TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

January 2014

Quarterly Insights

EXECUTIVE SUMMARY

U.S. Leads In A Banner Year For Stocks, But Bonds Fall

In the Fourth Quarter, the domestic S&P 500 Index was up 10.51% and finished the year up 32.39%. Other developed markets moderately lagged. Emerging Markets was a disaster, falling 2.66%. The ascent of the S&P 500 Index was remarkably smooth in the midst of three fears that tested confidence: Fed tapering, a potential interest rate hike, and the U.S. government shutdown. Bonds had their worst year since 1994. The Barclay's bond index returned 0.10% in the Fourth Quarter and finished the year down 1.74%. Longer duration bonds fared much worse.

We Believe The S&P 500 Index Will Rise 12%-15% In 2014

We are bullish for 2014 and believe the S&P 500 Index will rise 12% to 15%. Four factors should drive up the stock market: fiscal certainty, accelerating GDP growth, continued accommodative Fed policy, and higher capacity for corporate spending.

We believe the 30 year bull market run for bonds (1982 - 2012) is over. Having said that, we also see room to make some money in bonds in 2014. Interest payments should more than offset bond price declines should interest rates rise.

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Fourth Quarter 2013

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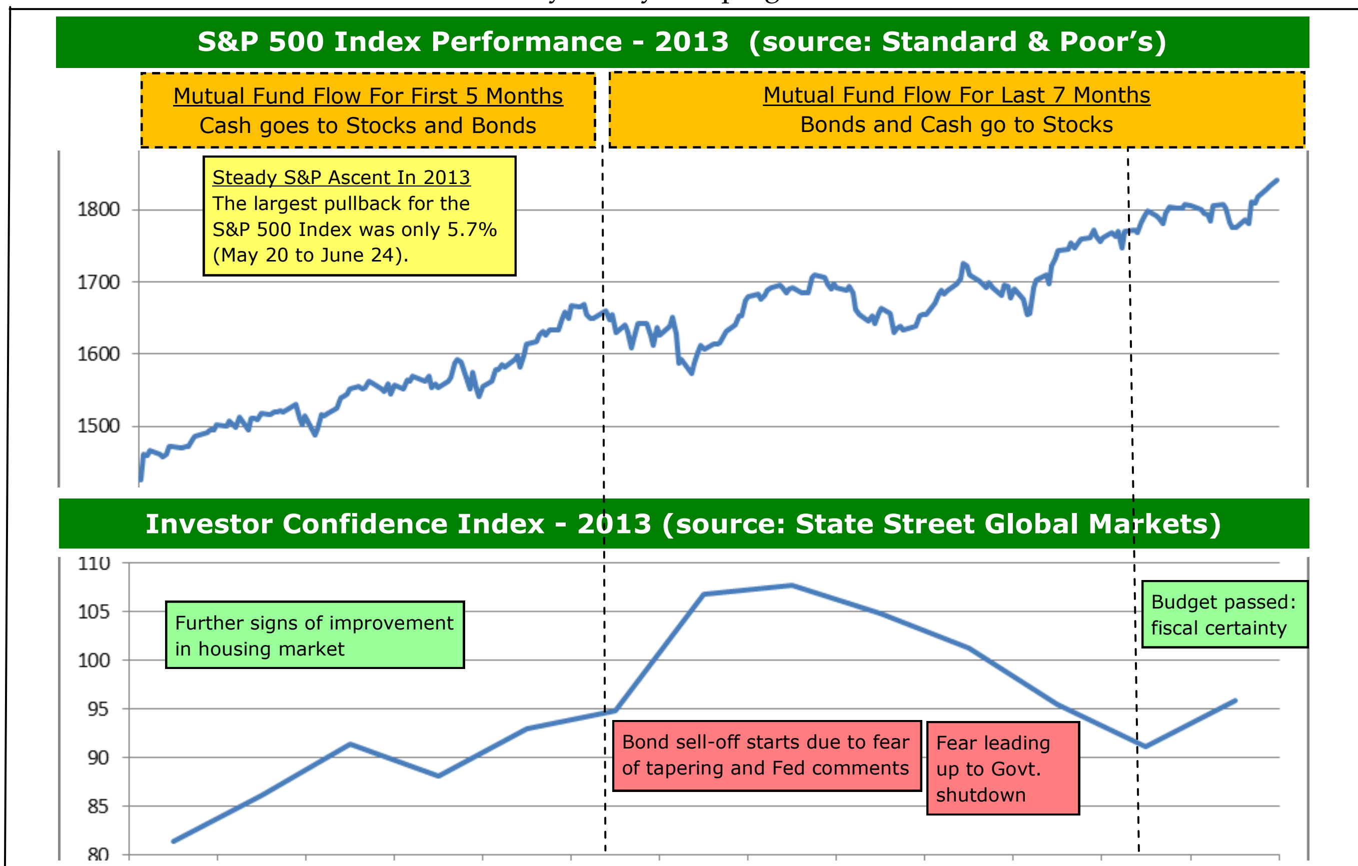
2013 - The Year In Review

