Upcoming Events

Fireside Chat:

Stock Markets boomed in 2013. What Now?

A discussion led by Thomas Twombly

February 27, 2014
6:30 to 8:00 pm

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

General Market Results

	4th Quarter	YTD	One Year	Three Year	Five Year	Ten Year
CPI	-0.46%	1.51%	1.51%	2.07%	2.08%	2.38%
Barclays Agg Bond	-0.14%	-2.02%	-2.02%	3.26%	4.44%	4.55%
S&P 500	10.51%	32.40%	32.40%	16.18%	17.94%	7.40%
DJI	10.22%	29.65%	29.65%	15.71%	16.74%	7.44%
S&P 400	8.33%	33.50%	33.50%	15.64%	21.89%	10.36%
Russell 2000	8.72%	38.82%	38.82%	15.67%	20.08%	9.07%
NASDAQ	10.74%	38.32%	38.32%	16.33%	21.51%	7.62%
MSCI EAFE	5.75%	23.29%	23.29%	8.66%	12.96%	7.39%
MSCI EM	1.86%	-2.27%	-2.27%	-1.74%	15.15%	11.52%

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FOURTH QUARTER REPORT 2013

January 2014

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A MESSAGE FROM THE PRESIDENT

Thomas G. Twombly

This is a time of year when it's customary to pause and reflect - to look back and take stock before moving into the future. Many think of it primarily as a time for new beginnings – with bad habits to be conquered and new resolutions to be kept. While that may work well for some, I think of it too as an ideal time to remind one-self of timeless principles and to reaffirm wisdom one has fought hard to acquire. Circumstances change from year to year, and it's important to note how our guiding beliefs and behaviors have been impacted by those changes, and where we might be vulnerable.

This is especially true after a period like U.S. equity investors have just experienced in 2013, and in fact the last twenty seven months. We're now seeing signs of excitement that we haven't seen in a long time. As markets have risen, many people's perception is that uncertainty has started to diminish. This is welcome news on one hand, because confidence is crucial to future economic growth. It's a sign for caution on the other hand, because the reality is that every day is uncertain. Wise leaders, advisors, and individual investors take pains to recognize that it's important to embrace this ambiguity.

Embracing ambiguity is a habit and a skill that requires high levels of emotional maturity and self-awareness. It requires that we constantly nurture the ability to hold two (or more) conflicting ideas in our arms at exactly the same time, and not get frozen by that conflict, or blinded by one particular perspective or another. It requires circumspection, balance and most of all - humility.

"Wise leaders, advisors, and individual investors take pains to recognize that it's important to embrace this ambiguity."

Think about the ambiguity we've embraced in the last few years. In our 3rd Quarter Report of 2011, very near what would eventually prove to be the bottom of the last significant correction we've experienced since March of 2009, we noted the huge equity fund outflows occurring during the previous five months. Financial markets were gripped in fear as the world fretted about a sovereign default somewhere (or everywhere) in Europe. Politicians here were playing a game of chicken with the debt ceiling and threatening a default, and Standard & Poor's had responded to that provocation by downgrading the credit rating of U.S. Government Debt. Equity markets were diving, on their way to an eventual 19.2% peak-to-trough decline, and more money was being pulled out of equity funds during that five-month period than had been liquidated in the five months following the collapse of Lehman Brothers in the fall of 2008. We stated then that it looked like one of the best buying opportunities for equity investors since March of 2009, but clearly many disagreed.

The following quarter, in our final Quarterly Report for 2011, we reiterated that message, saying "equities in general are as undervalued as we've seen them." Nevertheless, petrified investors elsewhere continued to liquidate assets from equity holdings in record amounts, continuing a record run of net liquidations from equity funds that eventually lasted more than 6 years, and continued well into the first half of 2013.

Throughout 2012 our reports reflected similar sentiments, and in our 4th Quarter Report exactly one year ago, when uncertainty was still much in abundance, we said "the U.S. could surprise the naysayers, as a number of factors are combining that offer companies, their employees, and their investors some attractive prospects."

Now we find ourselves in a very different environment. The S&P 500 closed 2013 at 1848, having run up from 1402 at the end of 2012 - a volatile one-year jump of 31.8%, not including dividends. Measuring back to the bottom of that last correction in early October of 2011, we've gone almost 27 months without even a 5% decline, and during that period we've seen a 750-point, 68% gain in the level of the index – again, not including dividends. And investors are getting enthusiastic about equities again…

Corrections and bear markets don't run on a tight schedule. Nobody sounds an alarm when they are about to happen. But history shows they happen all the time. Since 1946 we've experienced corrections of 10% or more approximately every 18 months. Bear market declines of 20% or more have occurred every four and a half years, on average. So at 27 months and counting in the correction department, and almost five years from the bottom of the last bear, we're getting a little long in the tooth. I say this not as a prediction, because I do not believe anyone, least of all me, can consistently time markets – nor do I think it's worthwhile to try. I say it by way of preparation and inoculation against surprise.

Evidence suggests that we're starting to see a synchronous global expansion. We believe that growing confidence presents great opportunities for disciplined investors in the long run. So continue to be optimistic – we certainly are. And at the same time, temper that optimism with realism – and the humility to admit that things are always ambiguous. It will help you maintain discipline and balance in your portfolio, and in your behavior.

Thank you again for your confidence and trust.

