Highlands Wealth Advisors

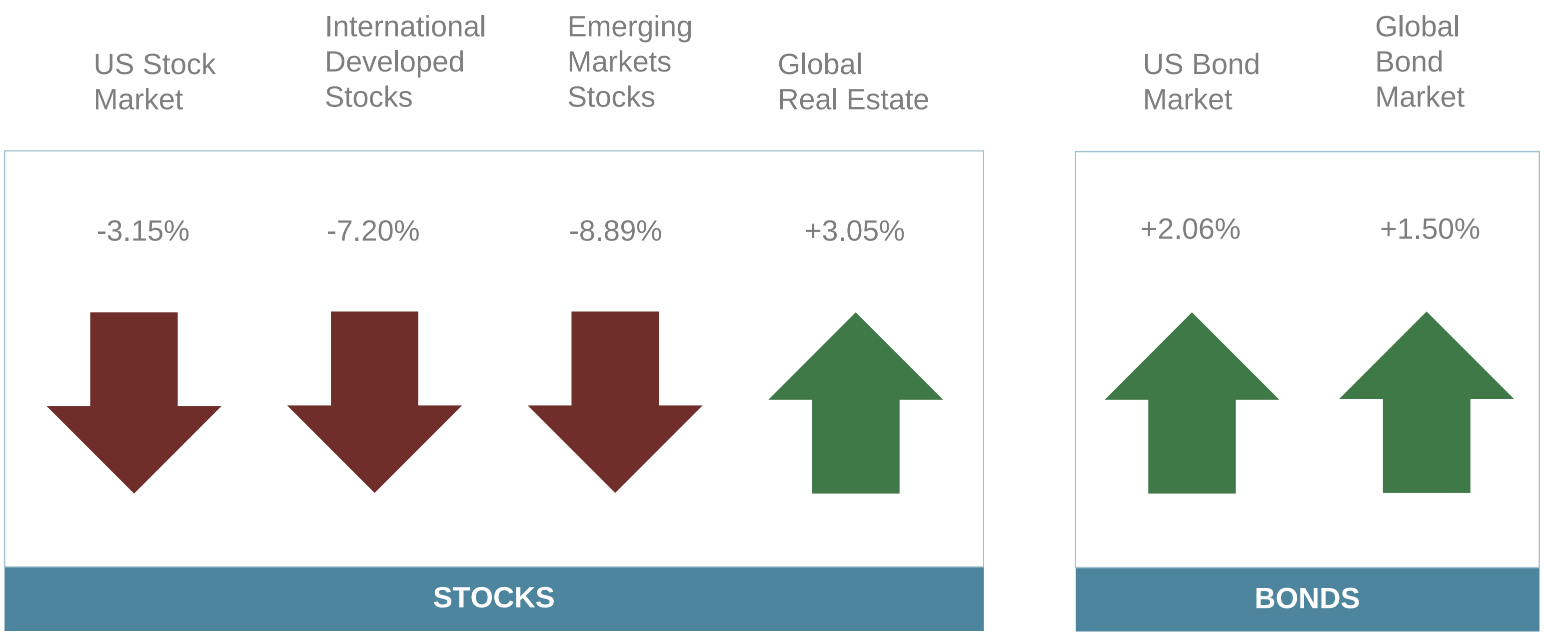
Q2

Quarterly Market Review

Second Quarter 2012

Market Summary

Second Quarter 2012 Index Returns



Past performance is not a guarantee of future results. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: US Stock Market (Russell 3000 Index); International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays Capital US Aggregate Bond Index), and Global Bond Market (Barclays Capital Global Aggregate Bond Index [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Barclays Capital data provided by Barclays Bank PLC. US long-term bonds, bills, and inflation data © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefield).

HIGHLANDS WEALTH ADVISORS

Timeline of Events: A Quarter in Review

Second Quarter 2012

US stocks finish at multi-year highs. The S&P 500 Index has its highest close since May 2008.

Mitt Romney officially named Republican Party's presumptive nominee.

Facebook's long-awaited IPO valued the firm at over $100 billion, yet in the weeks following the listing, it lost almost a quarter of its market value.

