



OCTOBER 9, 2007

In order to better acquaint you with Wealth Advisor Group LLC, we are sending you our quarterly client newsletter which accompanies our clients' quarterly performance reports. We hope this gives you some insight into our firm. If you have any questions about our services, please call.

THIRD QUARTER 2007 INVESTMENT REPORT

The Science of Freaking Out

There is a scientifically measurable human tendency to want to avoid losses more than acquire gains. Behavioral scientists call this **Myopic Loss Aversion**.* (We call it the average investor.) In fact, it has been shown that the average person is so highly risk adverse that they need odds of 2 to 1 to even accept a 50-50 bet. Said another way, an investor's pain in experiencing losses is twice as strong as the joy they get for the same amount of gain. That's the **Prospect Theory**. (*Quarterly Journal of Economics 2/1995)

All this scientific mumbo-jumbo is fine in the lab or a research report, but the actual trauma is clearly evident when you apply it to real life investing. The reason for this lies in the overall movement of stock prices, which, for the most part, happens to be random, noisy, helter-skelterish movement. For instance, it is a known fact that the majority of long term returns come from less than 10% of all trading months. That means that over 90% of all trading months are meaningless, relatively net zero experiences, with the markets going up and down, but in effect -- nowhere. It gets worse if you check out the market direction each day, because the odds are very close that the up versus down days will be about 50/50 over long periods of time.

Unfortunately, many investors, and even some of our super intelligent WAG clients, make a habit of checking their portfolios every day. If you combine this continual monitoring (which assures as much losing as winning) with a human's predisposition to hate losses more than they love gains (myopic loss aversion and prospect theory), you end up with a self-torturing behavior that is constantly tempting the investor to allow their irrational emotions to get the best of them and behave in a manner contrary to their goals. The big problem is that even when investors understand all this stuff, if they repeatedly monitor a combination of bad news and downward prices, they will be tempted to market time, run to safety, and turn a well designed portfolio into a speculative game of chance.

WAG advisors would love to prevent their clients' computer downloads, CNBC viewing habits and business section price quotes from ever occurring...just as a way to eliminate the mental anguish that inevitably will take place in the next scary market environment. But since we cannot do that, we will simply remind you that your portfolio has been calibrated to have a degree of risk and return that you believed were proper before any market agony or ecstasy started to kick in. Let the process of Modern Portfolio Theory, which is long term in nature, work. Leave the freaking out to those who believe they can successfully stock pick and market time their way to serenity.

Caught With Your Shorts Down

Something happened in July that changed the way US stock markets have worked for the last 60 years. Certain market observers believe that it was one of the main reasons for the increased market volatility we experienced this past summer. The change had to do with short selling, a trading technique that most retail investors don't use, but many professionals certainly do. Shorting stock is an attempt to make money when a stock goes down. Speculators borrow a stock, sell it, and at some point in the future have to buy it and deliver it back. If they buy it for less than they sold it, money is made. Like most investors, they want to buy low and sell high. The difference in short selling is that the sell comes before the buy.

In the early part of the 20th century, wealthy speculators would simply sell a particular stock like crazy, thereby driving down the price rapidly. This started a panic by other shareholders of the stock, who often were forced to sell because of margin calls. After the stock had been battered, the short seller would buy back the shares at a greatly reduced price, and make big profits.

Obviously, this practice had the potential for abuse. Often, there were absolutely no fundamental reasons for someone to short a stock, other than they felt they could force it to go much lower. In the 1940's, the Securities Exchange Commission passed rules that only allowed short sellers to short a stock if the price was on an "uptick". By only allowing short selling at a price (tick) above the last trade, it prevented the short seller from selling at lower and lower prices.

So why are we reciting this painfully tedious stuff? Simply this: the SEC repealed this 60 year old uptick protection this summer on July 6th. Can you guess what happened? The volatility of the S&P 500, and presumably all other asset classes, dramatically increased when compared with studies for that same time period in previous years. Coincidence? You can make up your own mind on this one. Fortunately, your portfolio's asset class ownership prevents you from worrying about any specific strategy that would greatly affect an individual stock. However, you can probably expect increased volatility in the markets well into the future. Don't get caught short!

