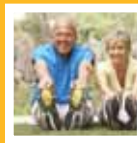




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October 2011
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WATERFORD ADVISORS
 An SEC Registered Investment Advisor

Quarterly Newsletter

QUARTERLY INVESTMENT COMMENTARY: THIRD QUARTER 2011



*Gregory L. Kozerski, CPA, CFP®, AIFA®
 President, Waterford Advisors LLC*

Concerns about Europe's debt woes and negative global economic news sparked recession fears and drove stock markets down steeply in the third quarter. Large-cap domestic stocks fell 13.9% during the third quarter and have lost 8.8% year to date. Smaller-cap stocks suffered larger losses, down 21.8% for the quarter, and 17% for the year through September. International stocks also suffered double-digit losses, with developed-market equities losing 20.9% for the quarter and 18% year to date. Emerging-markets stocks were hit hardest, losing 24% for the quarter and 23.4% year to date.

Domestic high-quality, intermediate-term bonds gained 4% in the third quarter and are up 6.6% year to date, driven by investors' flight to the relative safety of Treasuries. Spooked by macro events, investors have flocked to Treasuries, forcing their prices even higher and their yields lower. Developed-market international bonds were up 2.4% for the quarter and have gained 6.5% year to date. Local-currency

emerging-markets bonds dropped in September as capital flowed out of emerging-market currencies and are now in the red by 2.2% year to date. Floating-rate loans fell 3.9% in the quarter and have lost 1.4% year to date.

As we have discussed at length in the past, we have been significantly underweight equities for some time now. A portion of this underweighting has been allocated to various fixed income strategies while another sizable portion has been invested in Alternative Investment Strategies. As a result of these tactical allocations, our portfolios have outperformed their benchmarks in a very difficult market environment.

PORTFOLIO POSITIONING/ RECENT PORTFOLIO CHANGES

Panic filled headlines and market volatility, while unnerving, can also create buying opportunities for disciplined investors. In the third quarter, we took advantage of stock market declines on two occasions to incrementally reduce our underweighting to equities. We made our first move in early August, adding 5% to larger-cap U.S. equities in most of our balanced portfolios. Then, in late September, with emerging-markets equities down sharply, we initiated a 3%–4% dedicated emerging-markets equity position in most of our global

balanced portfolios, and added a 3% global equity position in our most conservative portfolios.

Very briefly, our reasoning is that emerging markets, representing a high proportion of the

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SEPTEMBER BENCHMARK RETURNS (PRELIMINARY)

Large-Cap Benchmarks	Sep	3Q	YTD
Vanguard 500 Index	-7.0%	-13.9%	-8.8%
Russell 1000 (iShares)	-7.5%	-14.7%	-9.3%
Russell 1000 Growth (iShares)	-7.4%	-13.2%	-7.3%
Russell 1000 Value (iShares)	-7.5%	-16.2%	-11.3%
Mid-Cap Benchmarks			
Russell Midcap (iShares)	-9.6%	-18.9%	-12.4%
Russell Midcap Growth (iShares)	-10.1%	-19.4%	-11.7%
Russell Midcap Value (iShares)	-9.2%	-18.5%	-13.1%
Small-Cap Benchmarks			
Russell 2000 (iShares)	-11.2%	-21.8%	-17.0%
Russell 2000 Growth (iShares)	-11.5%	-22.2%	-15.5%
Russell 2000 Value (iShares)	-10.9%	-21.5%	-18.6%
Other Benchmarks			
Vanguard Total Int'l Stock Index	-12.3%	-20.9%	-18.0%
MSCI World ex USA Index	-2.0%	-11.8%	-7.3%
Vanguard Emerging Mkt Stock Index	-16.2%	-24.0%	-23.4%
Vanguard REIT Index	-11.0%	-14.6%	-5.9%
Vanguard Total Bond Market Index	0.9%	4.0%	6.6%
Merrill U.S. High-Yield Cash Pay	-3.5%	-6.2%	-1.6%
Barclays 7 Year Muni Bond Index	0.1%	3.1%	7.2%
S&P/LSTA Leverage Loan Index	-0.4%	-3.9%	-1.4%
Citigroup World Govt. Bond Index	-2.0%	2.4%	6.5%
JPMorgan GBI-EM Global Div. Index	-9.8%	-8.5%	-2.2%
DJ-UBSCI (Commodity Futures)	-14.7%	-11.3%	-13.6%

