



PERSPECTIVES

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A newsletter for the clients and friends of Mercer Advisors

MERCER ADVISORS™

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OUR MISSION: PERPETUAL IMPROVEMENT

Eurozone Influence

On Wednesday, Italian borrowing costs soared to greater than 7% as investors lost faith in the country's ability to repay its debt, prompting the Dow Jones Industrial Average to drop 400 points. While Greece and Ireland received bailouts when their bond yields rose above the same mark (in fact, Greece's borrowing costs have climbed to nearly 28%), Italy's \$2.6 trillion debt is too large for other European countries to absorb. The impact of this latest Eurozone sovereign debt concern highlights the far-reaching influence of the domino effect and its broader global implications — the Dow down 3.29 percent, the S&P 500 off 3.58 percent and the Nasdaq 3.75 percent lower. The prices of safe haven assets rose sharply. The dollar jumped 1.6 percent versus the euro.

U.S. Economic Overview

While U.S. economic growth is beginning to move forward, albeit slowly and given to fits and starts, it continues to be influenced by the lack of confidence felt by both investors and corporations. As evidenced on a daily basis, the sluggish progress is further exacerbated by the perpetual media headlines and sound bites

spotlighting the Eurozone and its attempts to staunch an escalating and far-reaching sovereign debt debacle. At the same time, the just-released employment report indicates the addition of 104,000 jobs in the private sector in October — enough to nudge the nation's unemployment rate down to a flat 9%. Corporate profits remain robust; balance sheets are healthy and corporate debt and inventories remain at controllable levels. Furthermore, positive trends in monthly job growth rates, temporary worker hiring and weekly claims for unemployment insurance indicate the potential for momentum within the labor market with the possibility of stronger job growth over the next several months.

Our Response

Slow growth and higher sustained levels of uncertainty appear to be a new market reality — requiring a collective shift in mindset and expectation as the new price of admission into the markets. Within the context of this latest 'normal', Mercer Advisors continues to adapt and evolve in order to identify new methods for generating portfolio gains.

As your advocate and fiduciary, we maintain allegiance to a single entity: You — our client. We are not driven

For more information, read our *Fall Research Report*.

INTRODUCING BOND RISK PREMIUMS

THE IMPORTANCE OF BONDS
The primary advantage a bond has over a stock is one of consistency in that the bond carries a lower level of expected risk. Bond investments are considered less risky because historically they have exhibited less volatility than stock investments. Essentially, a bond is a lending contract between a company or government agency and a bondholder where the bondholder becomes a creditor. The creditor is owed a regular fixed interest rate payment in addition to repayment of the principal on a pre-determined future date. In contrast, a stock represents partial ownership in a company. Stock investments typically appreciate only if the company's earnings increase and after the payment of steady payment — in fact, a company may elect not to pay any dividends to shareholders.

When it comes to the construction of a well-diversified portfolio, bond investments are an integral component of all but the most aggressive portfolios. As an asset class, its primary responsibility within a diversified portfolio is to provide a steady stream of income and to reduce the volatility of the overall portfolio. Bond investments are best able to fulfill their objectives. Additionally, bond investments provide you portfolio with the benefits of diversification and stabilization. Because there are few risks which provide a solid foundation of consistency, you are able to implement a more aggressive approach to other asset class holdings associated to your portfolio that are better able to produce a maximized investment return.

Bond investments also facilitate the portfolio rebalancing process. When a methodical and objective rebalancing rule is applied and followed, the investor will sell stock holdings and buy bonds in high relative value in order to purchase bonds with the proceeds. Conversely, in keeping with an established investment strategy, the investor will also sell bonds to purchase stocks with low relative value in order to maintain the portfolio's optimized allocation weighting for its defined risk profile.

Shorter Bonds — A Great Beginning

Year	10Y	20Y	30Y
1980	14%	14%	14%
1985	10%	10%	10%
1990	8%	8%	8%
1995	7%	7%	7%
2000	5%	5%	5%
2005	4%	4%	4%
2010	4%	4%	4%
2011	4%	4%	4%

