LYKE Financial Inc.

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Investing Insight

Market Highlights

During the third quarter of 2012 investors rode a rising tide as equities mounted a comeback from a disappointing second quarter. Almost all investment categories advance during the quarter and surprised those expecting a repeat of the painful summer of 2011. The average US diversified stock fund gained 5.3% during the quarter while the Dow was up 5.0%. International stocks also enjoyed a strong quarter with their index (MSCI EAFE) advancing 6.14%.

Despite the respectable returns of US stocks year to date and for the past three years, investors continue to pull money out of stocks and invest heavily in bonds. August marked the 16 consecutive month in which investors pulled more cash out of stock funds than they added. This is unfortunate for the average investor when our DFA portfolios are hitting their year end return goals in the third quarter. The third quarter returns are upwards of 12%, 10%, 6% and 3%.

Investors' demand for bonds continued to push yields down and prices up for most bonds. Barclays US Aggregate Bond Index advanced 1.59% during the quarter continuing an impressive ride for bond investors. The current yield on a 10-year US Treasury stands at 1.63%.

Based upon the fresh round of bond buying announced by the Federal Reserve on September 13, it appears that the Fed is committed to injecting unlimited stimulus and maintaining near zero interest rates as long as they deem necessary to get the economy moving.

Fixed income savers continue to see a near zero interest rate environment. It's hard to justify leaving any substantial savings in the bank. Even with a low average inflation rate of 2.2% for the past three years, savers are falling behind before even considering the income tax on their paltry interest earnings.

The following chart compares the current interest rates offered by several local banks:

Term	Key Bank	First Merit	Third Federal
6 Months	0.20%	0.10%	0.35%
12 Months	0.20%	0.20%	0.40%
24 Months	0.45%	0.30%	0.60%
36 Months	0.65%	0.45%	0.90%
60 Months	0.90%	1.10%	1.50%
High Yield Savings	0.15%	0.55%	0.40%

A retired CD investor with $100,000 could earn up to $900 per year or $75 per month in a three year CD account. A $1,000,000 account would provide $750 per month of income. Savers and retirees are being forced to look for other prudent investment alternatives. Fortunately, you have been invested in a diversified portfolio that has provided a means of staying ahead of inflation and prudently managing risk.

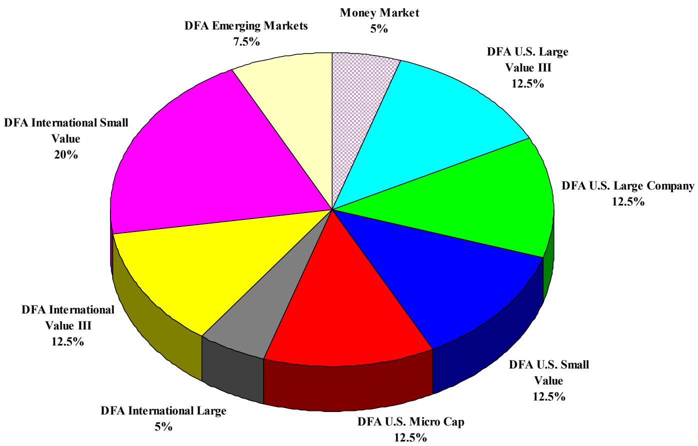
Inside this issue:

"If I hire you, son, you aren't going to move back home, are you?"

