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Letter from the President

The current market and economy are tough enough to understand for veteran financial professionals, let alone the average human being. One of the most trying aspects of wrapping one's arms around what is happening is cutting through all the jargon that permeates the industry. So, in an attempt to add clarity, I offer the following glossary of terms that you may find useful.

Head fake: An athletic reference wherein a player attempts to deceive an opponent by gesturing in one direction with his head, and running another. In market analysis it asks the question; Is this rally for real or is it a "head fake"? Right now, investors are basking in the fourth rally of the current bear market and this one has yielded the biggest gain for stocks since the markets began to tank in 2007. During the '00-'02 bear market, there were four head fakes before the real recovery.

Green shoots: A term used colloquially to indicate signs of economic recovery during an economic downturn. The first use of the term was by Norman Lamont, the then Chancellor of the Exchequer of the United Kingdom during the 1991 recession. Federal Reserve Chairman, Ben Bernanke, made use of the phrase in a March 15, 2009 interview with CBS'

60 Minutes. Since February and March, it has been used increasingly in the media and by a number of commentators to refer to positive economic data and encouraging statistics.

New Normal: Originally the title of an album released by the Australian progressive rock band, Cog, in 2005. In its current context, it is meant to suggest that a significant and structural change has occurred in the market and economy. It is directed to those investors who are thinking about how to position themselves once the crisis has passed and more of an equilibrium is reached. The question is, "What will the new normal be?" While no one can say how long the crisis will last, what we find on the other side will not look like the normal of recent years. The "new normal" will be shaped by a confluence of powerful forces, some arising directly from the financial crisis and some that were at work long before it began. By the way, normalcy is what people call "normal" when they no longer take it for granted.

Full Market Recovery: The return of investment portfolios to October 2007 market highs.

Recovery Curve: Refers to the shape of the performance curve when graphed. Recently, three letters, U, V, W, have been widely used to describe the state of various economies and their prospects going forward. It has nothing to do with what these letters stand for, but what their shapes resemble. When a recession is referred to having a V-shaped recovery, it means it is generally short-lived and a quick rebound is expected with a similar upward slope as the drop. In the U-shaped recovery, the difference is that there is a relatively longer "bottom time" than the V. How long this bottom time is will depend on how fast the economies adjust to the environment.

The W shaped recovery, with its double dips, would be the least favored.

This time it's different: A long standing Wall Street saying that argues that the 'old rules' don't apply. When an investment seems irrational yet irresistible, one rationalization for making it is, "This time it's different"; concepts such as a valuation, momentum and the fundamentals no longer apply. That was a motto during the Internet bubble, the heyday of delusional investing. The phrase has reappeared lately, as other asset classes have moved to extremes, perhaps entering bubble territory. Now, as a decade ago, it is used to coat an emotional investment decision in a veneer of logic.

Bull Market or Bubble? A common Bull Market definition is an upward trending market that rises 20% or more from a prior low point. A Bubble is a market (or sector) that has moved up to the point that it grossly exceeds rational historic valuation levels, and is ripe for a severe retracement. A cynic might say that it's a bull market if you are invested in it, and it's a bubble if you are watching in amazement from the sidelines. Bull markets tended to be built on sound foundations like low interest rates, rising earnings and high productivity. A bull market is justified by fundamentals and can be sustained indefinitely, while a bubble is a short-term phenomenon not justified by fundamental factors.

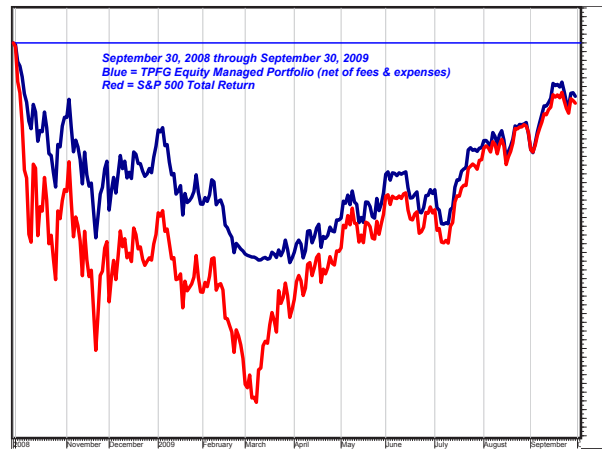
Inventory rebuild: Companies rebuilding inventories after a period of inventory reduction. In the cost cutting process, companies have cut inventories to the bone. Rebuilding inventory levels should boost GDP growth. For most of the year, companies have been rebuilding inventories, however if the end user doesn't purchase the finished goods, the production boost will peter out.