2013 Performance Was Surprising To Many, Including Us

We reflect on 2013 as a year where many investors were shocked that the S&P 500 Index rose 32.39%. So were we. The market ascent surprised us as we predicted a mere 6% to 9% rise (see Quarterly Insights January 2013). Trends from 2012 (where the S&P 500 Index rose 16.00%) continued in 2013: high stock returns, reasonable company earnings, a rising GDP, a falling unemployment rate, a strengthened auto industry, and a housing recovery. Unlike 2012, investor confidence rose in 2013 (although it peaked in July). Three government-related fears tested confidence: anticipation of Fed tapering, Fed comments regarding a potential rate hike, and a 16-day federal government shutdown in October. From a portfolio standpoint, the key to managing well in 2013 was to “avoid the noise” from June through October and maintain a disciplined investment strategy. In addition, decisions involving regional emphasis and sector weights were critical.

1. Steady S&P 500 Market Ascent Despite Waning Second Half Investor Confidence

The S&P 500 Index and investor confidence moved up in tandem for the first five months in 2013. For the following six months, they diverged. Starting in late May, fears of Fed tapering and comments by Fed Chair Ben Bernanke sent the bond market into a tailspin and weighed on investor confidence. The political theatrics leading up to the 16-day federal government shutdown brought confidence to its November low. Through it all, the S&P 500 Index ascent was remarkably steady. Keeping a cool head in 2013 was a virtue.



Rising and falling confidence drove mutual fund bond flows, but had no impact on equity flows (source: ICI).

	Equity	Bonds	Net Cash
First 5 Months	Equity: + $ 78B	Bonds: + $ 93B	Net Cash: - $171B
Last 7 Months	Equity: + $ 90B	Bonds: - $176B	Net Cash: + $ 86B
2013 Total	Equity: + $168B	Bonds: - $ 82B	Net Cash: - $ 85B

▲ confidence: cash goes to stocks and bonds

▼ confidence: bonds go to stocks and cash

2013 Net Flow: bonds and cash go to stocks

2. Huge Regional Performance Disparity

The U.S. led regional performance by a comfortable margin in 2013. Europe and Japan also fared reasonably well. The big story was what happened with Emerging Markets, where market performance in both absolute and relative terms was a disaster. Resource-driven countries such as Australia (-0.29%) and Canada (+3.30%) also had miserable performance. Regional emphasis largely determined portfolio success (or failure).