THE LATEST RESEARCH
The primary research of the Mercer Advisors Investment Committee is to continuously research, analyze and develop strategies to capture superior risk-adjusted returns for our clients. Current bond interest rates, both real and nominal, are at an unprecedented and historic low. Over the course of 2011 and into the summer of 2012, we are anticipating the possibility of global economic recovery from the financial crisis of 2008-2009, the potential for a more orderly debt default and the downgrade of U.S. government debt. The committee has identified two unique ways to capture additional return within the bond component of your portfolio. Now, in addition to the fundamental stability and consistency provided by short-term, high-quality bonds, essential to all but the most aggressive of portfolios, we are introducing a new strategy designed to generate additional potential bond return for clients willing to take an additional risk.

http://www.merceradvisors.com/reference_library/research_reports_&white_papers.php

Type Fund Fund Symbol	BASE STRATEGY		RISK PREMIUM STRATEGIES			
	Short-term, High quality		Short-term, Lower quality		Intermediate-term, High quality	
	DFA 2-Year Global DFGFX		Baird Short-term Bond Institutional BSBIX		Scout Core Bond Institutional SCCIX	
	Actual Return	Std. Dev. (Risk)	Actual Return	Std. Dev. (Risk)	Actual Return	Std. Dev. (Risk)
YTD (as of 08/31/11)	0.89%	0.28%	1.79%	1.19%	6.16%	2.08%
1 Year	1.05%	0.31%	2.23%	1.17%	6.02%	2.32%
3 Year	2.25%	0.86%	3.57%	2.56%	10.72%	10.28%
5 Year	3.11%	0.77%	4.01%	2.17%	8.61%	8.14%
7 Year	2.91%	0.79%	3.55%	1.94%	7.00%	7.05%

FIGURE 1: Bond Risk Premium Performance

Source: Morningstar, 2011.

by commission, and thus, are not committed or obligated to any company, fund, management firm, individual manager or strategy. Consequently, we are free to pursue those expertly engineered investment instruments and strategies which offer superior quality and institutional-caliber results.

We have identified several opportunities for garnering additional return for your portfolio, while maintaining vigilant control over the associated risk, costs and taxes. We recently expanded our investment strategies to include two new bond offerings and have implemented several improvements and modifications to existing stock strategies.

Expanded Bond Offerings: Recent research has identified that more return can be gleaned from the bond portion of client portfolios by shifting beyond our historical short-term, high credit quality bond standards. To that end, we have added two risk premium strategies to our bond inventory. One targets bonds of medium term that maintain high credit quality; the other maintains a short term but incorporates lower investment-grade bonds.

Our [Fall Research Report](#) features these fixed income risk premium strategies. It begins with a review of the Mercer Advisors fixed income philosophy. The report

then outlines in greater detail our new expanded position on fixed income risk premiums as being valid and worthwhile options for creating additional return and diversification. Given that our current record-low interest rate environment is likely to persist for some time, your ability now to realize additional return within the bond investment arena is both timely and opportune.

Change Necessitated by Fund Manager Fee

Increase: As your investment fiduciary, Mercer Advisors advocates for the lowest fund management fees possible for your portfolio holdings. Recently, DWS (Deutsche Bank Group) increased its operating expense ratio (OER) for both our S&P (BTIIX) and our EAFE (Europe, Australasia and Far East) (BTAEX) funds. In response to these increases, we researched the market for alternatives and will be taking our business elsewhere. We identified and selected two Vanguard funds whose simple index strategies will capture the same market risk profiles at significantly lower cost to you. The Vanguard funds will directly replace the DWS funds in all portfolios, except the most aggressive, where we have eliminated the simple index strategies that would impose a drag on long-term performance.

Renewed Availability of Superior Fund Prompts Strategy Replacement: A DFA Small Cap Value fund (of superior quality and expected performance) that had been closed due to capacity issues was reopened to investors recently. It will replace our DFA Targeted Value fund, which does not have as deep a value or small stock tilt. Although this Small Cap Value fund is slightly more expensive, the increased potency of its value and small company tilt is of significantly greater net value. This new fund heavily utilizes the strategy of security lending. This practice is able to offset the majority, if not all, of the associated management fees.

Sources: MSNBC.com, Broadridge-Forefield.

In order to best advise and assist you in realizing your financial and life goals, Mercer Advisors will continue its mindful and deliberate research, modeling and analyses in order to seek out the investment instruments that offer the highest probability of producing optimal return while at the same time maintain the greatest potential for mitigating risk and containing costs. Our quest for improvement remains constant and perpetual.

Talk with your strategic advisor to learn more about each of these enhancements and how they may be of benefit to your portfolio and your investment goals while remaining aligned with your established comfort level.

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