HIGHLIGHTS

- Retirees who continue to work, even part time, are less likely to suffer physical decline and disease, a study by University of Maryland found. Compared to those who quit working altogether, those who continue to work part time were less likely to suffer from high blood pressure, diabetes, cancer, lung disease, heart diseases, stroke, arthritis and psychiatric problems.
- One in five hedge fund managers misrepresents their fund or its performance to investors during formal due diligence investigations, according to research by New York University's Stern School of Business.
- Industrial production was stronger than expected, rising 0.7% in September. Also, industrial production was upwardly revised to 1.2% in August from an initially reported 0.8% gain, while manufactured production was revised to 1.2% from 0.6%.
- Business inventories fell 1.5% in August, a larger decline than forecasts. Manufacturing inventories fell 0.8%, wholesale inventories dropped 1.3%, and retail inventories posted a 2.3% decline on a 7.9% plunge in auto inventories (excluding autos, retail inventories fell 0.3%).
- Overall retail sales fell by less than expected in September, declining 1.5% on a 10.4% pullback in auto sales (on the end of cash for clunkers). Retail sales excluding autos rose 0.5% in September. Retail sales (excluding autos, building materials and gasoline) rose 0.5% in September. It has increased 4.0% at an annual rate, over the last three months.
- Web surfing via smart phones and other handhelds is growing rapidly among teens and seniors, a Nielsen study says. It rose 45% in July '09 versus a year ago among kids ages 13-17 and 67% among people age 65 and older.
- Import prices rose by slightly less than expected, increasing 0.1% in September. Over the last 12 months, total import prices have fallen -12.0% (this compares to a -15.3% year-over-year decline in August). Non-petroleum and non-fuel import prices rose 0.4% and 0.6%, respectively, in September.
- Canadian scientists succeeded in creating nerve cell connection by using plastic beads. The technique can help make faster nerve cell repair possible. Currently, the repair of damaged nerve cells is difficult because conventional therapies require re-growth of a severed nerve fiber.
- The trade deficit unexpectedly narrowed to \$30.7 billion in August from \$31.9 billion in July. Imports fell 0.6% in month (in nominal terms), while exports edged up 0.2%.
- The U.S. budget deficit hit a record \$1.4 trillion in the just-ended fiscal year. The tally was \$162 billion smaller than the White House had forecast in August, but it still equaled 10% of U.S. economic output.

Portfolio Commentary 9-30-09

Equity Portfolio



The Equity Strategy has performed very well over this market cycle. The attached performance chart shows the Equity Managed Portfolio versus its benchmark, the S&P 500 Price Index, over the past year. During the market downturn in the fourth quarter of 2008 through the market bottom on March 9th, the Equity Strategy was down far less than the market and endured less volatility. On a year-over-year basis, the Equity Strategy outperformed the broad equity market.

Some investors have asked why the Equity Strategy has not performed as well as the market since the March 9th bottom. The answer to that is fairly simple. First, we did not re-enter the market as soon as it turned around. It is our strong belief that prudent investment management does not consist of market timing. Rather, it includes careful, thoughtful insight and should not put investors in a position of unnecessary risk.

Secondly, we have remained underweight in the financials sector which has significantly outperformed all other sectors. For example, the financial sector has returned a whopping 140% since the market bottom while the next best performing sector, industrials,

gained a little over 74% over the same time. Again, we firmly believe a cautious approach in this market is warranted and, given that the financial sector precipitated the market crisis, we have been unwilling to fully re-enter that market.

As of quarter-end, the Equity Strategy is overweight in information technology, consumer discretionary, and the materials sectors. Currently underweight sectors include healthcare, financials, energy and utilities.

