Upcoming Events

Lucien, Stirling & Gray invites you to attend our

21st Annual Holiday Party
And Open House
December 13, 2012
3:30 – 7:00 PM

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

General Market Results

	3rd Quarter	YTD	One Year	Three Year	Five Year
CPI	0.39%	2.09%	1.54%	2.18%	2.02%
Barclays Agg Bond	1.59%	3.99%	5.16%	6.19%	6.53%
S&P 500	6.35%	16.43%	30.18%	13.20%	1.05%
DJI	5.02%	12.19%	26.52%	14.45%	2.16%
S&P 400	5.44%	13.77%	28.54%	14.33%	3.83%
Russell 2000	5.25%	14.23%	31.91%	12.99%	2.21%
NASDAQ	6.17%	19.62%	29.02%	13.66%	2.90%
MSCI EAFE	6.98%	10.59%	14.33%	2.59%	-4.77%
MSCI EM	7.89%	12.33%	17.33%	5.96%	-0.98%

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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Lucien, Stirling & Gray Advisory Group, Inc.

THIRD QUARTER REPORT 2012

October 2012

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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

We're pleased to provide you with our report for the period ending September 30, 2012.

At this writing in early October, highlighted by the final stretch of a long and contentious political campaign where a fair amount of discussion has been focused on whether or not anyone is better off now than four years ago, I find myself smiling in wry amusement at the recollection of my own state (financially, professionally, and emotionally) at the writing of this report exactly four years past.

Markets around the globe were in free fall then. Lehman Brothers had collapsed, the global banking system was teetering, and during this same week in 2008 Treasury Secretary Hank Paulson called an emergency meeting with the heads of nine major U.S. banks to tell (not ask) their CEOs what number of billions of dollars of their institution's preferred shares would be acquired by the U.S. Government.

Major stock indices were well on their way towards an eventual bottom that would see more than 50% of their value erased from their 2007 high points (reached, coincidently, this week five years ago) and everywhere people were reacting in terror. Daily volatility was unprecedented in virtually all asset classes, with mind-numbing declines so widespread that even the most carefully diversified portfolios were being pounded mercilessly. Anything we attempted to write about facts, or the current state of financial markets, seemed entirely irrelevant and outdated within 24 hours, and even the most sanguine of us had to wonder if this time really *was* different. And that pain continued for five more months.

"We remain convinced that prudently diversified equity holdings still have tremendous upside potential over the long run, and that patient, disciplined investors in those asset classes will be well-rewarded."

For as long as I live, I will never forget that experience. Neither, I believe, will anyone else who lived through it. In spite of the recovery that has occurred since, it was a period that reshaped not just the economic landscape, but the entire psycho-social makeup of the investing populace. It impacted, rightly or wrongly, the beliefs and behavior of an entire generation. And therein lays an important message.

Human beings are social creatures. We find strength and protection in numbers. For millions of years we've evolved instinctively to follow the herd, and to pay careful heed to the consensus. As a consequence, it's difficult for individuals to hold an opinion that differs from the majority. It just doesn't *feel* safe, or smart. Unfortunately, when it comes to investing, following that ingrained herd mentality, and heeding those feelings, has proven time and again to be neither safe nor smart in the long run.

In calendar year 1999, after the conclusion of one of the very best ten-year periods in U.S. equity market history, flows into stock funds reached never before seen heights as the populace piled relentlessly into a late stage bull market that had averaged more than 19% annual returns for the previous ten years. The euphoria was palpable, as a flood of new assets drove P/E ratios on the S&P 500 to a dizzying peak of 27.4 at the end of the year. The ensuing decade, as we now know, proved to be one of the worst ever for equity investors as not one, but two major declines brought on the worst economy in eighty years.

Now, and for the last five years, the herd has been stampeding out of equities and into cash and bond holdings. Scared stiff about ever having to go through an experience like 2008 again, and heedless of the lowest yields since the end of World War II (and an equity P/E ratio that is now less than half of what it was in 1999) the populace has yanked a net $466 billion from domestic stock funds, while pouring more than $1 trillion into fixed income mutual funds and ETFs. Additionally, despite nominal interest rates of almost zero, and inflation adjusted rates well into the negative column, commercial bank deposits have grown to something like $9 trillion today, and cash as a percentage of total assets for S&P 500 companies is near an all-time high. With additional foreign exchange reserves in emerging economies approaching another $9 trillion, the assets held in low-yield or no-yield positions the world over is staggering. This too, in time, shall pass.

The recent initiation of QE3 here in the United States, the further expansion of the European Central Bank's balance sheet, and similar increases in asset purchasing programs by the Bank of Japan must surely lead to inflation in the long run. As that eventuates, and as the populace comes to realize (too late) that rising inflation brutally drives bond prices lower and eviscerates the purchasing power of cash, outsized holders of those asset classes will begin a great migration back to a more balanced and rational allocation strategy that will help protect against those inflationary pressures. The owners of the great businesses of the U.S. and the world will benefit from that migration.