Third Quarter 2007 Asset Class Returns

	3rd Qtr	'07 YTD		3rd Qtr	'07 YTD
<i>S & P 500</i>	2.03	9.05	<i>Int'l Large Cap</i>	2.78	14.31
<i>Large Cap Value</i>	-5.62	2.78	<i>Int'l Large Cap Value</i>	1.08	14.47
<i>Medium Cap</i>	-0.91	9.83	<i>Int'l Small Cap</i>	-1.70	11.88
<i>Small Cap</i>	-2.44	6.52	<i>Int'l Small Cap Value</i>	-2.35	11.28
<i>Small Cap Value</i>	-8.59	-2.12	<i>Int'l Emerging Mkts</i>	14.43	34.94
<i>Micro Cap</i>	-4.03	1.82	<i>Int'l Emerging Mkts Value</i>	10.49	41.79
<i>Real Estate</i>	2.39	-4.09	<i>Int'l Emerg. Mkts Small Cap</i>	7.40	37.94
<i>Intermediate Income</i>	3.37	3.85	<i>Pacific</i>	3.01	10.30
<i>Long Term Income</i>	3.47	2.45	<i>European</i>	2.15	14.96
			<i>Int'l. Real Estate</i>	.69	---

Vanguard Group and DFA, Inc.

For the first time in many quarters, equity asset classes experienced both positive and negative returns. Through the first three weeks of July, most markets moved up to yearly highs. Then, over the ensuing four weeks, all markets experienced their largest corrections in years, fueled by sub-prime fears and potential stagnation in the economy. During that time, from their quarterly peaks to their troughs, Large Cap corrected 9%, Small Caps 13% and Emerging Markets a whopping 18%. In early September it became clear that Ben Bernanke and the Fed would be as helpful as possible, and prior to the end of the quarter the federal funds rate was cut ½%, with expectations for further cuts. All equity asset classes repaired themselves, so by the end of the quarter things looked a lot better. All in all, the year-to-date numbers of most equity asset classes are healthy, although there has been much volatility along the way.

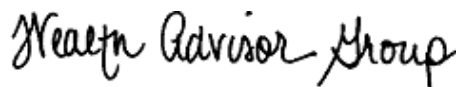
It was easy to see a cycle change during this quarter. Large Caps and Growth out-performed Small and Value in Domestic, International and even Emerging Market asset classes. The multi-year domestic leader, Small Cap Value, was hit the hardest, down over 8%. Potential slowing of the economy tends to spook small, lower quality companies, while larger, higher quality are viewed as more attractive. Both Domestic and International Real Estate, despite all the negatives regarding the sluggish housing markets, eked out small gains. This is because the income producing, institutional real estate found in these asset classes marches to a different beat than the single housing market that has been in the news headlines. Emerging Markets continued to rocket to new highs. Clearly, this asset class is a volatile one, and a meaningful correction should be expected at some point.

We don't try to anticipate the time and depth of an asset class's cycle, just like we don't try to time the markets. That is because there is no way to know how long any particular cycle will last. We do, however, rebalance to assure that major gains in asset classes that have dramatically out-performed are distributed into others that may have under-performed, which assures that we keep the risk/return levels of your portfolio at desired levels.

As always, your Quarterly Performance Report accompanies this letter. If we have managed your portfolio for less than 3 months, you will receive a partial report, and a complete one will follow next quarter.

The fourth quarter of the year historically brings some interesting market developments, so sit back, enjoy the cool nights, and get ready for three (at least) great holidays.

Sincerely,



Wealth Advisor Group LLC

Selected as one of [Medical Economics' 150 Best Financial Advisers for Doctors for 2006](#).

Our client centered portfolio management – something we call **The PROsperity Model (sm)**, is designed by combining:

- Our investment **Philosophy**, based in Modern Portfolio Theory,



- Our **Resources**, seen in human terms by our highly experienced, professional advisors; our affiliation with Dixon Hughes; and finally our unique ability to offer our clients institutional investment vehicles unavailable to most brokers, bankers or individual investors,
- Our **Objectivity**, which is anchored in our fee-only compensation structure, assuring no potential conflicts of interest of any kind.
- Our clients stand at the center of these principles, benefiting by the **Integration** of all three. We believe that a superior investment experience and performance can only be found when not one or two, but all three values occur simultaneously.