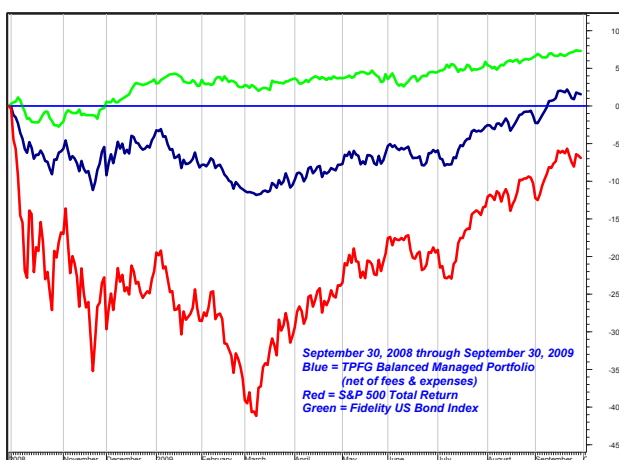
International/Global Portfolio

Stocks rallied around the world in the third quarter, with the highest returns coming from the emerging markets. Signs of stabilization in economics trends from their significant declines earlier in the year, as well as continued positive macroeconomic news, have added to investor's willingness to hold riskier assets. During the quarter the MSCI EAFE Price Index was up 18.8% easily outpacing the S&P 500 which was up 14.98%.

A myriad of factors have contributed to the extreme divergence of returns between countries during the early recovery. For example, countries dependent on manufacturing exports were hit first by the global downturn and will likely recover quicker as global restocking takes place. Countries with high credit growth were also hit hard but will be less likely to recover as quickly because of the painful, but necessary, deleveraging process. Returns ranged during the quarter in the international markets from 71.0% in Lithuania to -8.2% in Slovakia.

Our focus during the quarter was on overweighting countries that we believe will reap the benefits of the recovery more quickly than others. As of quarter-end we are overweight in Australia, New Zealand, and the Asia Developed countries (including Hong Kong, Taiwan, and Singapore). Underweight areas include the developed markets of the United Kingdom and Japan.

Balanced Portfolio



The broad equity market continued its stellar performance, with the S&P 500 Price Index ending the third quarter up 14.98%. Bonds continued their upward trend as well, with the Barclays Intermediate Government Credit Index ending the quarter up 3.25%. Lower credit quality bonds outperformed Treasuries as investors' desire for higher returns outweighed fears about the economy.

Our Balanced Strategy performed well during the quarter. The attached graph illustrates the Balanced Managed Portfolio's performance over the past year. There were three distinct time periods in which the

market sold off aggressively. During each one of those time periods, the Balanced Strategy lost far less than its benchmark. We are very pleased with the performance and our diligence in protecting assets on the downside.

As of quarter-end the Balanced Strategy is approximately 45% equities and 55% fixed income. On the equity side we are overweight in cyclical sectors including: information technology, consumer discretionary, and the materials sectors. Currently underweight sectors include healthcare, financials, energy and utilities

Absolute Return Portfolio

The Absolute Return Strategy posted positive results during the third quarter. The goal for this Strategy is to provide

downside protection and it has done just that. On March 9th the market reached its bottom and was down over 25% YTD; over the same time period the Absolute Return Strategy was up approximately 2%.

We gradually increased our equity holdings during the quarter as stocks continued to significantly outperform bonds. Equities as a percentage of the total portfolio increased to 13% from about 4% at the beginning of the quarter. With downside protection being the overriding goal in this strategy, we are looking for sustained, positive economic data as well as indications from our models that a

larger allocation to equity is warranted.

As of quarter-end the Strategy is invested primarily in fixed income securities with an average credit quality of AA.

Income Portfolio

Returns on non-US Treasury bonds remained strong during the quarter as the broader economy continued to stabilize. A myriad of other factors have also contributed to the superior performance of fixed income securities. The Fed announced its commitment to completing a \$1.25 trillion program to purchase mortgage-backed bonds, in effect keeping rates down. Additionally, the Fed has continued to reiterate its intent to keep interest rates low for an "extended period".

Our exposure in the credit markets was a positive for the Portfolio performance, as corporate bonds, especially high yields, were among the highest performing bonds during the quarter. Additionally, performance benefitted from positions with longer-term maturities as yields continued to fall, resulting in greater upward price movements for those securities

Tax Managed Portfolio

The Tax Managed Strategy had another good quarter, outperforming its benchmark. The strategic allocation did not change with regard to capitalization and sector emphasis, however some specific positions were changed to take advantage of tax harvesting opportunities, where possible. Small caps and international exposure were the biggest contributors to performance during the quarter.