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world's population, are rapidly developing and becoming a more significant force in the global economy. They will likely derive similar productivity benefits as the developed world did through its industrialization over the past two centuries. Emerging markets' productivity will likely grow at a faster rate than their developed counterparts as they adopt new technologies that appear to be more quickly disseminated now as a result of the Internet and communications revolution of the late 1990s. Given the prospects of better productivity, and also better demographics in many emerging-market countries (populations that are in general larger, younger and underutilized), emerging markets are likely to grow at a superior rate than developed markets over the foreseeable future.

Even after these changes we still remain underweight to equities (but less so) in all but our most aggressive portfolios and still hold a 10 - 15% position in Alternative Investment Strategies in all of our portfolios.

These portfolio moves demonstrate our incremental, scenario-driven, disciplined approach to tactical asset allocation. Even after the recent market declines, our analysis suggests that equities are still not fully pricing in the effects of the aftermath of the global financial crisis of 2008–2009, and therefore do not offer sufficient return potential to justify full equity risk exposure in our balanced portfolios. But, as the stock market has declined, stocks have become more attractive in terms of higher five-year expected returns across our scenarios. In previous commentaries, we have said this is how we would respond to a stock market drop, so our moves should not come as a surprise.

While we have been defensively positioned in terms of our equity exposure, our fixed-income exposure has been somewhat more aggressively positioned than normal, with a large allocation to flexible and absolute-return-oriented bond funds. As we've discussed previously, this is because the potential returns from U.S. Treasury bonds, and more generally investment-grade bonds, are unattractive over our five-year tactical investment horizon across

the entire range of scenarios that we think could play out.

INVESTMENT OUTLOOK

Politics and Policy

One of the challenges for investors today is that government policy is likely to determine the path taken by the global economy. This creates tremendous uncertainty because not only is it impossible to predict what will be decided by legislative bodies, it is also difficult to have confidence in what the ultimate effects of those decisions will be.

The past three months saw much debate and little progress on the U.S. fiscal deficit, as topics like tax policy continue to be very polarizing. The debt ceiling showdown earlier in the summer was the quarter's most dramatic example of politics contributing to general uncertainty. Despite an 11th hour agreement, the contentious process and lack of meaningful action seemed to drive down consumer confidence and were specifically cited as part of the reason for Standard & Poor's subsequent decision to downgrade the U.S. sovereign debt rating from AAA to AA. ***Overall, we continue to view policy mistakes, or simply inaction, as a major unknown and a potential risk factor.***

Meanwhile, with fiscal policy stalled by politics, monetary policy has been more aggressive with the Federal Reserve deploying a range of experimental tactics for boosting the economy. The quarter began with the end of QE2, the Fed's second bond-buying campaign, and it ended with Operation Twist, by which the Fed will in effect exchange short-term debt on its balance sheet for long-term debt in an effort to reduce long-term interest rates and encourage lending and investing. The Fed has also made an unusually explicit commitment to keeping rates low until at least 2013. All of these efforts represent extraordinary measures intended to further the Fed's dual mandate of ensuring price stability (which today means fending off deflation and avoiding runaway inflation down the road), and fostering full employment.

Our view is that monetary policy is not likely to help the economy much in the long run. We continue to believe the problem isn't that we have overly tight monetary conditions, but that we have stalled liquidity as banks,

corporations, and consumers hang onto their dollars rather than spending or lending them into the economy.

Debt Reduction Update

Despite the increasingly heated rhetoric of recent months, little progress has been made toward bringing down the government deficit and debt. The compromise agreement that enabled Congress to raise the debt ceiling promised some deficit reduction, mostly coming after the 2012 election. Nearer term, the budget reduction it effected is minimal and the plan puts off the inevitable decision to raise taxes, cut entitlements (Medicare in particular), or some combination of both, without which the deficit will reach unsustainable levels.