Portfolio Returns:
January 1, 2012—September 30, 2012*

AGGRESSIVE GROWTH

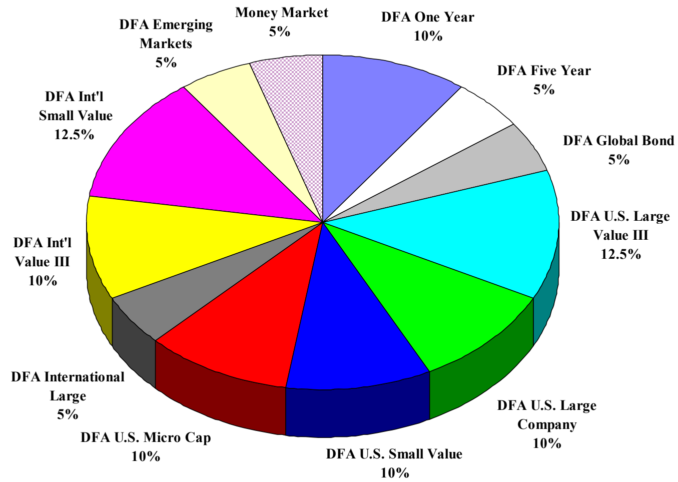
95% Equities/5% Fixed



Rate of Return 12.18%

LONG TERM GROWTH

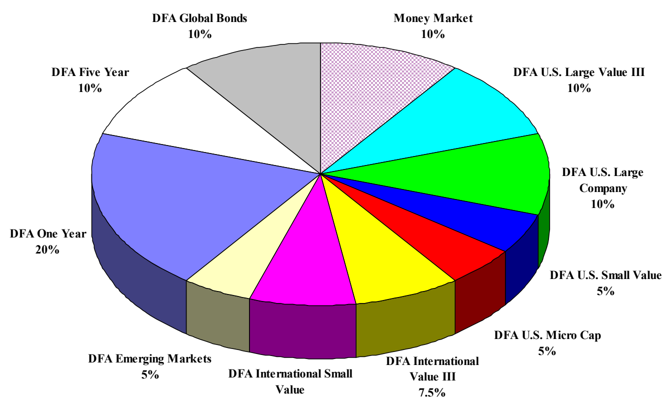
75% Equities/25% Fixed



Rate of Return 10.61%

BALANCED GROWTH

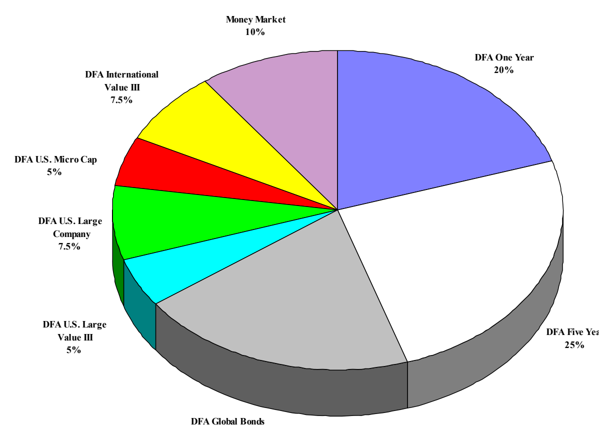
50% Equities/50% Fixed



Rate of Return 6.56%

INCOME & GROWTH

25% Equities/75% Fixed



Rate of Return 3.11%

**Individual returns may vary slightly based upon assets, size and fees charged.*

Another Wall of Worry

Stock prices rallied sharply around the world in the third quarter, with forty-two out of forty-five countries tracked by MSCI showing positive returns in US dollar terms. Total return exceeded 10% in nineteen different markets, while Ireland, Japan, and Morocco registered minor losses.

For the twelve-month period ending September 30, 2012, forty markets had positive returns, with six countries—including the US—delivering a total return in excess of 30%, according to MSCI.

Investors have been confronted with a steady drumbeat of discouraging news over the past year—a feeble economic recovery here and abroad, staggering budget deficits with no solution in sight, the prospect of a Euro zone breakup, an acrimonious presidential election campaign, banking scandals, and a punishing drought across the US. Considering all the uncertainty, it's not difficult to explain why mutual fund investors have generally favored fixed income strategies rather than equities over this past twelve-month period.

Many investors are easily persuaded that successful investing requires constant attention to current events and frequent adjustment of their equity exposure. The news excerpts below represent just a small sample of the issues investors might have dwelled on. We suspect that many investors not only failed to achieve their respective market rate of return over the past twelve months but would be surprised to learn how well stock prices have done in many markets over that period.

