Inside Views From an Investment Management Leader

UPDATE

April 2014

About our Company

Company Profile:

Concord Investment Counsel is a private, boutique investment firm who has helped our clients grow and protect their wealth since 1991.

Key Offerings:

- *Personal wealth management*
- *Proactive investment strategies*
- *Proprietary research*
- *A professional team*
- *Fee-only services*

Distinguishing Values:

- *Passion for excellence*
- *Strategic focus*
- *A disciplined process*
- *Prudent risk management*
- *Comprehensive client care*
- *Superior long-term performance*
- *Sound judgment*
- *Objective Analysis*

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In the News

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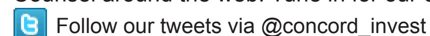
Why wait for paper when you can get the latest thoughts from your wealth manager in real time? Economic updates from Mitch Pletcher are seen first in real time by following Concord Investment Counsel around the web. Tune in for our exclusive up-to-the-minute commentary!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Economic Review & Outlook

Growth Concerns Mount

The US economy is progressing but is clearly challenged by secular economic themes. Economic growth has been modest for the last few years and earnings growth for the broad economy likewise has not accelerated from the single digit area we have been stuck in since 2012. While rapid growth is visible in many areas (Internet, Clean energy, Biotech, Cloud computing, Airlines, Leisure) (Fig 1 Pg 4), the modest size of these pockets of growth are not meaningful to the 16 trillion dollar US economy.

At this point in an economic recovery one would expect the major engines of consumption to be howling in high gear and spewing benefits for all. Unfortunately the engines are notably quiet with only modest feedback into the economic loop. The US and the globe are handcuffed by macro themes of high debt and other related long term obligations taken on carelessly over the last few decades. Consumption just won't accelerate and as a result most of the world is growth challenged with no short term solutions in place. Normal Fiscal policy help is not available for this cycle, unfortunately restrained by federal debt and poor leadership. It was the careless fiscal management by US and European leaders that produced the crisis and now they are obviously not in a position to aid the global economy with the needed consumption.

The global picture does have some bright spots that are saving the day for an otherwise desperate situation. The internet and all of the innovative tools for business continue to evolve bearing fruit for the global economy. The internet is relatively new and immature and much can be expected from it for decades to come. American ingenuity is at work and American companies are leading the globe in applications that increase productivity, consumption, confidence, and security. The other bright spot is all about the maturing world in China and India and the consumption from their burgeoning middle class. The Chinese love American goods and need American services and are consuming much of what the US consumer has left on the table. China, however, is no longer a small immature emerging market. They are the second largest global economy and struggling with old policy that does not align with the structure needed for an economic superpower. As a result, growth in China is threatening to slow and the globe is not ready for this event given the problems of the largest global economy (America).

Mitch Pletcher
President
Chief Investment Officer

The impact of the secular themes of debt and poor leadership combined with overly accommodative monetary policy manifests high unemployment and highly-valued assets. This trend for the globe is likely to continue and over time with better leadership will correct itself of the excesses.

We remain optimistic.

Financial Market Review & Outlook

Equity Markets Pause

Mitch Pletcher
President
Chief Investment Officer

After four years of economic recovery and a broad based rally in asset prices, a pause occurred in the first quarter of 2014. The S&P500 advanced a mere 1.3% after spending most of the quarter in negative territory.

Risk assets are no longer cheap and likewise non risk or low risk assets share the same overvaluation label. The first quarter's performance for equities (SPX + 1.3%) was the worst since Q2 of 2012 when the market fell 3.3%. Defensive value oriented sectors were the beneficiaries of this pause in equities. While this in itself is not concerning for equities as volatility in markets is normal, the poor relationship between valuations and the growth outlook cannot be sidestepped.

The leadership in the market has been broad since 2009 as the greater part of the economy was in economic recovery and earnings were bouncing from recession lows, and valuations were cheap. The snapback in earnings ended in 2011 and earnings growth since then has been modest (2012 +6%, 2013 +6%). Absolute valuation levels for stocks is reasonable with the forward PE of the S&P 500 still under 20, but the price to growth ratio is clearly stretched with PE's at 3 times the rate of growth.

As a result, investors have been repositioning portfolios into sectors and industries that have a better outlook for growth. This would include Internet, Clean Energy, Biotech, Cloud Computing, Autos, Airlines, and Leisure, which are enjoying strong consumption and pricing power (Fig. 1 pg 4). These areas led the market over the last few quarters, but have been volatile as fundamentals ebb and flow.