There has been some progress in bringing down the level of consumer debt relative to income, which is necessary for the economy to again grow at a healthy rate. But, government debt continues to grow. Ultimately, we think it could be close to a decade before overall household and government debt levels are reduced to a point where we can expect a more normal level of ongoing economic growth.

Debt and the Eurozone

European government debt problems are one of the other big-picture issues with potentially huge ramifications for the economy and financial markets. Investors grew increasingly concerned about Greece in recent months but also, more worrisome, about the larger economies of Italy, Spain, and even France, as well as European banks due to their exposure to European government debt. We share the view of most experts that Greece cannot repay its debt without some kind of restructuring, which is a deliberate euphemism for default. The question comes down to whether it is an orderly default, which can be managed in a way that avoids a damaging contagion effect that brings down other governments and/or banks, or a disorderly one, in which all bets are off.

As has been the case all along, we worry that markets may essentially force a resolution to Europe's debt issues by driving up bond yields (and therefore funding costs) to a level that would push the weaker eurozone nations (Greece, Portugal, Ireland) toward default

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THREE STEPS TO HELP SAVE FOR SHORT-TERM GOALS

SAFETY AND LIQUIDITY WILL BE PRIORITIES IF YOU NEED THE MONEY WITHIN A FEW YEARS

Pursuing short-term financial goals—those that you'd like to achieve within one to five years, such as a down payment on a home or car—can require a different strategy than pursuing long-term goals. Here are some steps to help you save and invest when you're going to need your money sooner rather than later.

Step 1: Be specific about your goal. Setting a specific short-term goal will help you to evaluate your progress toward meeting it. For instance, the vague objective "I want to save money to buy a house" becomes "I want to save \$25,000 over five years to put toward the down payment of a house in (town/city)."

Step 2: Take steps to free up extra cash. How will you save the money that you need? Eating out less often, canceling a gym membership that you don't use, or downgrading your cable from a premium to a basic plan could easily free up \$100 per month or more toward your goal. There are probably many areas within your monthly budget where you can save a few bucks. Make a detailed list of what you spend in an average month and see where you could afford to trim.

Step 3: Match your investments or savings vehicles with your goal. Safety and liquidity (how quickly you can sell an asset), will be priorities if you need the money within a few years. Equities can experience fluctuations over short-term periods. You don't want to be forced to sell your assets when the value of your investment has dropped. More appropriate

choices for short-term needs may be conservative instruments that offer a more stable return, such as short-term bond funds and money market funds. Federally insured savings vehicles, such as certificates of deposit, could also play a role.

UNDERSTANDING SHORT-TERM INVESTMENTS

Short-term bond funds primarily invest in U.S. government or corporate debt with maturities that range from one to three years. However, bond funds are subject to interest and market rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. Money market funds pool investors' dollars to buy money market instruments. These types of securities aim to produce current income, offer liquidity and usually aren't subject to the dramatic ups and downs of equities. Although money market funds seek to preserve the value of your investment at \$1.00 per share, it is possible to lose money by investing in these funds. Also, an investment in money market funds is neither insured nor guaranteed by the FDIC or any other government agency. Certificates of deposit are interest-bearing debt instruments with a wide range of maturities. In exchange for purchasing a certificate of deposit, the investor will receive the return of principal plus interest at the maturity date. Certificates of deposit offer a guaranteed rate of return, guaranteed principal and interest and are generally insured by the FDIC; however, early withdrawal of funds may subject the owner to penalties.

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and could also force Spain and Italy into a liquidity crisis and potential insolvency. We expect central banks to step in to provide liquidity but, even with support, this scenario (or a less severe version of it) would be a harsh economic shock at a time we can ill afford it.

China

We continue to lean toward the more pessimistic/skeptical opinion that China is experiencing unsustainable real estate growth which, once the balloon is pricked, would result in a sharper and quicker slowdown in economic growth than what investors are expecting. It is also the case that China, like emerging markets overall, is not immune to the slowdowns in the U.S. and Europe as these markets are key sources of demand for goods produced there. But our long-term positive view of emerging markets remains intact even as the nearer-term period

may see slower growth. Recently, investors have seemed to recognize the potential for an economic slowdown and emerging-markets equities have taken a beating. ***In fact, toward quarter end, emerging-markets equities reached a point of sufficient attractiveness for us to add them to our portfolios*** (as mentioned earlier).