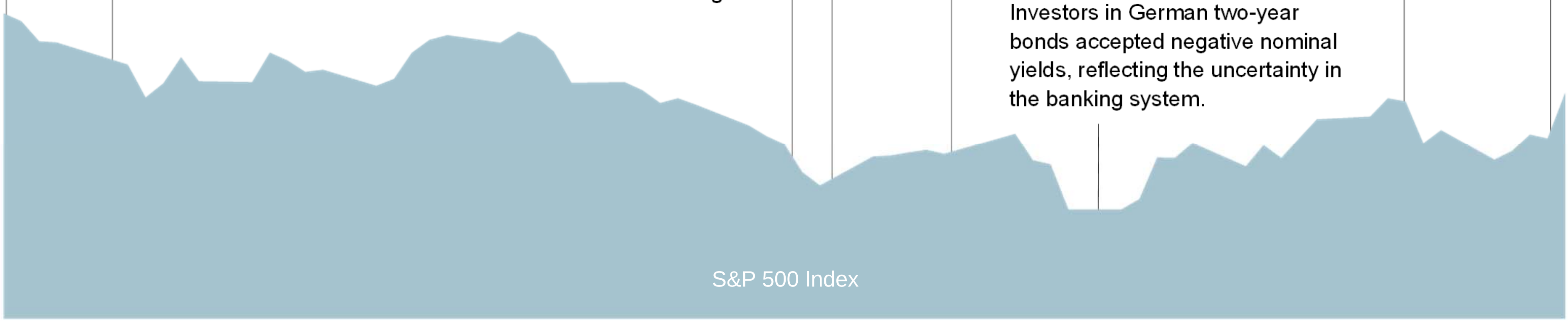
JPMorgan Chase reported losses in excess of $2 billion from trades made by a division *that was supposed to manage* risk. The CEO subsequently testified in front of Congress.

Dalian Wanda agreed to buy the theater chain AMC Entertainment, in the largest US acquisition by a private Chinese firm.

Investors in German two-year bonds accepted negative nominal yields, reflecting the uncertainty in the banking system.

The European crisis continued, with Spanish banks receiving capital from other countries and Greece voting for a leadership determined to preserve the euro and adhering to austerity.

The Supreme Court ruled that many of the provisions of the healthcare law are constitutional, including the requirement that most Americans obtain insurance or pay a penalty "tax."



1,419
04/02/2012

1,362
06/29/2012

The graph illustrates the S&P 500 Index price changes over the quarter. The return of the price-only index is generally lower than the total return of the index that also includes the dividend returns.
Source: The S&P data are provided by Standard & Poor's Index Services Group. The events highlighted are not intended to explain market movements.

The Cost of Caviar: Lower Expected Returns

Second Quarter 2012

Australia's champion racehorse Black Caviar is unbeaten over twenty-two races. Think of her as a growth stock with four legs. With a brilliant bloodline and a huge fan base—she even has her own Facebook page—Black Caviar is turning into the most popular racehorse since the legendary Phar Lap.

The five-year-old mare prevailed in Britain's premier racing event at Royal Ascot late last month. But unless you own part of Black Caviar, you're unlikely to make much money from placing a bet on her fortunes. "The Wonder from Downunder," as she is known, pays close to even odds with bookmakers.

That's the problem with (perceived) no-risk bets. The high probability of a win means your expected return is very low.

It's reminiscent of the equity market, where you can choose to buy highly priced growth stocks. Many investors are prepared to put a high price on these companies' expected cash flows. In other words, they are prepared to accept a lower expected return for the perceived lower risk of owning a stock that is growing faster than the wider market. This is similar to how gamblers in aggregate are prepared to accept a much lower return than the wider field for the perceived lower risk of putting their money on Black Caviar.

So why not back the favorite all day? Well, that could be a legitimate decision for some investors, if they are prepared to accept lower expected returns for lower risk. On the other hand, there is strong academic evidence that there is a long-term premium for tilting your portfolio to lower-priced "value" stocks. You could think of these as the unknown or unfancied horses—the ones with the wider odds.

Unlike the racetrack, however, there is more than one winner on the stock market. It is just a question of how much risk you wish to take. Backing past winners means you forgo the chance of earning a bigger dividend on the outsiders.

And keep in mind that even if you put it all on the stock market equivalent of Black Caviar, there is still no guarantee you will be rewarded. Even champion racehorses eventually lose. And by concentrating your bet, you leave yourself more exposed to specific risks related to that one entity.