Has anything happened we should know about? If there are any changes in your financial situation, investment objectives or specific restrictions, please contact your investment advisor or The Pacific Financial Group, Inc. It is critical to the achievement of your investment goals and the success of our relationship to discuss any changes in your financial needs.

Our clients receive quarterly performance on their accounts. For performance on any of our strategies, please contact your Investment Advisor.

Slack, or Economic Slack: This is a primary reason cited by the Federal Reserve for a lack of real inflation build up. One economic view is that there is a direct inverse relationship between resource utilization and inflation. At present, the main resource which is underutilized is labor. The Fed's current highly expansionary monetary policy would historically lead to inflation

however current "slack" is regarded to be at sufficient levels to counteract the existing policy, thereby dampening inflation.

Underemployment rate: Some argue that the widely cited unemployment rate of 10.2% may not effectively gauge how soft the labor market really is, insofar as the underemployment rate has reached 16.8%. It is possible that the

most common measure does not factor in those that have given up looking or have accepted jobs below their previous levels, for example.

New vocabulary is always fun to use. I hope this helps clear up some questions you may have had as you read the business page, or at least equips you with some ammunition for the upcoming holiday parties.

What's in the Future?

Financial markets have staged a dramatic rebound thus far in 2009. The S&P 500 has risen well over 50% since the March 9 low, and is up 17% for the year through the end of third quarter. To provide better perspective, the index is still down about -25% since the October 2007 high, and reached a low of -54.73%. At this point in time, nearly everyone wonders will financial markets continue to go up, or will they roll over and find another bottom?

In the near term, we expect fourth quarter market performance to largely be driven by earnings and revenue growth. The past two earnings seasons propelled the market higher: 10% in April and 8% in July. First quarter earnings rally came from the realization that the global financial system was not going to collapse. Second quarter's earnings were stronger than expected after companies aggressively cut costs to preserve margins and profitability. Thus far this season, a high proportion of earnings reports have beat expectations, and the percentage of positive surprises goes up even higher when financial companies are removed. If the season continues along this path, we expect the market to perform well through the end of the year.

While the earnings story seems fine at first glance, there may be a fly

in the ointment. Breaking down the companies that have reported thus far into two groups, intermediary goods producers and end-demand companies, we have discerned a potentially problematic trend. The intermediary goods producers have done well and have experienced decent revenue growth. The end-demand companies have posted reasonably good earnings, but they have not generated much growth in sales. The lack of top-line sales growth could serve as a harbinger of problems in the future, in that it would likely be a result of weak final demand which is needed to push the economy forward.

The labor market continues to be the Achilles heel of the economic recovery. Many economists expect employment to firm and begin turning around in early 2010, however the unemployment rate will probably continue to rise due to new entrants into the work force. Without much wage growth, consumers could easily lack much confidence in their own financial outlook and hold off from making certain expenditures. In aggregate, the effect keeps a lid on demand and growth.

Inflation has not become a problem yet, so interest rates remain very low. The Federal Reserve Bank has maintained a very accommodative policy with the Fed Funds target rate between 0 -

0.25%. Economic slack in the form of rising unemployment and low capacity utilization gives the Fed room to leave monetary policy at this low level. The latest FOMC statement articulated greater concern in the near future of deflationary risks to price stability, not inflationary. It appears very unlikely to us that interest rates will go up before year end, and perhaps on into 2010.

Third quarter was largely about economic recovery. It is very likely to post the first positive GDP growth rate in over a year. Most estimates range from 3.0 - 4.0%. It also appears probable that fourth quarter will be positive as well. Does this mean the recession is over? While that may make people feel better to hear, we believe there is a more important issue. Going forward, the critical element becomes sustainability. It is too early to render a definitive call in this regard, but we are optimistic that the economy can keep on keepin' on.

We are cautiously optimistic going into fourth quarter. The market rebound has come a long way since the March low, and a correction is possible and could even be viewed as healthy. We expect any pull back to be temporary however, and expect positive returns to be preserved at year end. As always, we are watching the situation very closely, and stand ready to re-adjust should conditions warrant action.



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