Upcoming Events

Fireside Chat:

Worldwide uncertainty – What should I do?

Thomas Twombly & Cass Grange

September 25, 2014

6:30 – 8:00 pm

RSVP: 512-458-2517 or by email to info@lsggroup.com

General Market Results

	2nd Qtr	YTD	One Year	Three Year	Five Year	Ten Year
CPI	0.68%	2.08%	1.88%	1.77%	1.98%	2.29%
Barclays Agg Bond	2.04%	3.93%	4.37%	3.66%	4.85%	4.93%
S&P 500	5.24%	7.14%	24.61%	16.58%	18.83%	7.78%
DJI	2.83%	2.68%	15.56%	13.57%	17.83%	7.63%
S&P 400	4.33%	7.50%	25.24%	15.26%	21.67%	10.50%
Russell 2000	2.05%	3.19%	23.64%	14.57%	20.21%	8.70%
NASDAQ	4.98%	5.54%	29.53%	16.70%	19.16%	7.97%
MSCI EAFE	4.34%	5.14%	24.09%	8.59%	12.27%	7.42%
MSCI EM	6.71%	6.32%	14.68%	-0.06%	9.58%	12.30%

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Lucien, Stirling & Gray Advisory Group, Inc.

SECOND QUARTER REPORT 2014

July 2014

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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

We are pleased to provide you with our report for the period ending June 30, 2014.

Mid-year is a time when our business traditionally slows down somewhat as clients get into summer vacation mode. In the past we've capitalized on this annual phenomenon as an opportunity to take stock, and "to work *on* our business, not *in* it." But this year is proving to be different. We've been impressed recently at the steady flow of new clients coming to us, and also with the number of existing clients who are accelerating their savings and investment activity.

While we hope this is due to our growing reputation and attractiveness in the marketplace, there is little doubt that at least some of it is reflective of an increasing sense of confidence in the economy as a whole – and certainly in Austin, Texas. With more than five years of steady improvement under our belts since the great trauma of 2008, general enthusiasm is finally rising. This suggests to me that this is an appropriate time for all of us to conduct an emotional check-up, to revisit our expectations, and make sure those expectations – and our behavior - are square with the historical record.

Successful investing is a counter-intuitive activity. It pays to keep your emotions in check and to think differently than the majority. To illustrate, the last five years has been marked by deep pessimism. The public and media disbelief that stocks (Wall Street) could do well while the economy (Main Street) remained so moribund has been palpable. Bordering on anger at times, this disbelief has caused a huge number of people to hoard cash, buy gold and guns, and prepare for the zombie apocalypse. Doing so, they missed out on an historic rally in the value of the great companies of the U.S. and the world.

"the only sane way to invest is to design a thoughtful long-term asset allocation strategy for your particular objectives"

Now, however, the mood is clearly shifting. Unemployment rates have dropped dramatically in the last five years and are now back at their 50-year average. Housing starts have increased notably and some areas of the country are now actually experiencing shortages of construction workers. Car and truck sales have climbed rapidly to regain their 15-year average. So Main Street is showing clear signs of improvement. Therefore, it seems quite possible to me (again, counter-intuitively) that financial markets could be somewhat less well-behaved for a while.

I point this out not as an effort to incite nervousness or urgently to provoke you to "do something", as so many articles do. You know quite well that I don't believe anyone can consistently time markets, and I think it's stupid to try. I believe the only sane way to invest is to design a thoughtful long-term asset allocation strategy for your particular objectives, and then to fund it with regular infusions of new capital through thick and thin. Rather, I point it out in an effort to inoculate you against surprise and to steel your resolve, so when the inevitable correction does come (and it will, I just don't know when) you're not tempted to blow your elegant plan to smithereens out of some misplaced sense of regret.

Corrections and bear markets are perfectly normal parts of market cycles in every asset class. They all experience regular pullbacks and consolidations. Consider large-cap U.S. equities as an example: since 1980 the S&P 500 has experienced flat or negative calendar year returns in 8 out of those 34 years, or 25% of the time. During 1981, 1990, 2000, 2001, 2002 and 2008 those year over year declines ranged between -10% and -38%. So some were quite sharp and deep, and some came in gangs.

More importantly, ***every single year*** during that time frame the S&P 500 experienced an *intra*-year decline of some magnitude. So in 34 out of 34 years, or 100% of the sample, large-cap U.S. stocks dropped in value at some point during the year – **and the average of those intra-year declines was -14.4%.** So in other words, meaningful pull-backs and corrections happen all the time.

Most important to understand, however, is that for 75% of the time (26 out of 34 years) this asset class has experienced *positive* returns – and eventually every single one of those previously mentioned declines has proven temporary. So a hypothetical investor who invested $100,000 at the beginning of 1980 - unless he got scared out along the way by mistaking one of those regular *but totally temporary* corrections for a permanent loss - would have seen that portion of his invested capital grow to approximately $4.7 million by the end of 2013 – an average annual return of over 11.5%.

So train yourself not to fear corrections, but to welcome them. Disciplined investors with longer-term time horizons should look at a pull-back as an opportunity to rebalance – adding to asset classes that have fallen, and trimming those that have out-performed. And for those still in the accumulation phase, to constantly bring a flow of new capital to a well-designed portfolio – especially when there's a sale. It works, but only if you're prepared in advance to behave appropriately when most others can't, or won't.