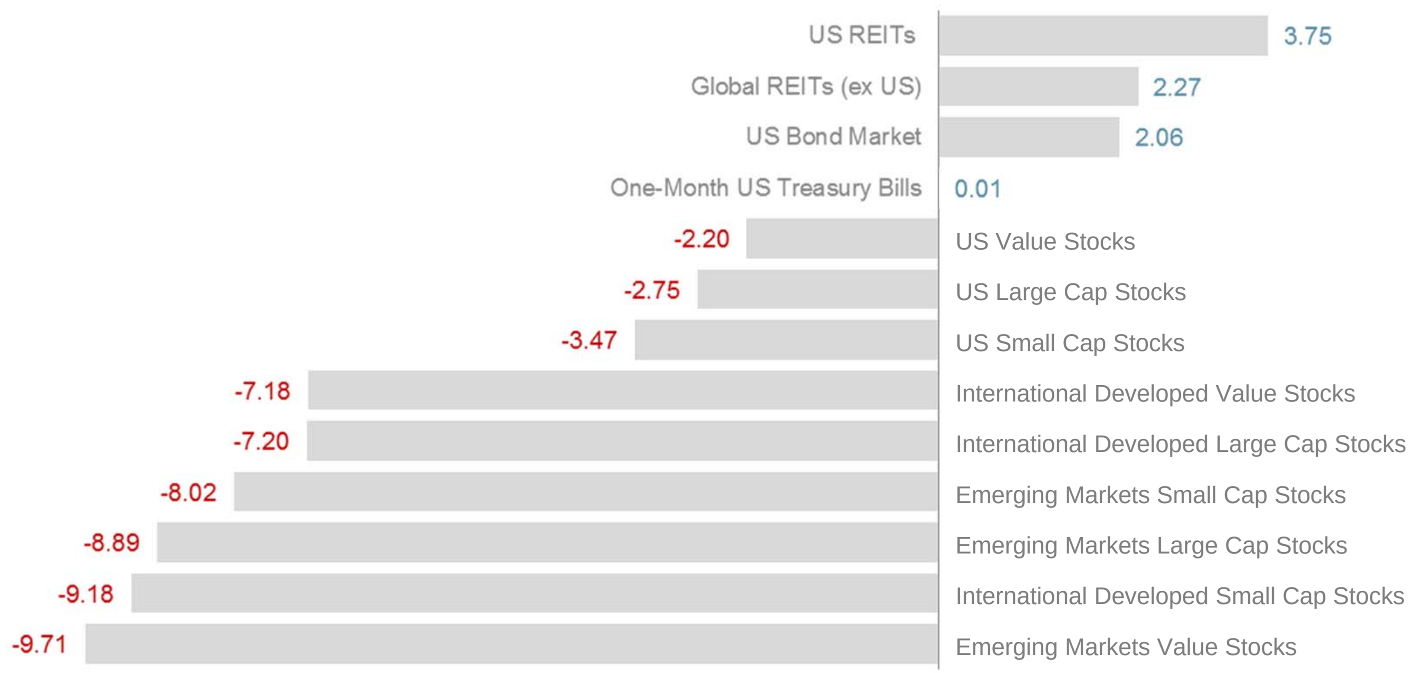
With long-term investment, you are better to spread your risk through diversification. Backing the entire field—or sections of the field—leaves you less prone to the risk associated with individual runners.

Ultimately, a great company or champion racehorse is one thing. A great investment is another. Black Caviar comes at a cost.

World Asset Classes

Second Quarter 2012 Index Returns

Global equity markets retreated in the second quarter, giving up much of their gains for the year. Fiscal and economic strain in Europe continued to capture headlines, weighing especially heavy on non-US markets. Investors continued to turn to US government bonds for safety, pushing yields lower.



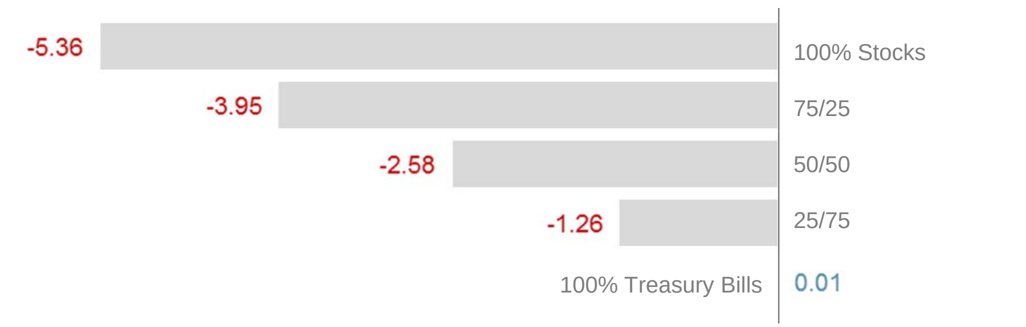
Global Diversification

Second Quarter 2012 Index Returns

These portfolios illustrate performance of different global stock-bond mixes and highlight the benefits of diversification. Those with larger allocations to stocks are considered riskier but also have higher expected returns over time.

Growth of Wealth:
The Relationship between Risk and Return

Ranked Returns for the Quarter (%)



Period Returns (%)

Asset Class	1 Year	3 Years*	5 Years*	10 Years*
100% Stocks	-5.96	11.36	-2.17	6.27
75/25	-4.10	8.76	-0.98	5.44
50/50	-2.48	6.00	-0.08	4.39
25/75	-1.10	3.10	0.51	3.15
100% Treasury Bills	0.01	0.03	0.07	0.81

** Annualized*

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance.

Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified portfolios rebalanced monthly. Data copyright MSCI 2012, all rights reserved.