CONCLUDING THOUGHTS

Investing is a Marathon, Not a Sprint

As one investor we respect put it, "You need to be a marathon runner when investing. Investors should never judge their decisions based on a moment in time."

Earlier this year when markets were shooting higher, some of our decisions and portfolio positions may have looked overly pessimistic or defensive. More recently, as markets tumbled and headlines blared about the possible collapse of the eurozone, some ask why we were not even more conservative in our portfolio

positioning.

But, in our opinion, that type of short-term thinking is what leads most investors to get whipsawed, chasing the market (or asset classes or fund managers) on the way up and then riding them down before jumping into the next hot asset class or manager. Conversely, we believe sticking with a process that has been successful over time, and using an appropriate time horizon to assess the success or failure of one's investment decisions, is critical to winning the marathon of investing.

We appreciate your continued trust and confidence. If you have any questions, please don't hesitate to contact us.

Gregory L. Kozerski, CPA, CFP®, AIFA®

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TAX CORNER: DID YOU KNOW?

There is still time to take advantage of the 0% Tax Rate on Long-Term Capital Gains.



Christine M.
Koniarczyk, CPA

The 0% tax rate was extended in the December 2010 tax deal. This means that any net long-term capital gains for taxpayers in the two lowest regular income tax brackets (the 10% or the 15% brackets) are taxed at 0%. This tax advantage applies to long-term capital gains and qualified corporate dividends earned. All other taxpayers are taxed at the maximum 15% rate on their net long-term capital gains and qualified dividend income. Taxable income (not gross income) determines the tax rate of 0% or 15%.

TAXABLE INCOME = ADJUSTED GROSS INCOME – ALLOWANCES FOR DEDUCTIONS AND EXEMPTIONS

For 2011 the 0% tax rate applies to single taxpayers with taxable income up to \$34,500 and married couples with taxable income up to \$69,000.

STRATEGIES FOR TAKING ADVANTAGE OF THE 0% TAX RATE

- Interest from tax-exempt bonds (municipal bonds for example) and distributions from Roth IRAs aren't included in taxable income. Therefore, to the extent income can be shifted to these two sources, you might qualify for the 0% rate.
- Bunching tax deductions (such as charitable contributions) into 2011 to reduce your taxable income to be able to take advantage of the 0% rate.
- If you are in one of the lower brackets:
 - It could make sense to sell assets with gains to take advantage of the 0% rate.
 - Shifting some investments to stocks that pay qualified dividends could make sense to take advantage of the 0% tax rate.
- If you are supporting a parent or an adult child, you could gift appreciated securities to them. They could then sell the securi-

ties and be subject to the 0% tax on those gains. Note that if the gift exceeds the annual gift tax exclusion of \$13,000 per person, you could owe gift taxes or use part of your lifetime gift tax exemption.

THERE COULDN'T BE A TAX ADVANTAGE WITHOUT TAX TRAPS TO BEWARE OF

- Don't forget the kiddie tax if you try to use the gifting strategy with dependent children. Keep in mind that children will be subject to the kiddie tax if they are under age 19 or under age 24 if they are full time students.
- Taxpayers receiving Social Security benefits must be careful since recognizing long-term capital gains will increase their adjusted gross income and thus could make social security benefits subject to income taxes.

Taking advantage of the 0% income tax rate should not be the only reason for selling an asset. It would be beneficial for someone who is planning to sell the asset in the next few years anyway, someone who needs to reposition a portfolio, or someone who has a new opportunity and needs to raise cash. The 0% income tax rate is a complex area, but anyone who qualifies for it should review the strategies while the rate is still available.

Waterford Advisors has experience in applying these and other income tax strategies for our clients; if you would like to discuss whether this would be applicable to you, or if you have any questions, please give us a call.

HOW DO YOUR ITEMIZED DEDUCTIONS COMPARE WITH OTHER FILERS?