Thomas G. Twombly
President

INVESTMENT COMMENTARY

2013 was a very big year for investors in U.S. equity markets. Other than the NASDAQ, which has yet to regain the lofty levels it set during the technology bubble back in 2000, all U.S. stock markets finished the year at record levels, and each has now far surpassed its previous peak set in 2007. Large-cap stocks, as represented by the S&P 500 rose by 32.4% for the year. Mid-cap stocks did slightly better than that, increasing by 34.8%, and small-cap companies collectively took the prize with overall gains of 38.8%. While the year was impressive on its own, it now caps a nearly five-year run from the market lows of March 2009 that now boasts more than 200% gains for large-cap equities, and more than 262% for both small-cap and mid-cap U.S. equity markets.

Price to earnings multiples expanded throughout the year, reflecting a growing confidence as investors indicated a willingness to pay steadily higher prices for earnings that continued to grow at a record pace. On a forward-looking basis, the S&P 500 reached a P/E of 15.4x at the end of December 2013, compared to a December 2012 multiple of 12.6x, and it now stands slightly above the long-term average since 1985 of 14.9x – a sign that some caution may now be in order for certain sectors of the market that are particularly richly valued.

In contrast, it was a very challenging year for bond investors overall, with High Yield bonds being the only sector to deliver positive results (+7.4%) for the period. After an unprecedented six-year run where equity funds saw steady outflows, and inflows into bonds and bond mutual funds set a record pace, the tide began to turn quite sharply before mid-year and long-term interest rates rose sharply. In turn, the dollar rose in international currency markets, causing assets

to move steadily out of developing markets debt. The result was that all other sectors of the bond market suffered, with particular pain felt in the most long-term, interest sensitive sectors. 30-year U.S. Treasuries fell by -15% for the year, while the popular 10-year Treasury fell by -7.8%. Treasury Inflation Protected Securities (TIPS) also fell sharply, notching losses of -8.6% for the year, and Emerging Market debt overall fell by -4.1%.

International equity markets also experienced a good year, with the exception of Emerging Market equities, which experienced declines of -2.3% in U.S. Dollar terms and were similarly impacted by rising U.S. interest rates. The MSCI Europe Asia and Far East Index (EAFE) rose by 27.5% for the year in local currency terms, but a strengthening dollar reduced the net to U.S. investors to 23.3% for the year. Germany (+32.4%) France (+27.7%) Japan (+27.3%) and the U.K. (+20.7%) led the way in developed markets, while Brazil (-15.8%) and India (-3.8%) provided the biggest overall drag.

Despite recent gains in foreign equity markets, the EAFE index remains quite undervalued relative to U.S. equity prices. With a P/E multiple of 13.9, and a dividend yield of 2.9%, many good companies domiciled outside the United States appear to offer comparatively attractive values. Additionally, with European interest rates dominated by the German 10-year Bund, which finished the year with a yield of 1.9%, a similar phenomenon exists in foreign markets as existed in the U.S. a little more than two years ago. Dividend yields exceed bond yields by a good margin, equity P/E multiples are still low in historical terms, and the EAFE index as a whole is still well below its 2007 peak. While there are still some unique challenges in Europe, there is growing evidence of a synchronous global expansion, and thus far the rest of the world has not participated as much as the U.S. With asset flows to those areas increasing recently, and with many of our portfolios overweight foreign equities relative to the vast majority of Americans, we feel well-positioned for 2014.

Looking forward, there is reason to be quite optimistic about the U.S. economy. Unemployment continues to decline, housing prices are moving up steadily, and the overall economy has regained approximately 90% of the jobs that were lost in the great recession. Corporate cash levels are still high, in spite of large dividend increases and growing levels of share repurchases, and there are early indications that corporate capital spending is on the increase. In all the recessions of the last 50 years business investment has been a late-inning phenomenon, so it's quite possible we may finally see companies start to invest and hire more as we move through the year. It's important to remember though that equity markets are typically leading indicators, and 2013 was a year of impressive returns. We would expect more muted results moving forward, and we would become concerned that things were getting frothy if we were to see a repeat. As always, it pays off in the long run to maintain broad asset allocation, and to rebalance periodically from asset classes that have done very well recently into those that have been out of favor – which we are doing now. Please call if you'd like to discuss.

Conservative Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
4.73%	15.48%	15.48%	5.57%	8.54%	5.51%

Inception Date 06/03/1999

Core Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
5.86%	18.09%	18.09%	6.51%	10.89%	6.30%

Inception Date 05/31/2003

Growth Model

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
4.86%	20.64%	20.64%	6.20%	11.55%	7.46%

Inception Date 10/16/1992

Specialty Model
Diversified Growth Model

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
8.23%	28.39%	28.39%	11.49%	14.91%	7.55%

Inception Date 10/31/00

Education Models
UT ORP

4th Quarter	YTD	1Year	3 Year	5 Year	10 Year
5.76%	19.41%	19.41%	8.26%	10.55%	5.75%

Inception 08/10/1999

Retirement Growth

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
6.29%	20.42%	20.42%	8.65%	13.31%	7.12%

Inception Date 06/03/1999

Growth & Capital Preservation

4th Quarter	YTD	1 Year	3 Year	5 Year	10 Year
4.55%	15.10%	15.10%	6.39%	10.08%	5.80%

Inception Date 11/30/2001