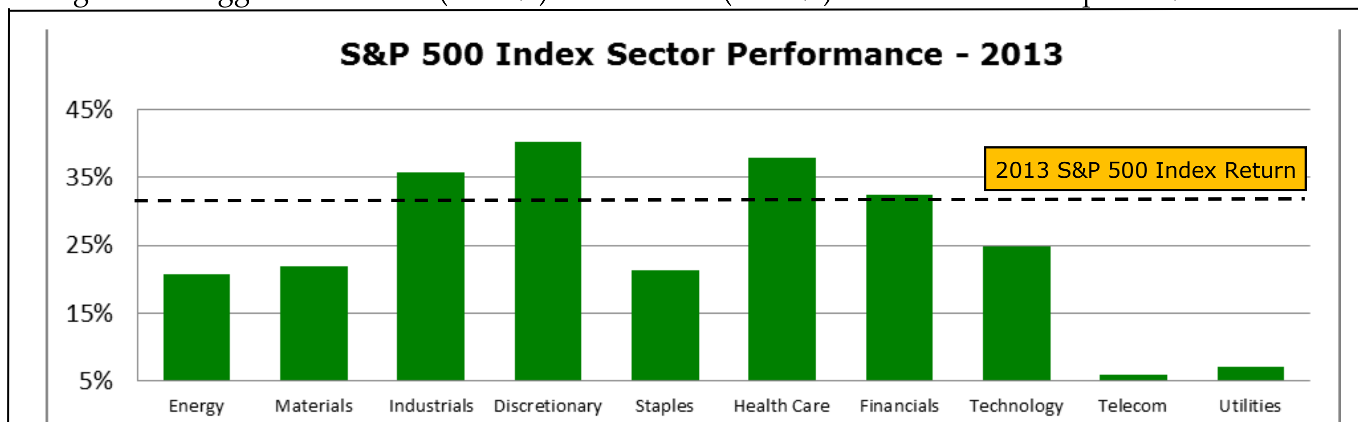
Equity Index Performance

Index	2013
S&P 500 (Domestic)	32.39%
MSCI EAFE (Foreign)**	22.77%
MSCI Emerging Markets	(2.66%)
MSCI BRIC (Brazil, Russia, India, China)	(3.66%)
MSCI EMU (European Monetary Union)	28.94%
MSCI Japan	27.16%

* Performance data does not include dividends ** Europe, Australia and the Far East

3. Wide Range Of Sector Performance

Only three out of 10 sectors out-performed the S&P 500 Index: Industrials (+36%), Health Care (+38%), and Consumer Discretionary (+40%). These sectors comprise 36% of the overall index. Two out of the 10 sectors were significant laggards: Telecom (+5.88%) and Utilities (+7.08%). These sectors comprise 5% of the index.



Assessment Of Our 2013 Portfolio Strategy And Performance

Your stocks performed at the level of the S&P 500 Index and your bonds performed at the level of the Barclay's Capital Aggregate U.S. Bond Index. We were pleased and we hope you were pleased. A key success factor was to maintain a considerable (85% to 90%) stock emphasis on large cap high quality U.S. stocks, coupled with minimal Emerging Markets exposure. It is somewhat ironic that we took this stance based on our initial expectation of a below-average (6% to 9%) year in stocks. We thought the "blue chip" U.S. stocks would fare better in this scenario. We were right about the U.S. relative out-performance, but we vastly underestimated how well the market would do. Another key success factor was to avoid getting faked out of the market from June to year-end. Many did. In terms of sector weightings, we over-weighted Health Care and Consumer Discretionary (good move), over-weighted Technology (bad move), and under-weighted Telecom and Utilities (good move). Your bonds had short portfolio duration to lower the sensitivity to rising interest rates (good move). There was a huge performance disparity between the shorter duration Barclay's Capital Aggregate Bond Index (- 1.74%) and the long duration Vanguard Long-Term Bond Index (- 13.25%).

2014 - Looking Ahead

We Believe The S&P 500 Index Will Rise 12% to 15% In 2014

We are bullish for 2014 and believe the S&P 500 Index will rise 12% to 15%. This may appear to be a bold prediction in light of the banner +32.39% performance in 2013. After such a strong 2013, can markets continue their rapid ascension? We think so. Many clients have asked if we should "cash out" some of their stocks at this time or, at the very least, reduce their target stock asset allocation. Our short answer is "no". Fear of a short-term potential market correction does not warrant a deviation from your long-term investment strategy. It may surprise you that the odds favor staying in stocks after exceptional "up" years.

Exceptional "Up" Years Are Historically Followed By "Average" Years, Not "Down" Years

A classic rock song opens with "What goes up must come down" (Spinning Wheel - Blood, Sweat & Tears). This does not historically bear out in the stock market. Exceptional "up" years are not followed by "down" years. Rather, exceptional "up" years are followed by "average" years. We examined S&P 500 Index annual market returns since 1926. In the 88 observations, there are 25 instances of market returns exceeding 25% and 16 instances of market returns exceeding 30%. What is most interesting is that the following years in either case had average returns and risk (standard deviation). Put another way, the following years were "normal".