The following table compares averages of several key itemized deductions for filers at various levels of income, using IRS preliminary data from 2009 returns filed:

Adjusted Gross Income	Taxable Income	Interest Expense	Taxes Paid Deduction ⁽¹⁾	Charity	Medical Expenses Deducted ⁽²⁾	Total Itemized Deductions
Under \$15,000	2,739	8,838	3,337	1,496	8,414	16,164
\$15,000 - \$29,999	9,279	8,434	3,184	2,048	7,783	15,608
\$30,000 - \$49,999	21,428	8,699	3,943	2,274	7,028	16,404
\$50,000 - \$99,999	46,401	10,133	6,247	2,775	7,269	20,350
\$100,000 - \$199,999	97,042	13,456	11,069	3,888	9,269	28,952
\$200,000 - \$249,999	171,938	17,572	18,524	5,947	21,599	41,595
\$250,000 & above	555,769	25,527	48,317	18,488	38,149	89,432

⁽¹⁾ Averages for taxes paid may seem low due to the fact that some filers elect to deduct state sales tax when they live in a state that doesn't have an income tax. The averages also include personal property taxes, as well as real estate taxes.

⁽²⁾ Only medical expenses that exceed 7½% of adjusted gross income are deductible. Therefore, relatively few filers actually take the write-off. These figures are for those filers only.

Having above-average deductions does not mean that you would be automatically audited. The IRS knows that filers living in states with high individual tax rates would claim larger state tax deductions than filers with low or no state income tax. The Service also matches deductions claimed with information it receives from other sources, such as 1098 forms provided from lenders for interest expense and W-2 forms for state withholding.

However, you should be aware that if you claim deductions that are disproportionately large compared to your income, your audit risk can go up since that is a key factor in the audit selection formulas used by the IRS.

MEDICARE: IT'S ALL ABOUT PLANNING



Christina M. Michalczak, CFP® Enrolled Agent

As the first baby boomers reach Medicare eligibility this year, they'll have to begin making critical decisions. Failure to make those decisions at the right time can be costly. Here are some important points to consider.

1. SIGN UP WHEN YOU'RE ELIGIBLE.

Fail to sign up within your initial enrollment period and you'll pay a higher Part B or D premium every month for life. This can be a real problem if you're a higher income individual, because Medicare premiums now are based on income (the higher your income, the higher your annual premiums).

For Parts A, B, and D the initial enrollment period stretches from the three months before you turn 65 to the three months afterward. Medicare Part A (hospital insurance) is typically automatic (if you have applied for Social Security), but all other Medicare decisions need to be made during this time. The only reason to delay enrolling that won't be penalized is if you're working and covered by an acceptable employer or union plan. If you delayed enrolling in Medicare because you were covered by an employer plan, you must sign up for Medicare within eight months after your group coverage ends. When you're phasing out work or have sold a business but still have a consulting or other relationship, you could fall into a gray area and unwittingly be hit with the penalty.

The premium penalty also applies when you sign up for Medicare Part D prescription drug coverage. Some people who sign up for traditional Medicare don't sign up for Part D right away, because they aren't taking prescription drugs regularly. But, if you decide you want Part D later on, you'll owe the penalty. Every day you wait permanently increases the cost of your monthly premiums. It's better to sign up for a bare bones coverage plan that charges a low monthly premium. Later, if you want

broader coverage, you might be able to switch plans during the annual enrollment period.

2. RECENT RULE CHANGES.

The open enrollment period (OEP), when you choose a plan for the following year, has changed. For 2011, the OEP is from Oct. 15 to Dec. 7. Previously the OEP was from Nov. 15 through year end.

Also note that previously you could switch from one Medicare Advantage plan to another, or switch from Advantage to traditional Medicare, between Jan. 1 and Mar. 31. That rule has changed. Now, your switch period is limited to Jan. 1 through Feb. 14; additionally, you can't switch from one Advantage plan to another during this period, you can only switch from Advantage to traditional Medicare.

