Upcoming Events

SAVE THE DATE!

Please Help Us Celebrate Our Twentieth Anniversary!

October 11, 2012
4:00 – 8:00 pm

General Market Results

	2nd Quarter	YTD	One Year	Three Year	Five Year
CPI	0.18%	1.84%	1.81%	2.14%	1.98%
Barclays Agg Bond	2.06%	2.37%	7.47%	6.93%	6.79%
S&P 500	-2.90%	9.31%	5.28%	16.34%	0.19%
DJI	-1.85%	6.83%	6.63%	18.25%	2.00%
S&P 400	-4.93%	7.90%	-2.33%	19.36%	2.55%
Russell 2000	-3.47%	8.53%	-2.08%	17.80%	0.54%
NASDAQ	-5.06%	12.66%	5.82%	16.95%	2.43%
MSCI EAFE	-6.85%	3.38%	-13.38%	6.45%	-5.63%
MSCI EM	-8.78%	4.12%	-15.67%	10.10%	0.21%

Lucien, Stirling & Gray Advisory Group, Inc. is a Registered Investment Advisory firm providing fee-only asset management, fiduciary-level advice and financial planning services to individuals, corporations, trusts and foundations.

For more information about our firm, please visit our website at www.lsggroup.com • Model holdings may change due to ongoing management • Sector and style breakdown is constructed with the best available information and therefore is only as accurate as the available information • Past performance is no guarantee of future results • It is impossible to invest directly in indices • Percentages may not equal 100 due to rounding

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SECOND QUARTER REPORT 2012

July 2012

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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

What does it mean to "invest?"

In an article published on June 25th on cnbc.com titled: "Is The Buy and Hold Strategy Officially Dead?" author John Mellory quotes a statistic from an investment analyst - one that surely sums up the speculative myopia behind what passes for "investing" in 2012. *"The average holding period for the S&P 500 SPDR (SPY), the ETF which tracks the benchmark for U.S. stocks, is less than five days."* Please pause for a moment, read this quote again, and think about what it reveals about the mindset of participants in today's financial markets. Then contemplate the following:

The S&P 500 index tracks the aggregate value of the 500 largest publicly traded businesses in the United States – a social, political, and economic marvel that is still, despite our many faults, the freest, most innovative and dynamic economy the world has ever known. These great American companies are now iconic global brands; highly successful multi-national organizations comprised of legions of smart and dedicated people working together, who have proven their ability – decade after decade - to navigate tough times as well as easy, and to provide valuable and constantly evolving products and services to billions of people all over the globe.

Because of their unique capacity to marshal massive amounts of financial and human capital in pursuit of innovation and growth, these dynamic businesses have come to provide the planet with the food, services, energy, technology, health care, clothing, shelter, and other important resources that support modern life as we know it. And despite the lingering economic malaise so widely reported in the press, they managed to achieve their most profitable year *ever* in 2011. Capitalism and entrepreneurship – the inimitable human desire to be, to do, and to create - works.

"I shake my head in wonder that one could own just one business for less than five days (let alone all five hundred of the largest ones in the U.S.) and still have the temerity to call it an "investment."

As an investor in many of these great businesses myself, and as a shareholder and leader of this particular business for two decades now, I shake my head in wonder that one could own just *one* business for less than five days (let alone all five hundred of the largest ones in the U.S.) and still have the temerity to call it an "investment." But so it is… as the refrain from the popular country song says: "God is great, beer is good, and *people are crazy…"*

Lucien, Stirling & Gray celebrates its twentieth anniversary this year. When we started in 1992 there were just four of us, and it's astounding to recall all that we lacked. We had no voice mail, no copier, no computer network, and no fax machine. (Email, desktop scanners, Adobe Acrobat, smart phones, and cloud computing were hardly even *ideas* yet.) We relied on the bike shop down the street for smudged copies and expensive faxes that came out like the Dead Sea Scrolls, and every weekend I brought my vacuum cleaner and a can of Lysol from home because we couldn't afford a cleaning service. Who would invest in such a venture?

What we ***did*** have was a belief that with discipline, patience, and faith in ourselves and the future we could create a profitable and sustainable business culture that would benefit clients and associates alike by providing objective, independent financial advice in a high-trust, professional environment. We had a clear conviction that if we would concentrate all of our efforts on serving our client's best interest – all the time – we would prosper and grow in the long run, and our clients would prosper with us.

Today the Lucien, Stirling & Gray group of companies serves hundreds of families and businesses, and oversees more than $120 million dollars of invested assets. In addition to two original founders, we now have five Senior Advisor Associates who average 15 years tenure with the firm, and another five professional support staff who average 6 years tenure. For three years running we have been voted among the top ten "Best Places to Work in Central Texas" and for the last four years our clients consistently report levels of overall satisfaction that place our advisors among the top 4% in central Texas. Despite formidable headwinds, our firm has grown stronger and our capacity to serve clients has improved year after year. I chuckle inside now when people remark how "lucky" we are to own a business. They have no idea of the adversity we've faced down in this "buy and hold" investment.

Investing for the long run is never easy. It's especially hard when others all around have no confidence and the "conventional wisdom" suggests that only fools would engage in such a venture. But history and our own experience say that's exactly when opportunities are the most attractive, and exactly the point at which true investors cement their long-term success.