S&P 500 Index - Annual Returns That Follow An Exceptional "Up" Year

	All Years (1926-2013)	The Year Following A 25%+ Return	The Year Following A 30%+ Return
# Of Observations (Years)	88	25	16
Return	9.8%	9.7%	10.4%
Risk (Standard Deviation)	20.2%	17.2%	20.2%

Source: Telemet

Don't be leery of 2014 because 2013 was exceptional. That could be a huge mistake. We do not view precedent in itself as the reason we believe the stock market should be average or better in 2014. Rather, history merely shows odds favoring a positive return. Our bullish outlook is primarily based on four factors: fiscal certainty, accelerating GDP growth, continued accommodative Fed policy, and higher capacity for corporate spending.

1. Fiscal Certainty Should Increase Business Confidence

Companies have held back capital expenditures for years because of an uncertain business environment. Conditions have improved tremendously. The federal deficit has declined from an alarming 10% of GDP in 2009 to a manageable 4% of GDP in 2013. Continued progress is likely as the Congressional Budget Office (CBO) projects the deficit as low as 2% by 2015. Congress recently passed a budget which minimizes the likelihood of another government shutdown through October 1, 2015 (well past the midterm elections). Improved fiscal certainty should unleash pent-up company demand for goods and services.

2. GDP Growth Is Accelerating

Political gridlock and forced government spending cuts (sequestration) have been holding back the economy. From 2009 to 2013, the International Monetary Fund (IMF) estimates the U.S. lost between 1.25% - 1.75% of annual economic growth because of these self-inflicted wounds. It appears we are moving past these obstacles as evidenced by an encouraging 4%+ Fourth Quarter GDP growth. Previous GDP growth was 1.8%.

3. The Fed Remains Accommodative

The December announcement by the Fed that monthly bond purchases (quantitative easing) would be "tapered" from $85 billion to $75 billion does not change the fact that interest rates are historically low. The Fed remains accommodative with its target rate unchanged at 0 - 0.25%. We don't expect a change in 2014. Fed Chair Ben Bernanke said he consulted closely with incoming Fed Chair Janet Yellin, saying "she fully supports what we did". We view continued accommodative Fed policy as good news for stocks. Here is a highlight excerpt from our Quarterly Insights April 2013, "Don't Fight The Fed", page 2:

We expect the Fed will remain accommodative for the next year or two. Over the last quarter century, annualized stock returns are triple the level (19.61%) with accommodative Fed Policy versus restrictive Fed policy (6.84%). We have no plans to "fight the Fed" by reducing stock exposure. The historical odds heavily favor stocks.

4. Falling Balance Sheet Leverage Means Higher Capacity For Corporate Spending

We know we just confused most of our readers with the term "balance sheet leverage"! A company balance sheet has three main categories (Assets, Liabilities, and Equity) that must balance as follows:

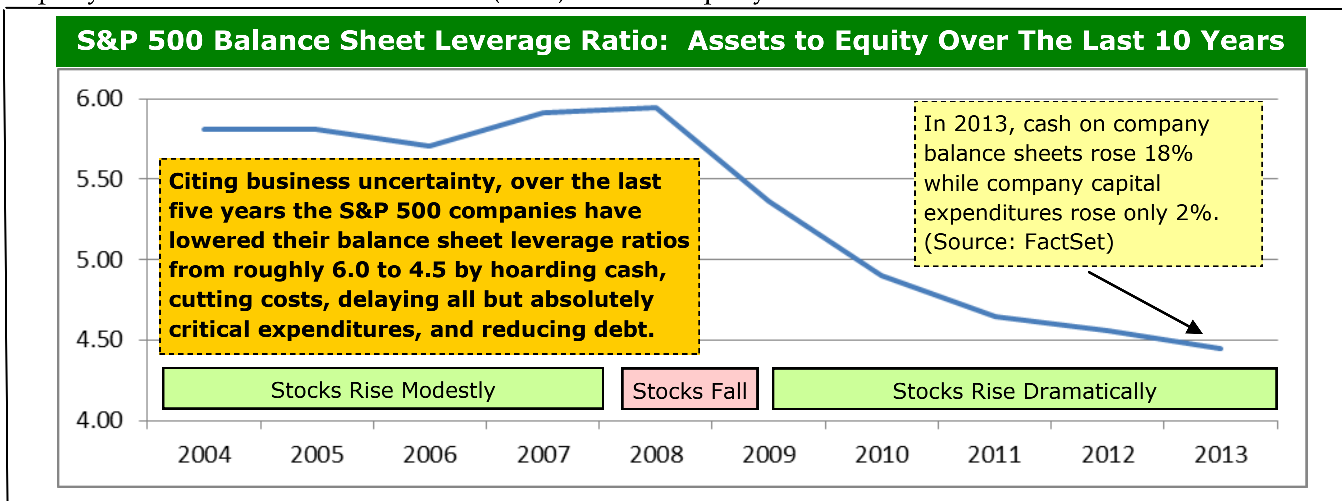
ASSETS = LIABILITIES + EQUITY

To illustrate, let's look at two fictitious companies that have identical equity values, but different levels of liabilities (such as debt). The "equity" value of a public company is called "shareholder equity" - this is the value of the company to its shareholders.

Company	Assets	Liabilities	Shareholder Equity	Leverage Ratio *
A	$6 billion	$5 billion	$1 billion	6
B	$4 billion	$ 3 billion	$1 billion	4

* Balance Sheet Leverage Ratio = Assets / Shareholder Equity

Company B has a lower leverage ratio than Company A. To achieve the same level of shareholder equity, Company B has assumed less liabilities (debt) than Company A. Now let's turn to the real world.



Portfolio Strategy - Stay The Course With An Emphasis On Large Cap US Stocks

Fiscal certainty, accelerating GDP growth, and a continued accommodative Fed policy should lead to higher business confidence. This higher confidence should "loosen the purse strings" of many companies that have excess cash. We anticipate increased corporate capital expenditures in stages. Companies will begin by purchasing the essential "picks and axes" products and services that they have delayed to now. For example, in the Technology sector this should benefit large cap bell-weather companies such as Oracle and Qualcomm.

Bond Market Spotlight

2013 Was The Worst Year For The Bond Market Since 1994

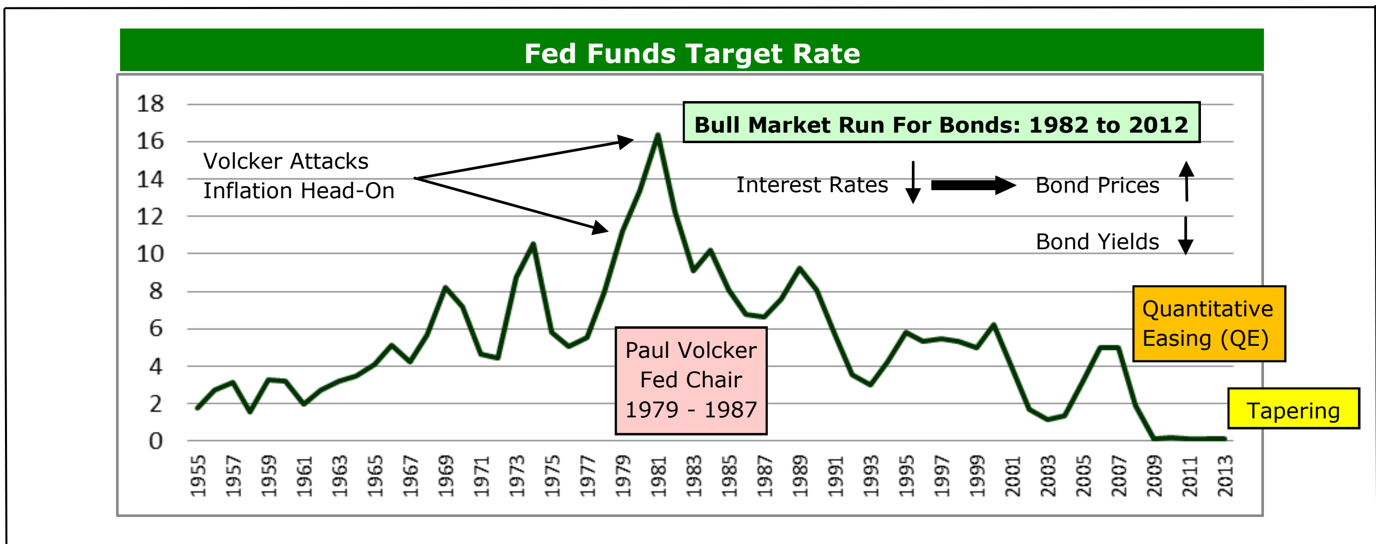
The Barclay's Capital U.S. Aggregate Bond Index, a broad-based representation of bond performance, returned 0.10% in the Fourth Quarter but finished the year down 1.74%. This is in stark contrast to 2012 where this index was up 4.03%. Bear in mind that the Barclay's index has a bond duration of roughly 5. The story was much worse for the more-interest-sensitive long duration bonds.

