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Portfolio Commentary Fourth Quarter 2013

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> "There's $14.4 trillion of value at stake in the next decade as we connect more things that drive productivity, that drive efficiency in the supply chain, that drive an expanded customer experience and revenue."
> –Robert Lloyd, head of development and sales at Cisco Systems

> "Pessimists may be paying too little attention to the strength of the underlying economic and social forces that generate innovation in the modern world."
> —Ben Bernanke, Chairman of the US Federal Reserve

The U.S. markets just completed one of the best years for equities since 1997 and the third best in the past twenty years. Who would have thunk? Fortunately, as I wrote in my expectations last January 18th, "We believe that the New Year will deliver positive surprises to those invested in equities. I have a sense that we are on the verge of a break-out in the value of equities", we were positioned to take advantage of this surge in stock prices. We came down on the right side of this guessing game this time round. Stocks took in $148 billion during the first ten months of 2013. This contrasts with the over $1 trillion that poured into bonds during the 2008-2012 period. The DJIA reached 52 new all-time closing highs during the year, ended the year at 16,577 and posted an overall return of 26.4%. Our average return for all accounts (aggressive to conservative) ended up at a plus 17%. Despite the sell-off in bonds that commenced in May, an event that we have been fearful for the past five years, we ended up in pretty good stead. Since 2006, our average annual returns have been 31.0%, 10.6%, -29.4% (the 2008 financial collapse), 33.5%, 24.5%, -12.5% (the 2011 US Congress Debt Ceiling debacle), 11.5% and 17.0%. With inflation currently running under 1.5%, 1-year Treasury Bills currently yielding .15%, and having lived through the most severe financial downturn in our lifetimes, we're happy with these returns over these past eight years.

You may have noticed that I did not include a written commentary in our third quarter performance reports. Apparently this wasn't missed, as no recipient of our reports asked about it. I promise to go light on this one and may forgo the written message in the future since these take a bundle of time to write and my time may be better spent in running your money instead of writing about it. All things considered, the percentage gain on your portfolio speaks more loudly than the words accompanying the reports: all of our work boils down to three digits.

Going forward, I expect that our economy will continue to improve over the next twenty-four months, and the global economy to move in lock step. Disruptions, yes, will pop in throughout and the 24/7 news will work its charm to scare you into listening or watching the "latest breaking news", but overall I anticipate a positive march forward. Some of the reasons follow.

Our world is on the verge of a period wherein productivity gains, rooted in round-the-clock interconnectivity, will soon manifest themselves. We will witness how this plays out in the always-connected Wi-Fi world as we did with the unfolding of the Internet world over the previous fifteen years. We have done our best to pepper your portfolio with some of those companies which should benefit from this unfolding. These include Dragonwave, Harmonic, PMC-Sierra, Anadigics, EZ-Chip, Quicklogic, Marvel Technology, Finisar, Intel and Cisco. Additionally, US Corporations hold about $1.8 trillion in cash, the highest level in history, and payout ratios to shareholders are at 50-year lows. This means that there is lots of money to buy back stock, increase dividends or merge. 80% of corporate debt is now long term and locked in at historic low rates. Thus, our corporations have fixed a large portion of their overhead expense for several years into the future. Jobless claims are trending downwards: the four-week average is under 370,000-a threshold indicating expansion. US auto sales are at 16.3 million and trending upwards with auto production assemblies advancing 4.6% to annual unit rates of 11.61 million. The National Association of Home Builders index is above 50 (the first time since 2008) while industrial production rose 1.1% in November (the most in a year). Capacity utilization increased to 79.0% (the highest reading since June 2008) still a bit under the 40-year average of 80.8 (indicating still a bit of slack in the economy). Private nonfarm payrolls gained for the 45th straight month in November. Finally, the recent US Congressional budget deal will increase federal spending by approximately $28 billion in 2014 and by $15 billion in 2015 in contrast to the restrictive Sequester of the past two years.

We have many possible disruptors before us. These include the impact of our Federal Reserve tapering its bond purchases, the approaching debt ceiling issue (again), a potential 10% or more “correction” in equity prices (we haven’t had a meaningful pull back in stock prices since 2009), the impact of the Affordable Care Act on our economy, Syria, The Middle East, China, India, Brazil, rising disparity of global wealth, etc. etc. But, as has been my frequent posture, we will work through these. Throughout good and poor times, we will continue to seek investments that we expect will appreciate.

Included with your 2013 Annual Progress Report is a Five-Year Progress Report measuring the changes in your investments since the end of 2008. We wrote then “that looking back five years hence; one will regret not buying equities during these bleak months.” The five-years hence is here. In looking at your returns over since 2008, we were on the right side of the guessing game then too.

I have two grandchildren now and have opened investments accounts for each into which I add $100 each month, or $3.33 daily (this is less than I spend on my breakfast). In sixty-five years (I’ll be well gone by then, but the investments won’t) at an 8% annual growth rate these accounts will be worth $2.8 million. They won’t have to worry much about Social Security, will they? Do the same. Start your kids investing early. Help them along. Give us a call to open an investment account for them.

At any time, should you wish to discuss your holdings, our outlook and your overall financial program in further detail, please feel free to call. We’re always happy to hear from you.