3. MEDICARE PLANS (OTHER THAN TRADITIONAL MEDICARE) ARE GEOGRAPHY-BASED.

Advantage plans, Part D prescription plans, and Medicare supplement plans (Medigap policies) are priced, and coverage is determined, based on your residence. Once your residence changes, your coverage under these types of plans often ends. You won't receive a warning or a grace period. When you begin submitting claims from medical providers in an area other than your principal residence, the insurer will assume you moved and terminate coverage automatically. When you plan to move during a calendar year, see if you're eligible to transfer coverage and be sure there is coverage you want and can afford in the new location.

4. INCOME-BASED MEDICARE PREMIUMS REQUIRE CAREFUL PLANNING.

Your 2011 premiums were determined by your 2009 income tax return. You can appeal for a lower premium when there's been a change that reduces income, such as loss of a job, death of a spouse etc. Note also that tax-exempt income will be included in MAGI (modified adjusted gross income) to calculate the Part B premium. Roth IRA conversions and capital gains will affect future premiums.

The bill for the increased premium comes due two years later, so the connection is often overlooked. The premium level is re-determined each year based on your income tax return of two years earlier. *Managing the timing of income is the key.* For example it might be better to withdraw tax-free cash from a Roth IRA, rather than a traditional IRA, in years where other income would push up Part B premiums.

The healthcare reform law passed last year makes such planning even more important. Part D premiums are now income-tested as well, using the same income definitions and breakpoints as for Part B. Planning around capital gains and Roth IRA conversions in order to remain under specific MAGI levels may reduce premiums.

5. SEEK HELP WHEN YOU NEED IT.

Medicare offers a web site, publications and telephone assistance, all at no additional cost. States also have agencies that offer free counseling. When you're looking at Medigap, Part D, or Advantage plans, insurance agents can provide advice and answer questions also.

In order to provide increased services to our clients, Waterford Advisors LLC has recently partnered with a Medicare consultant who is available to work with our clients to help them understand the Medicare Program and develop the appropriate strategies based on their individual situation. Please contact us if you wish to discuss your Medicare related questions in more detail.

If you wish to be removed from our mailing list or if you have friends, family, or colleagues you think would benefit from our newsletter, please email us at eml@waterfordadv.com or send a fax to 716-580-3913.

As always, we welcome your comments or questions, and we invite you to share our newsletters with friends and acquaintances.



STARTING A ROTH IRA EARLY CAN PROVIDE A NICE NEST EGG

Do you have a child or grandchild who worked hard at a summer job this year? If so, you should consider contributing to a Roth IRA for him or her.

You can contribute up to \$5,000, but no more than the child's earnings. The amount you put in counts toward the \$13,000 annual gift tax exclusion (\$26,000—if both spouses agree to gift \$13,000 each).

A \$5,000 contribution to a Roth IRA for a 16 year old, earning 8% each year will grow to \$217,000 when they reach age 65 and \$319,000 at age 70. If the child works several summers in a row and contributions are made for each year, the future balance will be significantly larger.

Besides the tax-free withdrawals after age 59 ½, the child could pull out the contribution amounts free of tax, which could help for example when purchasing a first home.

Also, any gifts made remove the assets from your gross estate along with any future earnings on those assets. This can reduce the size of your taxable estate and reduce the amount of estate taxes that ultimately have to be paid on your estate and leave more of your estate for your heirs.

2012 SOCIAL SECURITY & MEDICARE CHANGES

Social Security's annual cost of living adjustment (COLA) seems assured to rise a few percent for 2012, its first increase in three years. Whether that gain winds up putting many dollars in beneficiaries' pockets is another matter, however.

There are complex links between annual changes in Social Security and Medicare insurance premiums. Depending on your annual income and when you began Medicare, higher Medicare premiums could eat up much or all of your COLA gains.

HOW IS THE COLA CALCULATED?

The Social Security COLA is based on a version of the U.S. Consumer Price Index tailored for people who work. It's called the CPI for Urban Wage Earners and Clerical Workers, or the CPI-W. Every year, Social Security looks at the CPI-W average during the third quarter of the year, compares it with the average during the previous year's third quarter, and designates any percentage increase as the following year's COLA.

