Timmons Wealth Management

Market Newsletter – Fourth Quarter 2013

Fourth Quarter 2013 Review

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As we put 2013 in our rear-view mirror, it is difficult not to smile as we assess the past year's investment results. Despite the numerous challenges and worries that plagued both equity and bond markets throughout the year, investors that avoided knee-jerk reactions to the endless stream of sensational news stories and remained focused on longer term fundamentals and goals were richly rewarded. For the full year 2013, the US stock market experienced its strongest returns since 1995, outperforming most international developed and emerging market stock indices. With the exception of high yield bonds, fixed income investments experienced losses as rising interest rates caused bond prices to fall. Investment strategies focused on smaller and higher growth companies outperformed more conservative strategies focused on larger dividend paying companies trading at low valuations. Throughout the year, our diversified approach to portfolio construction enabled our clients to capture strong absolute returns while providing appropriate levels of defense in the event of a market correction. The more conservative and valuation-focused strategies among our core US stock investments proved a moderate headwind during the fourth quarter as several of these funds began to book profits and build cash levels. We remain encouraged by these prudent actions and continue to believe fund strategies with an established history of strong risk-adjusted returns will serve our clients well over the long term.

For the fourth quarter, the S&P 500 produced a total return of +10.51%. Valuations across US stocks continued to expand, with some bubbles beginning to form in certain social media IPOs and crowd favorites. US investors faced a myriad of challenges during the quarter including a 16 day government shutdown which raised concerns about a potential US debt default and the shutdown's potential drag on the US economy. In spite of these uncertainties, the US economy continued to exhibit signs of improvement. GDP growth for the third quarter was upwardly revised to a robust +4.1% by the US Bureau of Economic Analysis, while home prices rose +13.61% on an annual basis in October. A sharp rebound in household wealth driven by rising home prices, improving job conditions, low inflation, historically low interest rates as well as strong market returns have benefitted both consumers and businesses. The US unemployment rate in December fell to 6.7%, though concerns linger over the falling labor force participation rate of 62.8% which has hit a 35 year low as well as the level of long term unemployed. Key leadership and policy changes emerged from the Federal Reserve during the quarter. Janet Yellen was nominated as the next Federal Reserve Chair and the Federal Reserve announced plans at the December meeting to begin tapering its bond buying program in January 2014, essentially removing $10B a month in stimulus from the US economy.

Despite lagging the US market in the fourth quarter, international markets led by Europe and Japan experienced strong absolute returns of +4.8% as measured by the FTSE Global All Cap ex-US Index. Signs continued to emerge from Europe of improving business activity across manufacturing and services industries, while inflation levels remained low enabling the European Central Bank to take additional actions to boost economic growth. Unemployment has begun to show modest improvement across the Eurozone, and signs of stabilization in countries such as Italy and Spain have served to calm fears of a

Eurozone breakup. With the Eurozone's economy positioned to expand in 2014 and attractive relative stock valuations vs. the US markets, investors began to aggressively position portfolios in European stocks throughout the fourth quarter. Japan's efforts to boost inflation and restore growth via government stimulus and a weakened currency appear to have succeeded in boosting exports and improving business confidence.

Emerging markets once again significantly underperformed international developed and US markets, earning +1.54% in the fourth quarter and producing a -5.0% loss for the year as measured by the MSCI Emerging Market Index. Emerging markets have struggled in the face of rising investment outflows largely driven by slowing growth across emerging market economies, falling profitability levels and fears that reduced liquidity from the Federal Reserve will drive interest rates higher. China continues to grapple with the credit binge which has fueled growth in recent years and has led to significant housing inflation and rising bad loans, leaving open the distinct possibility of a major credit crisis in China's future. Brazil has been forced to confront high inflation, political unrest and a credit bubble exacerbated by slowing commodity demand. In the fourth quarter, Brazilian oil firm OGX defaulted on its debt, making it the largest default in the country's history. India's central bank continues to battle stubbornly high inflation levels by increasing interest rates which has simultaneously resulted in slowing economic growth. We remain cautious on emerging market investments, an opinion highlighted by our limited direct exposure to these markets at this time.

In the face of rising interest rates during the quarter, bonds produced a modest loss of -0.14% as measured by the Barclays US Aggregate Bond Index. As economic data continued to improve increasing the likelihood of tapering by the Federal Reserve, the yield on the 10 year US Treasury rose from 2.48% in October to a peak of 3.02% on December 31st. High yield bonds, those issued by companies with riskier investment profiles, continued to outperform government and investment grade corporate bonds, while US Treasuries and Treasury Inflation Protected Securities were among the worst performers. As discussed during previous letters, we continue to position client bond allocations within strategies that we believe will hold up best during a rising interest rate environment while avoiding unnecessary credit risk. During the quarter, we enhanced a portion of our bond models by implementing a new alternative investment strategy focused on merger arbitrage, maintaining our focus on lower volatility investments for clients with less aggressive risk tolerances.

2014 Market Outlook

As we look out to 2014, we believe stocks continue to be the preferred asset class of choice. However, we believe investors need to temper their return expectations as another year like 2013 is unlikely. Economists predict that US GDP growth may exceed 3% in 2013 with a pickup in economic growth driven by a variety of factors including reduced budget overhangs, no new tax increases, falling energy prices, lower import prices, healthy corporate balance sheets and low interest rates. The strength of US stock returns in 2014 will be largely dictated by the degree of improvement in company earnings rather than multiple expansions which was a driving force behind 2013 stock returns. From a portfolio positioning perspective, large US multinational companies may benefit disproportionately from improving economies outside the US vs. smaller, more domestically focused companies. With expansion forecasted throughout the Eurozone in 2014, a highly accommodative European Central Bank and attractive stock valuations, we have increased client allocations in European-focused investments. Low bond yields across Europe coupled with improving economic fundamentals and reduced austerity measures should serve to drive demand for European stocks, especially if company earnings should begin to normalize.

Throughout 2014, we expect various structural and cyclical issues will likely lead to emerging markets continuing to underperform more developed markets. Pricing pressure driven by changes in monetary policy in the US and UK, slower growth rates and lower commodity prices will remain major negatives for many emerging market economies. Though valuations may appear attractive, we believe they are warranted given the risks. We anticipate another tough year for bond investors, with the potential for interest rates to move 0.5% to 1% higher by the end of the year. Given this outlook, we continue to research and implement bond and alternative investment strategies that will help to soften the impact of rising interest rates while ensuring their primary role of balancing risk is maintained.

Market Data

Broad Market Benchmarks	**4Q2013**
S&P500	10.51%
FTSE Global All-Cap ex-US	4.80%
Barclays US Aggregate Bond Index	-0.14%
Barclays US Treasury Bill 1-3 Months	0.01%
TWM Client Benchmarks	**4Q2013**
Aggressive Growth Strategy	9.36%
Capital Appreciation Strategy	7.41%
Balanced Return Strategy	5.50%

Disclosure: Historical performance results for investment indices and/or benchmarks have been provided for general comparison purposes only, and generally do not reflect the deduction of transaction and/or custodial charges, the deduction of an investment management fee, nor the impact of taxes, the incurrence of which would have the effect of decreasing historical performance results.

As always, we encourage our clients to contact our office with any questions or to discuss our 2014 Market Outlook in greater detail. On behalf of Timmons Wealth Management, I want to wish you and your family a very happy and prosperous 2014!

Sincerely,

Liam Timmons, President

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