Upcoming Events

Lucien, Stirling & Gray invites you to attend our

20th Annual Holiday Party and Open House

December 8th, 2011

3:30 – 7:00 PM

RSVP: 512-458-2517 or info@lsggroup.com

General Market Results

	3rd Quarter	YTD	One Year	Three Year	Five Year
CPI	0.36%	3.36%	3.71%	1.17%	2.23%
DJI	-11.49%	-3.90%	3.83%	3.15%	1.37%
Nasdaq	-12.91%	-8.95%	1.97%	4.91%	1.35%
S&P 500	-13.86%	-8.67%	1.15%	1.23%	-1.18%
Russell 2000	-21.87%	-17.02%	-3.53%	-0.37%	-1.02%
MSCI World ex US	-18.95%	-14.62%	-8.94%	-0.66%	-3.00%
Barclays Captl Agg Bd	3.82%	6.65%	5.26%	7.97%	6.53%

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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THIRD QUARTER REPORT 2011

October 2011

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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

"Short-term, the market is a voting machine, long-term it's a weighing machine"

I am drawn to quotes. I write them down, I remember them, and I recite them to others. I can spend hours studying books of quotations, searching for messages that condense volumes of data into one pithy, concise thought – a few well-chosen words that help to distill a small drop of wisdom from the gaseous cloud of "information" that surrounds us.

The above quote from Benjamin Graham - noted economist, author, professor at Columbia Business School, and early mentor to Warren Buffet and other famously successful investors - seems particularly appropriate in the current climate. Not only are we in the midst of an extremely contentious political environment here in the United States, where the daily polls (votes) are every bit as volatile and unpredictable as the daily moves in financial markets, but career politicians all over the globe seem to be exercising an inordinate amount of influence on our day-to-day sense of stability and continuity.

Short-term thinking and behavior abounds. Billions of dollars rocket back and forth, controlled not by measured, methodical long-term investors in great businesses, but by high-speed computer programs designed to squeeze fractions of a point from stock and bond transactions in a quest for a quick edge. Exchange traded funds (ETFs) - huge baskets of stocks, bonds, and commodities – are now bought and sold on a minute-to-minute basis, adding to the volatility, and drawing consumers and some advisors alike into the mistaken belief that in order to be successful one must become ever more frenetic, plugged-in, and hair-triggered in response to the daily news flow.

Our answer is simple: refuse to play this game – because it's not investing, it's speculating.

Leveraged ETFs – funds that utilize derivatives to magnify these short-term movements – both up and down – by as much as two and three times the value of their underlying assets are available not only to professional money managers, but to any trade-hungry baby with a smart—phone app who sets up an account with an on-line brokerage firm. The advertisements for these services reinforce the notion that this is what "investing" is all about, and the "financial news" channels are dominated by traders and "Mad Money" proponents.

Is it any wonder that a growing number of people feel the game is rigged? Is it surprising that large numbers of former investors have thrown up their hands in despair and just quit altogether? How can one possibly compete in this kind of environment?

Our answer is simple: refuse to play this game – because it's not investing, it's speculating. Step back, reassess what it means to actually invest, and then utilize tools that make the most sense in that context. Find experienced professionals whose philosophy and approach you understand, who use methodical processes to identify good long-term values, and who have historically exercised the patience and discipline to allow those processes to work – in spite of short term volatility.

Train yourself to slow down, and to recognize that that very same volatility is ultimately your friend - if you treat it that way. The massive swings that result from the frenetic, knee-jerk behavior of others can often present the calm-minded and patient with significant opportunities. It's not easy, but it is simple.

We cannot afford to quit investing. Tempting as it might be, we cannot simply throw up our hands and walk away. We live in a world where the responsibility for our long-term security is increasingly being placed on our own shoulders, and where institutional and government-sponsored benefit programs are under withering pressure.

What we can do is to define investing in a healthy way, and behave appropriately. Like planting a young oak tree that eventually will provide shade and a sense of strength and enduring calm, we must resist the temptation to pull up our sapling every few weeks to see if its roots have grown, or to replant it in another part of the yard. Instead, we must water and fertilize it occasionally, have faith that nature will take its course, and allow it time to grow.

In the long run, enduring investment values have always been a reflection of the careful deployment of capital by great companies – on new products, entrepreneurship, services, and innovation. We are confident that this is still as true today as it ever was, and that the indomitable human spirit to be, to do, and to create is still very much alive. In the near-term interim, to throw in a final quote from Warren Buffet: "the market is a very efficient mechanism for transferring capital from the impatient to the patient."

Be patient, and keep investing with an eye towards 2021, 2031, or 2041 – not the next 12 months.

Thank you for your confidence and trust.