Following a big surge in oil prices in the summer of 2008, the CPI-W spiked and led to a big 5.8% COLA increase for 2009, the program's largest in 25 years. Oil prices later declined and so did overall inflation. In both 2009 and 2010, the third-quarter average for the CPI-W was less than it was during 2008's third quarter. As retirees know all too well, this meant no COLA in 2010 or 2011.

Since last summer, however, energy and other prices have risen. At the end of July, the CPI-W was 4.1% higher than in July 2010, and the index stood at 222.686. This is 3.3% higher than the CPI-W average of 215.495 during the third quarter of 2008.

Prices for crude oil have plunged in recent weeks, so it's possible that the CPI-W would dip during the next two months. However, food prices have been rising, and prices for imported goods are up 14% from a year ago, due primarily to the diminished purchasing power of a weaker U.S. dollar.

THE COLA AND MEDICARE PREMIUMS

If the COLA does rise by a few percent, it would also trigger the first increase in three years for Part B Medicare premiums. Parts A and B, commonly known as traditional Medicare, cover

hospitals plus physician and outpatient expenses. There is no premium for Part A coverage. The government backs Part B premiums directly out of a beneficiary's Social Security payment.

The "hold harmless" clause prohibits Social Security payments from declining from one year to the next. So, the absence of a COLA in 2009 and 2010 meant that there could be no increase in Part B premiums for existing beneficiaries. This premium has thus been frozen at \$96.40 a month for about 75% of beneficiaries.

Another provision of the law requires Part B premiums to finance 25% of the costs of providing covered services. With premiums frozen for most beneficiaries but healthcare costs still rising, Medicare had to look to the new and higher-income beneficiaries to pay bigger premiums to maintain that 25% finance level.

New enrollees in 2011, for example, pay a monthly Part B premium of \$115.40 if they earned less than \$85,000 a year (\$170,000 for couples). Rates for higher-income earners rise substantially, and the wealthiest beneficiaries pay premiums approaching 80% of their costs, not 25%.

"In most years, a significant portion of the cost-of-living increases received by most Social Security beneficiaries" is used to pay for higher Medicare premiums, Rudolph G. Penner wrote in a recent study for the Urban Institute. Social Security benefits thus are "not keeping up with inflation, and for those retired a long time, the real value of the net benefit can erode significantly."

Looking ahead, Penner said in the study, "the rapid growth in healthcare costs is leaving the entire population with relatively less to spend on non-health goods and services, and the elderly are affected the most because so much more of their income goes to healthcare."

One of the impacts of raising Part B premiums would be to make it more attractive for beneficiaries to seek coverage through a Medicare Advantage policy. MA policies compete with traditional Medicare. Open enrollment for 2012 plans begins October 15 and extends until December 7. Details on any changes to the 2012 COLA and increases in Part B premiums are expected to be announced later in October.

As an added feature to our newsletter, each quarter we will highlight an investment that may be contained within your portfolio. We hope you find this information beneficial. As always, if you'd like to review or discuss your portfolio in greater detail, please feel free to call our office at any time.

LONGLEAF PARTNERS FUND (LLPFX)

INVESTMENT PHILOSOPHY & PROCESS

The fund is a concentrated mid- and large-cap value fund. The team employs a highly disciplined approach aimed at identifying stocks selling for less than 60% of their appraisal of the company's underlying value. They prefer companies with strong balance sheets, growing free cash flow, competitive advantages, pricing power, and skilled management. They evaluate management based on their operational and capital allocation skills, and also like to see evidence that management's financial incentives are aligned with shareholders.

In determining their appraisal value for a particular stock, three separate analyses are conducted, and a stock is only purchased if the current price is 60% or less of that appraisal (Longleaf says the appraisal represents the price that rational, independent buyers would pay in an arm's-length transaction). First, they evaluate the company's liquidation value based on assets and liabilities. Next, they do a discounted cash flow analysis based on the company's ability to generate free cash flow after required capital expenditures and working capital needs. The cash flows for each year are then discounted back to present value using a conservative discount rate. Finally, they assess their appraisal against a database of corporate transactions (takeovers, mergers, etc.) to see how similar companies have been priced when purchased outright.

