# Investment Committee

Quarter Analysis
01/21/2012

## 4th Quarter Review

The widely followed S&P 500 Index came in slightly negative at 0.38% in the 4th quarter. The losses happened in October and then the market bounced back for the months of November and December with slight gains. All in all the positive returns for 2012 in the overall market were a surprise to us as it seems that risk factors including Europe and the US fiscal situations were pushed down the road yet again. As we begin our outlook for 2013, we simply cannot ignore the fact these risks have not been dealt with in the economy but simply pushed down the road.

For the 4th quarter, the TFS Low Correlation Core also suffered a loss of -0.57%. The TFS Balance Growth model also had a negative return of -1.26%. For the year, the TFS Low Correlation Model returned a positive 2.8% after fees and the TFS Balanced Growth Model returned 7.76% after fees. While these returns are not as good as we would have hoped, we feel that with the risks looming during 2012 a more conservative approach was necessary.

The best performing assets in the "Low Correlation Core" model during 4th quarter were:

- Cheniere Energy = 21.24% (2% of portfolio)
- Templeton Global Bond = 3.91% (5% of portfolio)
- Royce Special Equity = 2.79% (7.5% of portfolio)
- Mid-America Apartment Communities = 1.99% (5% of portfolio)
- Arbitrage Fund = .74% (10% of portfolio)

The worst performing assets were:

- Poseidon Concepts Corp = -77.00% (1% of portfolio)
- Chevron Corp = - 6.96% (2% of portfolio)
- Annaly Capital Management = - 3.91% (Was 5%; Now 0% of Portfolio)
- iShares Barclays 20+ Yr Treas Bond = - 1.98% (5% of portfolio)
- Hussman Strategic Total Return = -0.91% (15% of portfolio)

In the 2nd quarter we purchased Cheniere due to the possibilities we see long term in exporting liquefied natural gas. It took us a couple of quarters to get ahead but it appears this investment is beginning to pay off. We see Cheniere as a long term hold as we watch the market for LNG develop. Our investment in Poseidon (while only 1% of the portfolio) really hurt us over the 3 month period. We picked it up after the stock had fallen over 60% only to watch it fall another 77%. After this destruction it is only a 0.24% weighting in the overall portfolio. Therefore, we do not see much reason for selling at current levels. Based on the numbers produced by Poseidon we believed to be getting a good value where we bought.

Political events ruled the quarter but ended up not really making a difference. Now there are many issues still to deal with as we turn the page to 2013.

**1st Quarter Analysis**

**Based on long-term rolling average P/E ratios and historical research we believe that broad US stock markets are in a secular bear market. We believe we will remain in a long term secular bear market cycle until 10 year rolling P/E ratios are less than 10 on the S&P 500. Do to the high valuations that were seen in the previous long term secular bull market (1981-1999), we believe it is possible that this market will reach lower valuations than past long term bear market cycles. Therefore, our long term strategies for our model portfolios seek consistent returns through low correlation portfolios.**

*Economic Analysis – Neutral*

- [1]***Employment – Neutral*** – The unemployment rate remains unchanged from Q3-2012 at 7.8%. The year over year comparison is an improvement from 8.5% in December 2011. Non-farm payroll employment rose by 155,000 in December 2012, and the unemployment rate was unchanged from the month prior. Employment increased in health care, food services and drinking places, construction, and manufacturing.
- [2,3]***Consumer Credit/Savings – Positive*** – Consumers credit was 5.8% higher year over year as of November 2012. The personal savings rate ended the 3rd quarter of 2012 at 3.6% declining to 3.2% in November 2012. While this should be positive for the economy, it is not evident in the Money Velocity numbers.
- [2]***Money Velocity – Negative*** – The current money velocity ratio is 1.57. We have eclipsed the 1.60 ratio that was observed in the mid 1960's. This number indicates that the Federal Reserve has still not been able to reverse the decline in money velocity despite its efforts. We will get new numbers on money velocity which we will be watching very closely in about 2 weeks.

*Market Analysis* – ***Leaning Positive***

- [4]***Fundamental Analysis – Positive***

- Revenue growth of S&P 500 companies – Positive – Per analysts estimates for the 4th quarters, sales were up 4.3% over the 3rd quarter and 2.9% over 4th quarter 2011 actual sales.
- Earnings growth of S&P 500 companies – Positive - Per analysts estimate of 4th quarter earnings, earnings are 6% higher than the same quarter in 2012.

- [5]***Technical Analysis – Positive***
  - The S&P 500 is currently trading 3.3% above the 50 day moving average of 1413
  - The S&P 500 is currently trading 5% above the 200 day moving average of 1391
  - The 50 day moving average is trading 1.6% above the 200 day moving average
- [6]***External Analysis – Neutral***
- With the re-election of President Obama, the business community now knows Obamacare is here to stay and is currently preparing for what that will entail as far as increased costs. Europe has seemed to stabilize due to the ECB claiming it will do whatever it needs to in order to save the Euro currency.
- [7]The Fiscal Cliff proved to be a last minute scramble for a vote and ultimately extended most of the Bush tax laws, with the estate exemption of $5,250,000 per individual being put in place and the estate tax rising to 40%. Income and long term capital gains tax rates did rise for income levels above $400,000 for a single filer $450,000 for a joint filer going forward, but remained at the same levels as 2012 for income levels under the new threshold.
- The debt ceiling debate is currently scheduled for mid-March of 2013. Due to the pattern of political gamesmanship that has occurred over the past few years when deadlines have been in place, we do not anticipate the pattern changing for the debt debate and another vote not taking place until the last hour.
- [8]In March, Congress will be voting to extend or do away with the debt ceiling which is currently approximately $16 Trillion dollars. The consequences of not having a debt ceiling are unknown and will more than likely result in a volatile government bond market. The reason for the debate is that we have maxed out our debt, meaning we have approximately $16 Trillion dollars in government issued debt. With the 2013 US Government annual budget of approximately $4 trillion dollars and tax revenue of $3 trillion, our current deficit is approximately $1 trillion annually. Without the ability to borrow, our government would have to cut spending by $1 trillion. That would have an enormous impact on our GDP which is currently approximately $16 trillion also.