Thomas G. Twombly
President

INVESTMENT COMMENTARY

For the third quarter, domestic and overseas equity markets ended markedly lower as global macroeconomic issues caused dramatic volatility. Sovereign debt worries in Europe, slowing economic growth in China and the U.S., and worrisome political intransigence in the United States and abroad caused a sudden reassessment of risk appetites, especially after Standard & Poor's lowered their rating on U.S. Government bonds early in August in response to a contentious debt-ceiling debate in Washington.

Domestically, the S&P 500 index fell by 14% during the period, and the small company Russell 2000 index dropped by 22%. More defensive areas such as healthcare, consumer staples, utilities, and telecommunications performed relatively better during the period as investors sought the perceived safety of dividends and withdrew from the more economically sensitive areas of the economy.

Energy, industrial materials, and precious metals stocks moved sharply lower during the period on worries that Chinese and emerging markets economies were slowing, and concerns that the robust demand for natural resources from those economies might wane. Bank and financial service stocks also fell sharply under concerns about Eurozone debt, and the potential exposure of U.S. banks to those troublesome areas.

International markets fell more sharply than the U.S., with particular weakness among major European markets. The MSCI EAFE Index declined by 19%, affected particularly by the equity markets of France and Germany, which fell by 30% and 31% respectively. Japanese markets declined by 6%, while Hong Kong and Australian markets fell by 20% each.

In spite of the downgrade by Standard & Poor's, U.S. Treasury Bonds enjoyed a very strong quarter as rates declined in response to substantial new inflows of assets from unnerved investors. Yields on the 10 year Treasury bond fell from 2.57% on August 5th – the day S&P downgraded U.S. debt – to 1.92% at the end of the quarter, bringing yields in the interim within 3 basis points (3 100ths of a percent) of their all-time lows on September 22nd. Investment grade corporate bonds also did quite well, while lower-quality, higher-yielding

corporate bonds fell sharply and yield spreads widened considerably. Municipal bonds also posted very solid returns for the period, and finished the quarter among the top performing asset classes on a year-to-date basis.

Volatility during the months of August and September was particularly gut-wrenching, with 27 of the 44 trading days experiencing changes of at least 1% (up or down) in the S&P 500, according to information from BTN Research. This represented 61% of the trading days for that two month period. Compared with all of 2010, when 75 of 252 trading days (30%) experienced 1% changes, the change was dramatic and equity investor's confidence has been shaken.

According to data supplied by Bloomberg in an article published on September 19th, more money was pulled out of U.S. Equity funds in the five months since the end of April 2011 than was pulled out during the five months after the collapse of Lehman Brothers from October 2008 through February 2009. Notably, early 2009 represented one of the best buying opportunities for equity investors in memory, and compared to that period, the balance sheets and earnings power of U.S. corporations are far superior today.

Further, with interest rates having fallen so far, the dividend yield of the S&P 500 exceeded that of the 10 year Treasury near quarter's end – a situation that has occurred only 20 times since 1953, and which has been followed in every past instance by a rise in stock prices by an average of 20% in the following 12 months, according to Standard & Poor's.

During the quarter we made few changes to equity allocations in our portfolios, preferring to allow the underlying managers to adjust holdings as they saw fit during this highly volatile period. While the downdraft has been painful across the board, we remain confident in the long run that those assets are being shepherded with due care, and that the companies held within those positions represent attractive values. Towards the end of the quarter we did take advantage of a sharp rise in U.S. Treasuries to pare back on holdings in these assets and to add correspondingly to somewhat higher-yielding corporate bond positions.

If you have questions, or would like to discuss your personal situation we encourage you to call and we'd be happy to schedule a meeting.

Conservative Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
-9.99%	-7.49%	-2.76%	1.55%	1.50%

Inception Date 06/03/1999

Core Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
-15.96%	-14.50%	-7.49%	1.41%	0.17%

Inception Date 05/31/2003

Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
-17.54%	-16.39%	-8.85%	1.42%	1.15%

Inception Date 10/16/1992

Specialty Model

Diversified Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
-17.39%	-13.29%	-5.75%	0.29%	-1.02%

Inception Date 10/31/00

Education Models

UT ORP

3rd Quarter	YTD	1 Year	3 Year	5 Year
-16.95%	-13.73%	-7.57%	-1.69%	-1.12%

Inception 08/10/1999

Retirement Growth

3rd Quarter	YTD	1 Year	3 Year	5 Year
-16.64%	-13.84%	-5.41%	0.34%	-0.59%

Inception Date 06/03/1999

Growth & Capital Preservation

3rd Quarter	YTD	1 Year	3 Year	5 Year
-10.63%	-7.90%	-2.85%	2.65%	1.87%

Inception Date 11/30/2001