation that the results of the upcoming November elections could indeed help boost the equity markets. With the recent fast run-up of stocks in September, we have been cautioning clients that in this type of environment, it only increases the probability of a short-term correction. Our most likely scenario is that the markets will remain inside a trading range of roughly 10,500 – 11,500 on the Dow, with possibly a short-term correction before the November elections, then a boost afterwards. We do believe the equities' markets will be up a year from now, over today's levels. However, we are not anticipating substantial returns that would be well beyond the historical average of approximately 10%. While not out of the realm of possibility, we do not anticipate a double-dip recession, nor do we anticipate substantial returns over the next year.

Fixed Income – We continue to believe interest rates will remain low for the near term, with the prospect that they will start to rise a year or two out. We have continued to hold positions in Treasury Inflation Protected Securities (TIPS) to hedge client assets. With interest rates as low as they are, finding risk appropriate attractive yielding assets is becoming increasingly difficult. We continue to maintain our position in a high yield bond exchange-traded fund (ETF) to incorporate higher yields into portfolios. Otherwise, we continue to favor short-term high grade CDs and corporate bonds (callable and step-up). We remain cautious on investing new funds into municipal bonds. There have been several articles written recently suggesting the possibility of upcoming municipal defaults or refusal to pay interest payments (Harrisburg, PA recently). In essence, higher unemployment and more vacant homes => less payroll taxes, lower personal spending, & lower real estate taxes => higher pressure on municipal default or refusal to make interest payments.

Yanni & Associates Investment Advisors, LLC Firm Update

Our Firm continued growing in the third quarter through the addition of new clients. Every client who signed with us this past quarter was referred to us by existing clients or through mutual people we know. We continue to service clients in 14 different states: Alabama, Arizona, California, Connecticut, Florida, Georgia, Illinois, Maryland, Michigan, New York, North Carolina, Pennsylvania, South Carolina, and Virginia.

Yanni & Associates Investment Advisors, LLC recent quotes in various publications:

- Pittsburgh Post Gazette, ETFs Can Be Safe, If You Do Your Homework, Len Boselovic October 10, 2010

Our Actions and Recommendations Can Be Summarized As Follows

- We are still **neutral-weighted stocks relative to bonds** in relation to our guidance for asset allocation and otherwise customized portfolio structures for our clients on an individual basis.
- Within equities, we maintain our **slight overweight “value” stocks relative to “growth” stocks**.
- Within equities, we remain **over-weighted “small/mid” capitalization stocks relative to “large” capitalization stocks**.
- Within equities, we remain **underweight international stocks relative to domestic stocks**.
- Within fixed-income, we maintain our overweight to **shorter maturity/duration fixed-income vehicles**, while focusing on high-grade corporate bonds and FDIC insured certificates of deposit.
- While we continue to strongly encourage a diversified portfolio of more traditional securities, we do invest in niche areas as well, based on our views of the economy. A few of our “niche” type investments include:
 1. A Technology ETF (3Q10) – We did initiate a “niche” position into a Technology ETF in the quarter as we have witnessed on average positive earnings announcements from this sector.
 2. Treasury Inflation Protected Securities (TIPS) – Our expectations continue to be that inflation will start to rise at some point in the upcoming years.
 3. A “clean technology” ETF – Over the next several years, we believe the government will continue to provide incentives for “green” businesses. Additionally, we believe we are in the early stages of a fundamental shift in consumer preferences to be more eco-friendly.
 4. A position in an Oil ETF – We are maintaining our position in an Oil ETF as we believe the economy will continue to recover thus, putting pressure on oil prices to slowly advance upwards.
 5. High Yield Bond ETF – We believe the economy will continue to grow, therefore high-yield bonds may prosper during the upcoming months.
 6. Health Care ETF – With the passing of the healthcare legislation in the first quarter and the potential increase of millions of citizens obtaining health care coverage, we believe that the demand for drugs and other health care related products will increase.

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The Basics to Understanding Exchange-Traded Funds (ETFs)

Yanni & Associates recommends utilizing a diversified portfolio through a combination of ETFs, no-load mutual funds, high-grade corporate bonds, and tradable FDIC insured CDs as its primary choice of investment vehicles. As an additional excerpt for the third quarter, we are including this write-up on exchange-traded funds.

Most ETFs are passively invested vehicles that simply track specific investment benchmarks. Most ETFs do not attempt to outperform their benchmarks, thereby reducing the risk of variation of return relative to that index. While mutual funds still remain an integral part of our investment process, we want to take an opportunity to explain why in many instances we prefer to utilize passive ETFs versus mutual funds:

1. **Cost** - ETFs are generally the least expensive vehicles that can be used to obtain stock & bond market exposure. For example, Standard & Poor's S&P 500 ETF has an expense ratio of 0.1% while on average most actively managed mutual funds have expense ratios in excess of 1%. As a result, most actively managed mutual funds are forced to take on additional risk just to perform in-line with their benchmark. On average, most actively managed mutual fund managers have not been able to outperform their respective benchmarks in the long-run. Our Firm attempts to find actively managed funds that ideally will outperform their benchmarks over time. We examine many aspects to these funds including proven track records, tenured investment professionals, reasonable underlying expenses, amongst other things and use these particular funds in conjunction with ETFs.
2. **Liquidity** - ETFs trade intra-day like stocks; mutual funds trade at the end of day's closing price. We will note that if Yanni & Associates trades a position in an ETF, a large block trade (maybe \$500k or more) is executed and appropriate shares are then allocated to clients at the same price to ensure equality. We will also note that during periods of high volatility ETF's bid-ask spreads tend to widen. However, we still believe it's better to have intra-day liquidity than have to wait until the end of the day to execute the trade. Additionally, many mutual funds now have a "short-term trading fee" associated with them. For example, if a purchase then a sale is executed within a certain time frame (often 60 days, but can be up to a year) an additional "exit-fee" may be levied. We would consider the requirement to hold any investment vehicle for up to a year without being penalized as excessive.
3. **Transparency** – ETFs offer daily transparency into their holdings; mutual funds only have to report their holdings once a quarter. With passively invested ETFs, you do not have to worry about a mutual fund manager holding considerable excess cash during a rising market. The SEC has mentioned that they will particularly be examining "window-dressing" in the future. This is a term in the industry whereby mutual fund managers place trades at the end of the quarter selling stocks with big losses. This is done so that these managers need not show investors current holdings at a significant loss.
4. **Taxes** – In general, ETFs have traditionally had lower year-end "pass-through" capital gains as compared to mutual funds. On that note, many investors also do not realize that short-term pass-through capital gains cannot be offset with other realized losses. We certainly monitor upcoming pass-through gains on ETFs and mutual funds for all of our clients and make adjustments as necessary.
5. **Niche Investment Opportunities** – ETFs allow the opportunity to invest in many niche areas where mutual funds do not have exposure. For example, investors can now gain much more direct exposure to areas such as gold, oil, currencies, etc... through ETFs where this type of exposure was not able to be obtained through mutual funds.

Certainly, Yanni & Associates does not have that "crystal ball" whereby we will know all the upcoming movements in the markets. Our fee structure (being a percentage of assets) is such that we do not sell product such as annuities, life insurance, one particular fund family, etc... and collect "hidden commission" (loads, 12b-1 fees, embedded annuity or life insurance fees, etc...). Our investment style, however, is to attempt to invest in the best investment vehicle (ETF, mutual fund, corporate bond, CD, etc...) at the least expensive price. There is no hidden incentive to do otherwise. We are a Fiduciary on all of our clients' accounts!