Thank you again for your confidence and trust.

Thomas G. Twombly
President

INVESTMENT COMMENTARY

Despite headwinds from mixed economic data and heightened geopolitical tension throughout the world, financial markets overall experienced a solid second quarter and have rewarded diversified investors for the first half of 2014.

U.S. and overseas equity markets posted gains for the quarter, adding to slight increases that had been notched during the January – March timeframe.

Emerging market equities showed particular strength in the recent period, with the MSCI Emerging Markets Index rising by 6.7% on particularly strong performance from Asian and Latin American equity markets. China gained 6% as factory activity rose to a six-month high in June, and India rose by 13% as newly elected Prime Minister Modi outlined policies for increased growth in that economy. In this hemisphere Brazil, Mexico, Peru and Colombia also saw gains between 7-8% for the quarter. Though modest overall, allocations to managers in this asset class have provided some very attractive results for our clients since we added to them in late January, a time when published fund flows indicated that many others were exiting similar holdings.

Large cap U.S. stocks also provided solid results for the quarter. The S&P 500 reached a record high of 1960 by the end of June, rising 5.2% during the period and bringing year-to-date total returns to slightly over 7%. Energy, utilities, and information technology were among the top-performing sectors, while financials, consumer services and industrials lagged. Small cap U.S. equities fared less well than their larger brethren, rising by 2% for the quarter and 3.2% for the year so far, and suggesting to some that upward momentum in U.S. markets is beginning to wane.

Finally, the MSCI Europe, Asia and Far East Index (EAFE) also provided attractive results for the quarter,

rising 4.3% for the period and bringing year-to-date gains to 5.1%. Among the largest European markets, Germany and France each rose 2%, while Spanish equities experienced a 7% gain. In the Pacific region, Japan rose by 7% while Australia gained 3% overall.

Fixed income markets also rose during the period. Emerging market bonds did particularly well, rising by 4% for the quarter and 6% for the year so far. This result was closely followed by the Barclays U.S. TIPS index, which rose by 3.9% for the quarter and 5.0% for the first half of 2104, providing perhaps some early indications that fixed income investors are starting to look for some inflation protection moving forward. The more broadly followed Barclays Aggregate Bond Index was up 2.0% for the period and 3.9% for the year thus far, while the comparable High Yield index rose 2.4% for the quarter and 5.5% for the year to date, indicating that yield-hungry investors continue to stretch further and further out on the safety spectrum in search of shrinking income.

We have been quite pleased with the performance of the select managers we employ in these asset classes. Nevertheless, our on-going caution regarding the future direction of interest rates and worries about liquidity in the more speculative areas of the bond markets has kept overall allocations near their prescribed minimums, and steered us to managers who have kept average duration quite short.

Over the last several years we have gradually added to various holdings designed to offer growth and some protection against inflation in most client portfolios. Among these are domestic and international REITs, natural resource holdings, and investments in energy infrastructure. These asset classes too have performed nicely in 2014 so far. The NAREIT All Equity REIT Index rose by 7.1% for the recent quarter while the S&P Developed world Property Index rose by 9.2%, bringing year-to-date performance in these two indices respectively to 16.2% and 12.3%.

Looking forward, there are indications that core inflation is starting to move up. Though not a problem now, it could overheat more quickly than markets expect. According to JP Morgan, light vehicle sales in the U.S. have recently increased at a 26% annualized rate, and housing starts in the U.S. are currently rising at a 50% annualized rate. Unemployment rates have dropped from a high of 10% in October of 2009 to 6.1% by the end of June, and are now sitting right on the 50-year average. With central banks around the world still taking a very accommodative stance, and with economic activity on the rise, there is potential here for increased volatility if inflation were to surprise on the upside. We believe it is very important, therefore, to maintain broad asset class diversification and keep your seatbelts fastened.

Please call us if you would like to discuss.

Conservative Growth Model

2nd Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.70%	3.44%	12.54%	5.80%	8.57%	5.53%

Inception Date 06/03/1999

Core Growth Model

2nd Quarter	YTD	1Year	3 Year	5 Year	10 Year
3.93%	4.32%	17.02%	7.41%	10.62%	6.10%

Inception Date 05/31/2003

Growth Model

2nd Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.48%	3.68%	18.35%	6.99%	10.67%	7.32%

Inception Date 10/16/1992

Specialty Model
Diversified Growth Model

2nd Quarter	YTD	1 Year	3 Year	5 Year	10 Year
3.23%	4.54%	21.10%	11.33%	14.48%	7.19%

Inception Date 10/31/00

Education Models
UT ORP

2nd Quarter	YTD	1Year	3 Year	5 Year	10 Year
2.99%	3.95%	16.57%	8.29%	10.54%	5.85%

Inception 08/10/1999

Retirement Growth

2nd Quarter	YTD	1 Year	3 Year	5 Year	10 Year
3.77%	5.60%	18.53%	9.43%	12.97%	7.16%

Inception Date 06/03/1999

Growth & Capital Preservation

2nd Quarter	YTD	1 Year	3 Year	5 Year	10 Year
2.84%	3.52%	13.91%	6.54%	9.41%	5.85%

Inception Date 11/30/2001