While it will surely take some time, we remain convinced that prudently diversified equity holdings still have tremendous upside potential over the long run, and that patient, disciplined investors in those asset classes will be well-rewarded. We are not following the herd, and we are not looking back in fear. We are exercising the patience and discipline to look forward, and to prepare our clients for a future that will be very different from that of recent memory. Count on it.

Thomas G. Twombly

President

INVESTMENT COMMENTARY

The third quarter of 2012 provided a mixed bag for investors. On the positive side, equity indexes around the world continued the upswing that had begun in the latter part of the second quarter, while various longer-term bond indices provided positive, but less robust returns. International real estate holdings continued their strong run for the period, providing investors with some of the best overall results of any asset class for the year thus far. On the negative side, domestic real estate investments, which had provided strong results earlier in the year, softened somewhat during the period, as did shorter-dated fixed income positions.

The S&P 500 rose 6.35% for the quarter, bringing its year to date returns to 16.43%. The MSCI EAFE Index, which tracks international developed markets, rose 6.98% for the quarter, with year to date gain of 10.59%. The MSCI Emerging Markets index, which tracks developing markets throughout Asia, South America, and Europe, rose 7.89% for the quarter, bringing its total return for the year to 12.33%.

Of particular note during the quarter, news from Europe that German Chancellor Angela Merkel had prevailed in her quest to provide greater assistance to the European Union, and the European Central Bank taking steps to expand asset purchases in an effort to spur growth was greeted with enthusiasm by investors in the Euro zone. The decline of the dollar against many foreign currencies provided an additional boost to U.S. investors in international markets.

Also benefitting from the falling dollar, and reversing a downward trend established earlier in the year, various natural resource investments performed nicely. Countries like Canada and Australia, whose economies are heavily dependent on the production of those resources, experienced gains in excess of 10% in their respective equity indexes for the period, providing the vast majority of the gains they've seen for the year so far.

For our clients, patience and discipline proved their worth as asset classes that had been a drag on overall investment performance for much of the first half of the year began to reassert their importance in properly diversified portfolios.

In particular, natural resource holdings, emerging markets allocations, and global large cap equity positions showed noted strength. A declining dollar relative to other global currencies helped to augment results experienced in local currency terms, and many of these positions played key roles in the overall investment results experienced for the quarter.

Except for the most conservatively managed portfolios, where bond holdings are more heavily allocated to managers who focus on shorter-term securities, our fixed income managers performed very well during the quarter. While we continue to maintain bond holdings on the low side of our prescribed ranges due to concerns about extremely low rates and eventual rising inflationary pressures, we are gratified to note that these managers continue to add value in a challenging fixed income environment.

On a closing note, while there are still a number of challenging issues facing both the domestic and global economies, we believe that the underlying facts are notably better than what the headlines would have us believe.

Though the U.S. recovery has remained quite slow compared to other post-recessionary periods in recent memory, it continues to show resilience nevertheless. We have now experienced growth for eleven consecutive quarters, unemployment rates continue to decline, and the U.S. economy is now larger than it was at its peak before the recession. There is also a growing body of evidence to suggest that housing and automobile sales, which have been very notable weak spots in U.S. GDP for some time, are now starting to firm and turn upwards.

New household formation has been delayed substantially during the last five years, and the average age of light vehicles on the road is now at an all-time high of eleven years. If recent trends continue, and if the rates at which people replace old cars and buy new homes keep improving, we may see these important sectors start to contribute some surprising strength to the overall economy. Stay tuned.

As always, please call us if you would like to discuss.

Conservative Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
2.93%	4.73%	8.64%	4.85%	0.01%

Inception Date 06/03/1999

Core Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
4.27%	8.78%	17.50%	5.91%	0.27%

Inception Date 05/31/2003

Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
6.27%	10.87%	17.73%	5.79%	0.19%

Inception Date 10/16/1992

Specialty Model

Diversified Growth Model

3rd Quarter	YTD	1 Year	3 Year	5 Year
4.85%	10.26%	21.89%	8.35%	-0.36%

Inception Date 10/31/00

Education Models

UT ORP

3rd Quarter	YTD	1 Year	3 Year	5 Year
5.13%	11.36%	20.56%	5.56%	-0.75%

Inception Date 08/10/1999

Retirement Growth

3rd Quarter	YTD	1 Year	3 Year	5 Year
5.84%	11.72%	21.20%	7.50%	-0.61%

Inception Date 06/03/1999

Growth & Capital Preservation

3rd Quarter	YTD	One Year	Three Year	Five Year
4.62%	8.56%	13.13%	5.51%	1.36%

Inception Date 11/30/2001