Key U.S. Interest Rates	Jan. 1, 2013	Dec. 31, 2013	Change
Federal Reserve Board Funds Target Rate	0-0.25%	0-0.25%	No change
5-Year Treasury (Constant Maturity)	0.73%	1.75%	+ 102 basis points
10-Year Treasury (Constant Maturity)	1.76%	3.04%	+ 128 basis points
30-Year Treasury (Constant Maturity)	2.95%	3.96%	+ 101 basis points

Note: 100 basis points (bp) = 1.00% Source: Telemet

The Bond Bull Market Is Over

Fed Chairman Paul Volcker is widely credited with breaking the back of inflation by hiking interest rates to record highs in 1982. The Fed rate has declined ever since, causing a tremendous 30 year bull market for bonds. We believe this run is over. Rock-bottom interest rates signal lower future bond returns.



Despite Lower Future Returns, We Maintain Bonds To Control Portfolio Risk

We welcome controlled Fed tapering as positive for the economy (See Quarterly Insights, October 2013, Fed Tapering Should Catapult Lending) and because interest rates should rise as the Fed extricates itself from its $3 trillion of bond purchases (quantitative easing). Higher rates is good news for investors. At this time, we believe bonds offer a small potential rate of return. The 10 Year Treasury yield increased by 0.42% in the Fourth Quarter, yet still managed a positive return of 0.10%. We calculate that interest rates would have to increase by over 1% this year for the bond market to lose money. In our opinion, this is a low probability scenario. We think a 0.25% to 0.50% rate increase is more likely. There is room to make some money in bonds as interest payments should more than offset bond price declines should rates rise.

Your Portfolio

The S&P 500 Index had a phenomenal year (+32.39%). Our 2013 market prediction of 6% to 9% made at the beginning of the year proved dead wrong. We will always be happy to be wrong to the upside! Aside from performance itself, this was an easy year to be in U.S. stocks because the ascent of the S&P 500 Index was so smooth. We had relatively few phone calls from clients concerned about their stock exposure and hope this trend continues in 2014. The bond component of the portfolio was down a little - fortunately we maintained a low bond duration and had limited sensitivity to rising interest rates.

Our Fourth Quarter trading was limited. We sold Time Warner (symbol: TWX) to take profits and to lighten our overall exposure to Media & Entertainment (we continue to hold Walt Disney, another stock that has done very well). In its place, we bought eBay (symbol: EBAY), a leader in global e-commerce best known for its auction business but even better poised to profit from mobile and e-commerce payment transactions.

On another note, we celebrated our 10-year anniversary in November. Our company continues to grow. Thank you for your continuing support and the faith you have placed in us to manage your assets. We appreciate it very much.

We are bullish for 2014. Over the next few months, we anticipate further adjustments to both the stock and bond components of your portfolio. Market conditions will change and we believe in style rotation. Stay tuned for updates.

We will continue to closely monitor the market and adjust your portfolio as needed. Please feel free to contact us anytime to discuss questions or comments you may have. We will keep you informed of portfolio progress.

Respectfully submitted,

TRIVANT

CUSTOM PORTFOLIO GROUP, LLC

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Disclaimer

The information presented herein is intended for informational purposes only. All views are subject to change based on updated indicators. The recommendations made in this publication are made without regard to individual suitability. Investors should consider their own needs and objectives before making any investment decision.

Commentary in this review reflects our portfolio strategy. Many of our clients have different objectives and circumstances which are reflected in unique portfolio considerations. Please note that accounts may not contain all elements of the strategy discussed here. Additionally, individual client customizations and start dates may preclude certain elements of this strategy from being implemented.

Past performance is no guarantee of future results. A risk of loss is involved with investments in stock markets.