*Price Analysis – Negative*

- [9]*In long term secular bear market cycles markets tend to trade in a large range for a very long period of time. For instance, from 1966-1981 the Dow Jones Industrial Average started at 969 in 1966 and ended at 875 in 1981. That is a 15 year period where you pretty much ended at the same place you began. However, there were 4 positive swings of more than 20% and 4 negative swings of more than 20% in that cycle. Therefore, we are breaking down this secular bear market by price quartile. If we are trading in the top quartiles of the bear market cycle that will be considered a negative for adding stock market exposure. If we are in the bottom two quartiles that will be considered a positive for adding stock market exposure. This analysis is based on first deciding that we are in a long term secular bear market.*
- [5]*Current Price on the Dow Jones Industrial Average = 13,649.70*
- *Quartiles*

- *Bottom Quartile = 6626 – 8486*
- *2nd Quartile = 8486 – 10346*
- *3rd Quartile = 10346 – 12206*
- *Top Quartile = 12206 – 14066*

***Overall – Since our last investment committee meeting our economic analysis has remained in neutral*. Our market analysis has flipped back to slightly positive from negative. At the beginning of 2013, we will take steps to add to the ends of the portfolio that can provide more return in volatile times. We want to leave downside protection and a balance of inflation and deflation assets in the portfolio as we do not believe those risks have been removed from the market.**

Disclaimer: Please note that individual client performance returns may vary depending on a variety of factors: when invested into a specific portfolio, other non-model holdings etc… Please consult your most recent quarterly performance reports for your personalized returns. As always past performance is not a reliable indicator of future performance.

***Portfolio Decisions***

TFS Low Correlation Models:

- Sell Arbitrage Fund (ARBFX) – Arbitrage has been a holding that has provided incrementally positive returns. At this time, we do not believe the added value is worth the cost of the mutual fund in the portfolio. We think these funds will be better suited for areas that can provide more return to the overall portfolio.
- Sell Hussman Total Return (HSTRX) – This is actually a very similar story to Arbitrage. At this time, we do not believe that this low volatility position is necessary in the portfolio and is dragging overall returns. We believe Hussman is a very intelligent manager and there could be a good time in the future to return to his strategies.
- Sell iShares Barclays 1-3 Year Treasury Bonds (SHY) – This is a fund we have been utilizing more as a cash position. At this time, we are going to implement our cash on the ends of the portfolio by adding to gold, small cap stocks, and long term treasuries. We believe this will increase returns while leaving hedges in place to reduce downside volatility.

- Buy Apple Stock for 2.5% of portfolio (AAPL) -- Apple is trading at a 30% discount to its 52 week high. We do see some headwinds for Apple to continue to grow but they are trading at very good valuations and still have good possibilities for growth in global markets.
- Add to Royce Special Equity (RYSEX) – Royce Special Equity is a small cap value fund that continues to outperform broad indices by implementing very solid value investing strategies. This holding performed very well for us in 2012 and this along with Apple is where we are going to add a little market exposure for this quarter.
- Add to iShares Long Term US Treasury (TLT) -- The Fed has told us that they are going to hold down long term rates through 2014. We believe people will continue to go to long term

treasury bonds and gold in times of high uncertainty.  With 30 year yields back around 3%, we think it is a good time to increase our downside hedge through treasury bonds.

- Add to SPDR Gold Trust (GLD)  – Same reason as TLT above, however, we think gold could spike in a really gruesome debt ceiling debate.
- Add to Pimco Long Term Treasury Inflation Securities (LTPZ) – Another way to invest in the long term bond position.  These bonds are a kind of a middle ground in that they can make positive returns in both inflation and deflation.

TFS Balanced Growth

- No Changes
- We feel that TFS Balanced Growth is suited well to handle this market with the understanding it will see a little more volatility than Low Correlation Core.

***If you would like to go through the exact allocations in your portfolio please set up a time with your advisor.  We appreciate the opportunity to serve you!***

***Data Sources***


1. *US Department of Labor; http://www.dol.gov/*
2. *St. Louis Fed; http://research.stlouisfed.org/fred2/series/PSAVERT/*
3. *Federal Reserve; http://www.federalreserve.gov/releases/g19/HIST/cc_hist_sa_levels.html*
4. *Standard & Poors; http://www.standardandpoors.com/home/en/us*
5. *YahooFinance; http://finance.yahoo.com/*
6. *Personal Opinions of Team Financial Strategies*
7. *HorsesMouth; http://www.horsesmouth.com*
8. *http://www.usgovernmentrevenue.com/numbers; http://www.usgovernmentspending.com/*
9. *Crestmont Research;  http://www.crestmontresearch.com/*