Winter 2013 Commentary

Erich Imphong CFP®

ASSISTANT PORTFOLIO MANAGER

Long Term Discipline

The S&P 500 concluded the year with its best performance since 1997, posting a stellar annual return of 32.39%.

This is the fifth consecutive year of positive gains for the S&P 500, and you may wonder if after five consecutive years of positive performance, will 2014 be the year that the S&P 500 breaks this string of wins? No one knows this answer, but we can look to historical market performance, economic data, and collective corporate earnings to assign a probability of performance. To elaborate on historical market performance, since 1928 the S&P 500 has returned negatively 24 times and positively 62 times, which translates to a 72% probability you'll have a positive return in any given year and a 28% probability to the contrary. It is important that in understanding this probability you give yourself an adequate time horizon, which is why we believe investing is a long-term discipline. There may be some bumps along the way as we go through economic cycles, but history has shown that stocks and the financial markets do have a positive trend. We stated last quarter that it pays well to stay invested, and we still believe this is true today. Warren Buffet summarized this well in his annual shareholder letter, "The risks of being out of the game are huge compared to the risks of being in it."

Fourth Quarter

Despite the brief and partial shutdown of our government in early October, the fourth quarter finally showed the markets that positive economic news translates to good performance in the financial markets. The media has painted an overblown image that once Quantitative Easing (QE) concludes the financial markets will experience a substantial pullback. Therefore, whenever positive economic data was released, investors became nervous that the Federal Reserve would begin to taper. Case in point was the negative reaction to Dr. Bernanke's hinting at tapering late spring 2013 amidst improving economic data. However, we argue that tapering is bullish as we normalize monetary policy in that it shows our economy has the legs to support itself in a post QE world. Interestingly, on December 18, 2013 stocks rallied on the news that tapering would begin January 2014. Further, good news came from stronger payroll data in October and November, and this drove stocks higher as investors were reassured by the strengthening job gains dropping unemployment to 7.0%. Lastly, data released in December showed that the economy had grown at an annualized rate of 4.1%, which is significantly better than forecasted as the year began. All data combined led the S&P 500 to a fourth quarter gain of 10.51%.

The U.S. Bond Market saw the yield on the 10-year Treasury note climb from 2.61% at the beginning of the fourth quarter to 3.03% at the conclusion as a result of the Fed's tapering decision. It is expected that the yield curve will become more normalized, and as this happens we expect there will be further pressure on fixed income investments. Positive performance in the bond market has come from high yield corporate bonds, which have significantly outperformed the Barclays Aggregate Bond Index. Credit Suisse's High Yield index ended the year in the black at 7.53% while Barclays Aggregate Bond Index ended -2.02%. Lastly, in the fixed income markets, municipal bonds suffered their worst calendar year performance this year in more than two decades. Yet, despite the pressure muni's had this year; we believe there is value in this market for investors as we look outside of isolated risks like Puerto Rico.

We believe there is still significant value in the European and developed markets. In addition, for the investor with a long-term investment horizon there is even greater opportunity in the emerging markets as their economies assimilate towards developed economies, particularly those with less sensitivity to commodity prices. The MSCI European Index finished the fourth quarter up 7.92% and for the year up 25.96%. The MSCI Emerging Market Index finished the quarter up 1.86% and down -2.27% for 2013. Japan's market had a banner year, and though monetary easing has significantly weakened the yen to the USD, it may have pushed the export-driven economy out of its deflationary slump. In conclusion, it was a better than average year for MSCI's All Country World ex-U.S. index, which in the 4^{th} quarter returned 4.81% and for the year ended up 15.78%.

In Summary

2013 was an incredible year for equities, but we must always be cautiously optimistic about the financial markets. Looking ahead to 2014, we do understand there are risks we can identify in interest rates, inflation and monetary easing, but there are also risks we can't identify or simply don't know. However, we do know that the best defense to risk is diversification, which is why we believe diversification is so important. Yet, despite the potential for risk, we are inclined to think the economy will continue to heal, the unemployed will continue finding jobs, and we will look ahead to an even better tomorrow. In investing, just as in life, there are no certainties, but we can successfully manage and maneuver both with a positive attitude and diligent approach.

As always, we greatly appreciate your continued confidence in our firm.

U.S. Bond Market		
Index	**Fourth Quarter 2013**	**Year-to-Date**
Barclays Capital U.S. Aggregate Bond Index	-.14%	-2.02%
Credit Suisse High Yield Index	3.45	7.53
Barclays Capital Municipal Bond Index	.32	-2.55
Barclays Capital Global Aggregate Ex-U.S. Dollar Government Bond Index	-.72	-3.08
J.P. Morgan Emerging Markets Index Plus	.64	-8.31

U.S. Stocks		
Index	**Fourth Quarter 2013**	**Year-to-Date**
DJIA	10.22%	29.65%
S&P 500	10.51	32.39
Nasdaq Composite	10.74	38.32
S&P Mid Cap 400	8.33	33.50
Russell 2000	8.72	38.82

International Averages		
MSCI Index	**Fourth Quarter 2013**	**Year-to-Date**
EAFE (Europe, Australasia, Far East)	5.75%	23.29%
All Country World ex-U.S.	4.81	15.78
Europe	7.92	25.96
Japan	2.31	27.35
All Country Asia Ex-Japan	3.42	3.33
EM (Emerging Markets)	1.86	-2.27

results. The investment return and principal value of an investment in Mutual Fund will fluctuate so that an investor's shares, when redeemed, may be worth more or less than their original cost.

Fluctuations of the overall stock market due to economic, political or other factors may affect the equity related holdings of the investor. Asset classes and sectors may rise and fall at varying degrees.

Sectors such as oil & gas, real estate, and precious metals tend toward higher volatility than broader market segments.

Bond and other related fixed income investments are subject to the rise and fall of interest rates and changing assessments of issuer credit worthiness and ability to pay.

Cash Investments Risk - the need to hold a given amount of an investor's portfolio in cash or other money market instruments to meet withdrawals or respond to anticipated unfavorable market conditions could result in a lower return than if the cash had been fully invested.

Investments in real estate investment trusts (REITs) and real estate related securities involve special risks associated with an investment in real estate, such as limited liquidity and interest rate risks and may be more volatile than other securities. In addition, the value of REITs and other real estate related investments is sensitive to changes in real estate values, extended vacancies of properties and other environmental and economic factors.

Investments in international markets present special risks including currently fluctuation, the potential for diplomatic political instability, regulatory and liquidity risks, foreign taxation and differences in auditing and other financial standards. Risks of foreign investing are generally intensified for investments in emerging markets.

An investment in an exchange-traded fund (ETF) generally presents the same primary risks as an investment in a conventional fund (i.e., one that is not exchange traded) that has the same investment objectives, strategies, and policies. The price of an ETF can fluctuate up or down, and the Fund could lose money investing in an ETF if the prices of the securities owned by the ETF go down. In addition, ETFs may be subject to the following risks that do not apply to conventional funds: (i) the market price of an ETF's shares may trade above or below their net asset value; (ii) an active trading market for an ETF's shares may not develop or be maintained; or (iii) trading of an ETF's shares may be halted if the listing exchange's officials deem such action appropriate, the shares are delisted from the exchange, or the activation of market-wide "circuit breakers" (which are tired to large decreases in stock prices) halts stock trading generally.

Performance reporting for the above indexes is obtained from publicly issued and available data from a variety of sources including financial web sites such as Morningstar ®, Yahoo Finance ®, and The Street.Com ®.