- "Unless politicians act more boldly, the world economy will keep heading toward a black hole….At a time of enormous problems, the politicians seem Lilliputian. That's the real reason to be afraid." *"The World Economy: Be Afraid," Economist, October 1, 2011.*

- "The Dow Jones Industrial Average turned in its worst Thanksgiving-week performance since markets began to observe the holiday in 1942." *Steven Russolillo. "Investors Go Shopping—Just Not for Stocks," Wall Street Journal, November 26, 2011.*

- "The managing director of the International Monetary Fund has raised fears that the world faces the risk of economic retraction, rising protectionism, isolation, and….what happened in the '30s (Depression)." *Hugh Carnegy and George Park. "IMF Chief Warns over 1930s-Style Threats," Financial Times, December 16, 2011.*

- "It is hard to avoid the conclusion that stock prices are levitating at over-inflation values, thanks to the herd-like behavior and collective fear of investment institutions." *Financial Times, December 30, 2011.*

- "This may be the unhappiest bull market ever. We love to hate it, but that may be just egging it on." Tom Petruno. "The Unhappiest Bull Market Every," Los Angeles Times, February 12, 2012.

- "US companies are more uncertain about the future than at any point since the financial crisis, with just one in five of the biggest corporations making any predictions as they published quarterly results." *Ajay Makan. "Doubt Haunts US Company Results," Financial Times, February 21, 2012.*

- "It remains clear that this almost uninterrupted equity market lacks substance and conviction. The rally's volume has been very weak, and institutional operators have been absent from the market. There has been very little participation from the retail investor, based on data from Lipper, a provider of information and ratings on mutual funds. Corporate insiders have been big sellers of stock, exceeding $6 billion last month (with the ratio of selling to buying hitting the astronomical 13-to-1 mark)." *David Rosenberg, chief economist and strategist, Gluskin Sheff. "The World Is Not Fixed and This Equity Rally Lacks Conviction," Financial* Times, March 15, 2012 .

- "We think that most of the US market is just not worth investing in…..And it's our belief that profitability will have to come down and the market isn't priced for it."

Meeting Expectations

All DFA portfolios are designed to deliver "market rates of return." DFA is not trying to "beat" the market by employing crystal ball type strategies, only working to achieve market returns, historically outpacing 90% of the active managers who attempt to beat the market.

To evaluate your portfolio, it is helpful to look at the various DFA funds and **compare them** to the specific markets in which they are invested:

	09/30/12 Return*
DFA U.S. Large Co.	**16.28%**
S&P 500 Index	16.44%
DFA U.S. Large Value	**18.03%**
S&P 500 Value	15.78%
DFA U.S. Micro Cap	**15.21%**
Russell 2000	14.23%
DFA U.S. Small Value	**16.18%**
Russell 2000 Value	14.37%
DFA Emerging Markets	**11.80%**
MSCI Emerging Market Idx	9.41%
DFA Int'l Large Company	**10.21%**
MSCI EAFE Large Co Idx	6.95%
DFA Int'l Large Value	**8.27%**
MSCI EAFE Value	9.59%
DFA Int'l Small Value	**12.46%**
MSCI EAFE Sm Cap Index	10.59%
DFA One Yr. Gov't Bond	**0.84%**
BarCap 1-3 Yr. Gov't	0.44%
DFA Short-Term Gov't Bond	**1.48%**
BarCap 1-5 Yr. Gov't	0.91%
DFA 5 Yr. Global Bond	**4.36%**
Citi World Bond Index	3.41%

**Morningstar 9/30/12*

Quotation attributed to Ben Inker, head of asset-allocation group, Grantham, Mayo; Van Otterloo. Jonathan Cheng. "Two Pros Weigh In on US Stocks," Wall Street Journal, April 2, 2012.