Emerging markets and other defensive areas which have lagged badly throughout the last year unexpectedly sprang to life at the end of the first quarter. The rebound is a bit unexplainable as the secular headwinds impacting China and other Asian players have not abated. The most recent trends in the equity markets involve investors fear of highly valued areas and hence money has poured into lagging areas like treasuries, high quality corporate debt, REITs, commodities, and emerging markets. Without fundamentals behind this move we can only conclude that this rally will not hold and a return to growth will again unfold once fears about China moderate.

Table 1: Stock & Bond Market Returns 3/31/14

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	1.0%	23.0%	Small Cap Value (IWN)	1.7%	22.6%
Large Cap Value (IWD)	3.0%	21.4%	Small Cap Growth (IWO)	0.6%	27.4%
Europe Asia Far East (EFA)	0.2%	17.2%	Emerging Markets (EEM)	-1.9%	-2.0%
Invest Grade Bonds (LQD)	3.0%	1.3%	High Yield Bonds (HYG)	2.6%	6.2%
Interm Treasurys (IEF)	2.9%	-3.5%	Mortgage Bonds (MBB)	1.8%	-0.3%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

Table 2: Real Estate & Commodity Returns 3/31/14

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	8.5%	1.3%	DJ Commodity Index (DJP)	7.3%	-2.9%
NAREIT Industrial/Ofc (FNIO)	10.8%	5.9%	Goldman Commodity (GSG)	2.4%	0.2%
NAREIT Residential (REZ)	12.0%	0.7%	Gold (GLD)	6.5%	-20.0%

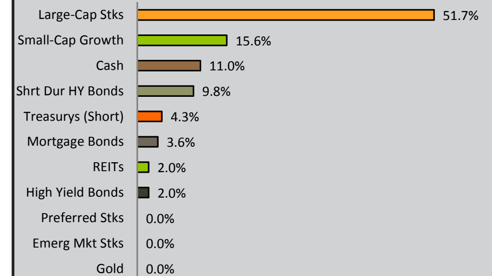
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

CIC Managed Accounts

Growth Portfolios

Dynamic Growth

A dynamic blend of stocks, bonds, commodities, REITs, and cash for growth investors with a bias toward timely asset classes.

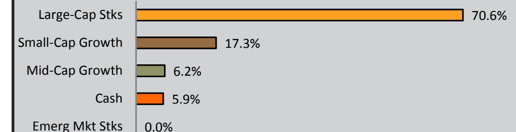


Growth

A portfolio of large- and mid-cap US stocks that are industry leaders with strong brands and timely products.

Diversified Equity

A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.



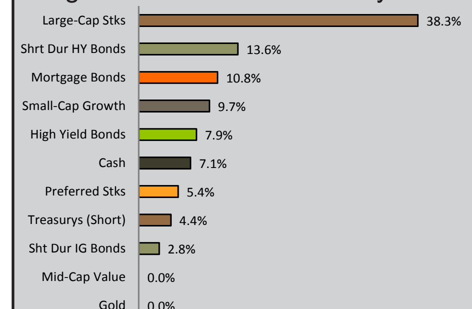
Focused REIT

A portfolio of companies whose primary business is owning and leasing real properties.

Balanced Portfolios

Asset Allocation for Income

A portfolio of stocks, bonds, and cash for moderately-conservative investors seeking income and growth with relative stability.



Equity Markets: Consumption Drives Growth

Earnings growth drives leadership in the stock market, while consumption generally drives earnings. Every market cycle has consumption themes which are either secular or cyclical in nature. Here's what is active in this market cycle.

Secular Consumption Themes:

- **Theme:** Global demand for wireless devices, digital media and cloud computing power. Demand growth is a product of industry's ability to innovate. Sector: Technology
- **Theme:** Global demand from wealthier and growing emerging market populations for meat and poultry to support more "western-like" eating habits, as well as growing demand for technologies that provide greater agricultural yields.

  Sector: Materials
- **Theme:** Global demand for energy as population grows as well as increasing demand for the technologies that make it viable to extract natural resources from the farthest reaches of the earth. Sector: Energy
- **Theme:** Increasing demand for healthcare as population ages, as well as growing demand for new and better products provided by innovation in the development of life-saving drugs, devices, and services. Sector: Healthcare

Cyclical Consumption Themes:

- **Theme:** The return of mild consumer discretionary spending balanced against purchasing decisions based on need instead of want. Sector: Consumer Discretionary/Staples
- **Theme:** Pent-up demand within the enterprise upgrade cycle. Sector: Technology
- **Theme:** The re-surfacing of emerging market infrastructure spending. Sector: Industrials
- **Theme:** Credit market stabilization and a return of demand for investment banking products and services. Sector: Financials
- **Theme:** The return of demand for manufactured products.