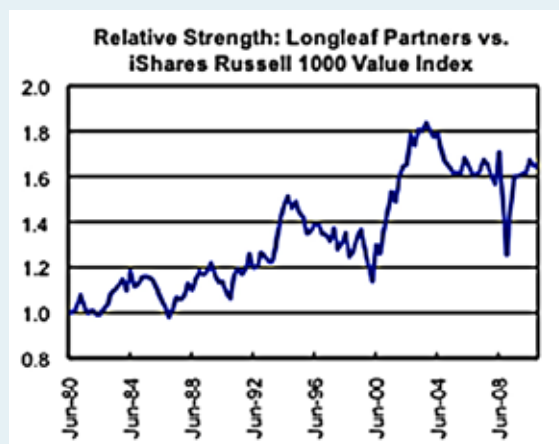
Stocks are sold if they hit their price target, if a clearly superior investment is found, if the fundamentals decline significantly, or if Longleaf loses confidence in the management team. The fund generally holds 25 or fewer stocks, with position sizes as high as 10% to 15% for their highest conviction positions.

ANALYSIS & OPINION

Opinion: Longleaf Partners' highly disciplined approach has proven itself over many years and is deeply ingrained in the firm's culture. They have an incredibly thorough understanding of the companies they own and the depth of their research is truly impressive. The team focuses on the long term. These factors give us a high level of conviction that the fund will be able to beat its benchmark on a long-term basis. Investors should take note that this fund is highly concentrated and it will often have significantly different sector weightings than the benchmark. As such it can have extended periods of noticeably out-of-sync performance, although overall volatility has historically been no worse than the benchmark.

Asset Class	Larger-Cap Value
Managers	Mason Hawkins Staley Cates
Min. Initial Inv.	\$10,000
Expense Ratio	0.91%

Relative Strength: Fund vs. Peer Group



Performance as of 7/31/2011*

	Longleaf Partners	iShares Russell 1000 Value Index
YTD	6.65%	2.14%
1 Year	32.04%	28.94%
3 Year	2.41%	2.28%
5 Year	1.84%	1.15%
10 Year	5.00%	3.99%
Since Inception (April 1987)	11.39%	4.15%

*Past performance does not guarantee future results

WATERFORD HAPPENINGS



HOW DO WE COMPARE WITH OTHER ADVISORY FIRMS?

Waterford Advisors participates annually in the Charles Schwab's Registered Investment Advisory Firms (RIA's) Benchmarking

Study. We do this to see how we're performing compared with other RIA firms and against the Best Managed Firms in our industry. Over 800 firms who custody assets with Schwab were participants in 2010's study. We are very pleased with our performance in this important analysis, but the statistic we are most proud of is how we scored against our peers on client retention. ***Over the past five years, Waterford Advisors LLC has ranked in the top 1% of firms in terms of client retention, which makes us one of the Best Managed Firms when it comes to retaining our clients.***

NEWS FROM OUR TAX DEPARTMENT

Christine M. Koniarczyk, CPA, continues to be an integral part of the Waterford team. She managed our Tax Department for the past two years and will continue to do so in 2012, and her professionalism and experience are valuable assets to our firm. Additionally, beginning September 1st, Chris is now on Waterford's staff full-time.

We anticipate significant changes in tax legislation in the near and mid-term and Chris will play a key role as Waterford offers expanded tax planning services to our clients.

NEED HELP WITH MEDICARE PLANNING?

To further demonstrate our commitment to delivering superior client service, Waterford recently partnered with a Medicare consultant, who is available to work with our clients to help them understand the Medicare Program and develop the appropriate strategies based on

their individual situation. Please contact us if you wish to discuss your Medicare related questions in more detail or to schedule an appointment to meet with our consultant.

WELL DONE!



Elaine Lechanski's son Tom was recently promoted to the rank of Corporal in the United States

Marine Corps while serving in Afghanistan. In addition, he received the Navy and Marine Corps Achievement Medal for his service to his squadron. After a seven month deployment, Corporal Thomas W. Lechanski will head back to his base stateside, with plans to come home to Buffalo in December for the holidays.

WATERFORD ADVISORS

An SEC Registered Investment Advisor • Certified Financial Planner™

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