- "It's simple arithmetic and it leads to a simple yet alarming conclusion that unless current law is amended before year-end, the stock market has to fall by at least 30%." *Donald J. Luskin. "The 2013 Fiscal Cliff Could Crush Stocks," Wall Street Journal, May 4, 2012.*

- "Stocks have not been so far out of favor for half a century. Many declare the 'cult of the equity' dead." *John Authers and Kate Burgess. "Out of Stock," Financial Times, May 24, 2012.*

- "Dr. Doom', Nouriel Roubini, says the 'perfect storm' scenario he forecast for the global economy earlier this year is unfolding right now as growth slows in the US, Europe as well as China." Ansuya Harjani. "Roubini: My 'Perfect Storm' Is Unfolding Now," CNBC, July 9, 2012.

- "Bill Gross, co-founder and co-chief investment officer of Pacific Investment Management Co., says stock investors should rethink the age-old investing mantra of buying and holding stocks for the long run...Stocks, he says, operate much like a Ponzi scheme, showing returns that have no real bearing on reality. *Steven Russolillo and Kirsten Grind. "Bill Gross: Stocks are Dead and Operate Like a Ponzi Scheme." Wall Street Journal, August 1, 2012.*

By Weston Wellington, Vice President, Dimensional Fund Advisors, Inc.

All expressions of opinion are subject to change without notice in reaction to shifting market conditions. This article is provided for informational purposes, and it is not to be construed as an offer, solicitation, recommendation or endorsement of any particular security, products or services.

Year End Planning

There are a number of potential changes that should be considered as you think about year end financial planning. One of the big items that could impact families with significant assets is a reduction in the amount of assets that can be passed onto heirs without incurring an estate tax. In 2012 you can pass $5,120,000 and any excess assets are taxed at 35%. In 2013, the amount drops to $1,000,000 and the tax rate on the excess goes up to 55%. Some of our clients are making gifts and implementing other plans before the end of the year.

Various income tax changes should also be considered. The Bush tax cuts are scheduled to expire at year end and there will be substantial increases on tax rates for nearly all tax brackets for ordinary income, long term capital gains and dividends. The following chart summarizes current and future tax rates.

There are other tax increases that will take place in 2013:

- For the last few years, the employee portion of the FICA tax was discounted by 2% down to 4.2%. In 2013, it goes back up to 6.2% resulting in an extra $1,000 of tax for someone earning $50,000 per year. For employees earning over the annual wage base, the increase will be about $2,200.
- The Child Care Credit drops from $1,000 to $500.
- The "marriage penalty" returns.
- The AMT "patch" expires leaving more taxpayers subject to the alternative minimum tax.
- Medical expenses will have to exceed 10% instead of 7.5% of income to be used as an itemized deduction.
- A new 3.8% surtax will apply to investment income or modified adjusted income over a certain threshold. (Approximately $250,000)

These outlined changes are not meant to be all inclusive and should be reviewed with your accountant. We are simply trying to point out that it is more important to be proactive in your year end planning than it has been in recent years. It's possible that Congress will act after the election to make some changes to the above.

Barring something unusual in the fourth quarter, the portfolios should have nice dividends and long term capital gains added in December.

If you would like a current estimate for year end tax planning, we can fax or email you the report. We also can get together to review in person. Please contact us to schedule a meeting.

	2012			**2013**		
Income	**Income Tax Rate**	**LTCG Rate**	**Div Rate**	**Income Tax Rate**	**LTCG Rate**	**Div Rate**
Up to $17,400	10%	0%	0%	15%	10%	15%
17,401-70,700	15%	0%	0%	15%	10%	15%
70,701-142,700	25%	15%	15%	28%	20%	28%
142,701-217,450	28%	15%	15%	31%	20%	31%
217,451-388,350	33%	15%	15%	36%	20%	36%
388,351 & up	35%	15%	15%	39.6%	20%	39.6%

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