  Sector: Industrials, Energy

Commentary: Trend Reversal to Start 2014

Investor concern over not only geopolitical risk, but also slowing growth in the emerging markets and the potential fate of the US economy with relatively less monetary accomodation drove an interest in lower-risk sectors in the first quarter of 2013. Investors shifted into sectors that had been underperforming over the past 12 months and conceivably offered more value than the sectors which had been strong outperformers and experienced significant P/E expansion over the past year.

Sector Performance Review *3/31/14*

	Quarterly Change	Trailing 12-Months
Telecom	4.7%	4.6%
Utilities	3.3%	9.9%
Financials	2.9%	22.3%
Energy	2.4%	15.5%
Consumer Staples	2.2%	11.3%
Materials	0.7%	22.4%
Industrials	0.7%	27.5%
Technology	-0.1%	26.7%
Healthcare	-1.7%	29.8%
Consumer Discretionary	-2.6%	26.0%

Data based upon Russell 1000 Index and GICS sectors. Source: Bloomberg Financial

Fixed Income Review

By Kyle Aron

Fed Passes the Torch

Kyle Aron
Senior Analyst

The Federal Reserve began to wind down its massive monetary stimulus initiative this past January. Previously purchasing a mix of Treasury and mortgage debt to the tune of $85 billion per month, the Fed is tapering this amount by approximately $10 billion each month. At this pace, the Fed's asset purchase program will end this coming September. This tapering, coupled with the recent change in leadership at the Fed and geopolitical turmoil around the globe, led the markets to a volatile start in 2014.

The S&P 500 ended the first quarter up a modest 1.3% after having been down as much as 5.8% in early February. Gold (GLD) rallied 6.5% for the quarter alongside heightened market volatility and a recent jump in many commodity prices. REITs (IYR) began to gain strong positive momentum after lagging throughout 2013, ending the quarter up 8.5%.

Despite a major buyer (the Fed) steadily exiting the asset class, fixed income outperformed in the first quarter of 2014 in light of the conditions outlined above. Investor concern over not only geopolitical risk, but also slowing growth in emerging markets and the potential fate of the US economy with relatively less monetary accommodation drove an interest in lower-risk assets. What's more, investors may have felt some fixed income segments were arguably a good value after their broad, forceful sell-off in 2013. Long-term Treasurys (TLT) lead the way, up over 7.6% for the quarter. Investment-grade corporate bonds and mid-dated Treasurys were both up approximately 3.0%. Some segments of the lower-quality market performed well (leveraged mortgage-backed debt (PCM) up 6.7%), while others were only up slightly (short duration high-yield corporate bonds (HYS) up 1.3%).

In our view, much of the rotation into high-quality fixed income in the first quarter may have been overdone. As elaborated upon in previous commentary, many segments of the fixed income space are not as low risk as they may appear nor a good value. A rising rate environment and the eventual absence of one the largest buyers within the market are not reasons to be taking positions in high-quality fixed income. Given in part that the Fed feels sufficiently compelled by incoming economic data to continue its tapering of the asset purchase program, we continue to favor other asset classes (equities in particular) over fixed income on a relative basis.

Additionally, despite Janet Yellen's (the new Fed Chief) seemingly hawkish first appearance before the press, she reiterated later in March her stance that "[The] scars from the Great Recession remain, and reaching our goals will take time….I think this extraordinary [stimulus] commitment is still needed and will be for some time, and I believe that this view is widely shared by my fellow policy-makers at the Fed." The S&P 500 rallied nearly 1.5% in anticipation of and reaction to this clarification. While economic data at present has warranted tapering, the Fed intends to continue providing support as is necessary.

Taking the aforementioned into consideration, short-maturity and high-yield remain the most appealing segments within the fixed income space. As the Fed is looking to essentially pass the torch to the private sector with the hope and expectation of continuing positive economic momentum, other asset classes like equities continue to be relatively more appealing.

A Word From Our Advisory Team

Jill Pletcher
Vice President
Senior Financial Advisor

Can you trust your broker's tax reporting?

1099-R, 1099-B, 1099Misc, 1099-G, 1099-OID, 1099-REMIC, 5498, gain/loss report, the list goes on… Annually from January to May brokers and banks send their client's a stream of tax info that has investors swearing in frustration and frantically digging through statements to verify the accuracy of the tax reports sent to them that just don't look right. Government regulation requires the custodian of investor's assets report endless amounts of data to them in an effort to keep investors honest about earnings that are taxable. Can you trust your Bank or Broker to get this reporting correct?