Be patient, keep your eye on the far horizon, and most of all have faith that long-term ownership of innovative companies is still the road to lasting wealth. Nobody ever got rich by betting against the ability of U.S. business to succeed in the long run, and I'm quite certain they won't do so this time.Thank you for <u>your</u> confidence and trust.

Thomas G. Twombly

President

INVESTMENT COMMENTARY

In spite of a volatile second quarter that saw a continuation of the bi-polar "risk on – risk off" pattern of short-term trading behavior that has characterized most of the globe's financial markets for the last twelve months, the first half of 2012 provided our clients with respectable investment results.

After two previous quarters of double-digit returns from domestic equity markets, we'd cautioned in our last report to be prepared for a corrective phase in the recent period – and markets did not disappoint.

Stocks dropped sharply across the globe in the first two months of the recent quarter. Anxiety about the slow-motion train wreck in the Euro-zone flared back up, and concerns about a slowing economy in China sent commodity prices worldwide on a steep decline. Emerging markets equities also experienced a sharp contraction.

Domestically, the S&P 500, the NASDAQ, and the small-cap Russell 2000 fell by 9.9%, 12%, and 12.3% respectively between April 1st and the beginning of June. Major European markets saw similar behavior, with the German DAX falling 15.5% during the same time frame, and the London FTSE dropping by 10.5%. Markets elsewhere experienced similar patterns as the unusual level of correlation that has characterized global financial markets for the last several years persisted.

In several models we used those declines as opportunities to add selectively to equity holdings from cash and debt positions, making some modest allocation changes on May 30th.

The month of June brought a sharp reversal of those trends as perceptions shifted towards the possibility of political solutions emerging in Europe. Equity markets around the globe responded in short order, providing unusually strong results for a month that is typically characterized by more tepid behavior. The S&P 500 rebounded from its lows to finish the quarter down by only 2.8%, providing a total return for the year so far of 9.5%. The NASDAQ regained more than half its decline to finish the quarter down by 5%, providing a first-half total return of 12.66%. And the Russell 2000 erased most of its previous decline to finish the quarter down by 3.47%, and up for the year to date by 8.53%.

Major European markets, as well as those in the Far East, experienced very similar patterns. Germany regained more than half its earlier decline in the final month of the quarter to finish the first half of 2012 up by almost 10%, and the FTSE finished the second quarter down slightly, but up by 1.2% for the year so far.

Bonds and REITs were the asset classes that performed best during the recent period, and our portfolios benefitted from allocations to those areas. REITs experienced total returns of 4% for the quarter, bringing first-half results to 14.9%. The Barclay's Aggregate Bond Index rose by 2.1% for the quarter, aided particularly by strong flows into TIPS and Treasury's in response to on-going uncertainty. Notably, that represents the vast majority of the gain for that index for the year so far, which finished the first half up by 2.4%.

While short-term volatility and catastrophist headlines will surely continue – especially as we get closer and closer to the November election – we'd like to reiterate the importance of keeping a long-term view and keen awareness of both the opportunities and the risks present in today's financial markets. Since the beginning of 2007 the flows into bond mutual funds and ETFs have exceeded those into equity funds and ETFs by a factor of five. During this time, rates on U.S. Treasuries have fallen from 4.7% to 1.7%. The price of "safety" has gotten very dear in the process.

For five and a half years now we have experienced net liquidations from domestic equity funds. During this time the ratio between the dividend yield of the S&P 500 and the 10 year Treasury has risen from .38 to 1.24, and the earnings yield on the S&P 500 now exceeds the 10 year treasury yield by a factor of 4.75. The ownership of great companies is looking increasingly "conservative" to us.

There will always be risk involved in investing in equities, but at these levels we believe the uncompensated risk has been well and truly squeezed out. We may have several more years of uncertainty ahead of us, but we believe those who have the patience, and the discipline to remain properly diversified will eventually be very well-rewarded for their perseverance. Please call if you'd like to discuss.

CONSERVATIVE GROWTH MODEL

2nd Quarter	YTD	1 Year	3 Year	5 Year
-3.43%	1.75%	-5.00%	6.56%	-0.04%

Inception Date 06/03/1999

Core Growth Model

2nd Quarter	YTD	1 Year	3 Year	5 Year
-4.62%	4.33%	-5.29%	8.18%	0.07%

Inception Date 05/31/2003

Growth Model

2nd Quarter	YTD	1 Year	3 Year	5 Year
-6.55%	4.32%	-8.65%	7.37%	-0.55%

Inception Date 10/16/1992

<u>Specialty Model</u>

Diversified Growth Model

2nd Quarter	YTD	1 Year	3 Year	5 Year
-4.48%	5.16%	-3.96%	11.01%	-1.18%

Inception Date 10/31/00

<u>Education Models</u>

UT ORP

2nd Quarter	YTD	1 Year	3 Year	5 Year
-4.45%	5.92%	-4.76%	7.37%	-1.33%

Inception 08/10/1999

Retirement Growth

2nd Quarter	YTD	1 Year	3 Year	5 Year
-4.48%	5.55%	-4.54%	10.25%	-1.45%

Inception Date 06/03/1999

Growth & Capital Preservation

2nd Quarter	YTD	1 Year	3 Year	5 Year
-3.56%	3.77%	-3.36%	7.79%	0.74%

Inception Date 11/30/2001