The answer for the most part is yes, but today I am not near as confident in that answer as I was a decade ago when required reporting was simpler and securities less complex. The financial engineering of the last decade that almost brought down our economy has yet another bad repercussion – highly complex securities that banks and brokers can't report on correctly. Yes, that dreaded CMO that turned toxic for banks and investors, that were lured to drink from a mislabeled punch bowl, now has reporting problems that banks and brokers are ill prepared to administrate. Many of these troubled CMO's have made negative principal pay-downs that custodians have either not reported at all or reported in error. What is a negative pay-down? This is when a mortgage pool has a loss and allocates that loss to the tranche that has the lowest payment priority. This loss of principal is tax deductible for the investor but most banks and brokers are not providing their clients with the loss data so they can easily account for this loss.

Concord has recognized this deficiency and has gathered the gain/loss data itself and included this needed data in its year end Gain/Loss report so our clients can easily account for any losses realized from CMO's that had negative pay-downs. The securities world is complex and cutodians are still working to conform to new regulations put into place after the financial mess of the last decade. Problems are inevitable but Concord has your back and will do the work to maximize returns and minimized taxes for our clients.

Financial Market Charts

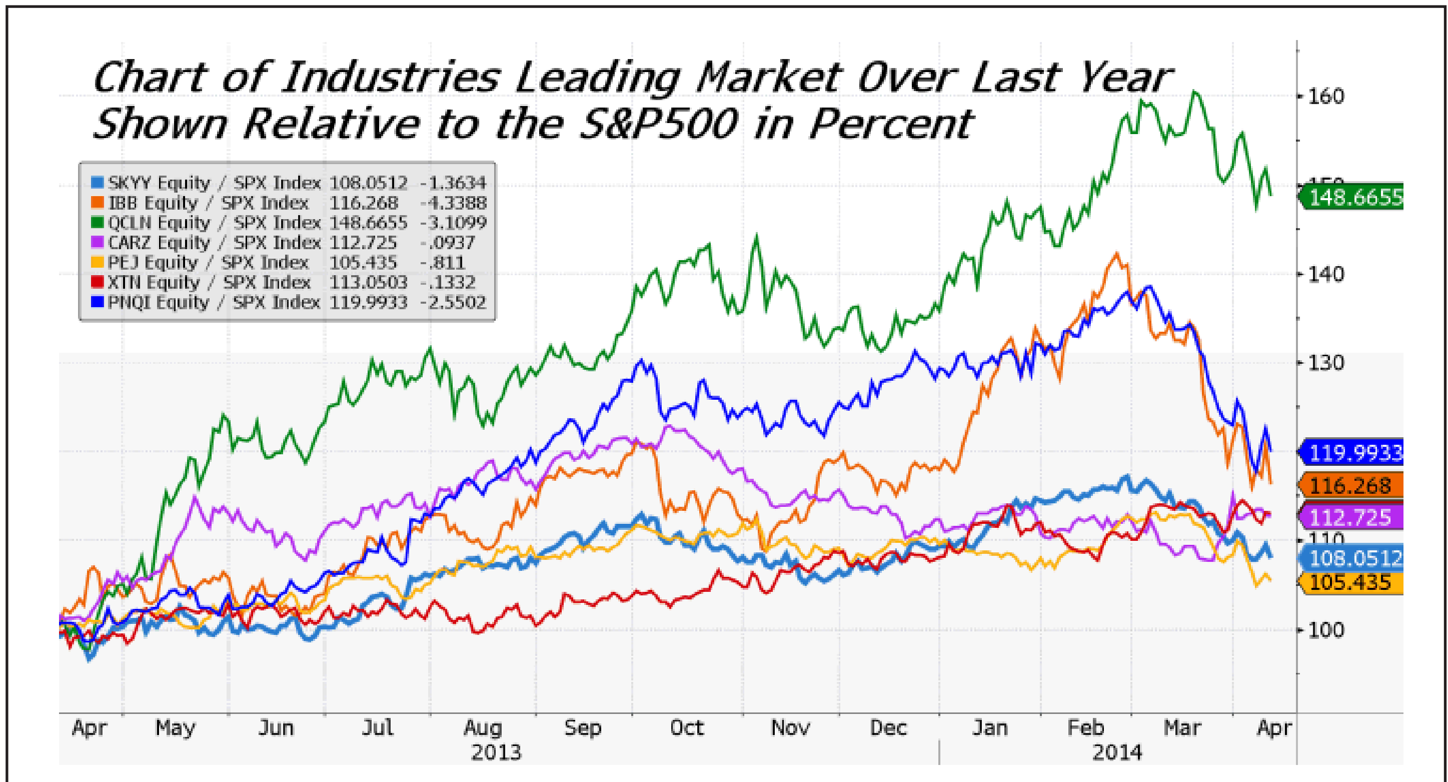


Figure 1 - Source: Bloomberg Financial

SKYY - Cloud Computing
IBB - Biotech
QCLN - Clean Energy
CARZ - Autos
XTN - Airlines & Transport
PNQI - Internet
PEJ - Leisure & Entertianment