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## Q4 2013 Commentary: A remarkable year.

Financial markets were both remarkable and unremarkable in equal measure in 2013. Remarkable certainly is that the S&P 500 finished the year at its all-time high and rose 32.4%. This return was the index's largest annual gain since 1997 and came despite an economy that is still growing modestly and experiencing annual corporate earnings growth that is a pedestrian five percent. In this environment, our stock holdings performed well. The bond market continues to suffer from interest rates creeping higher and the US aggregate bond market index fell 2.0% in 2013. Unless there is a crisis that causes investors to pile into US bonds as a safe haven, we expect the upward pressure on rates to continue and for the US bond market to continue to struggle as the economy improves slowly, but steadily.

Unremarkable in 2013 was stock market volatility which was the lowest since 2007 as measured by the S&P 500 volatility index. More importantly to investors, the stock market traded in a very limited and stable range over the entire year. Historically, the stock market experiences around three market corrections of five percent or greater per year. In 2013, however, the S&P 500 did not correct by more than five percent even once. When the market did retreat, it did so for just a handful of days before turning around and heading back to new highs. Our outlook was and is positive, but we have waited for more significant pullbacks in the market to invest cash.

The tranquility in financial markets is remarkable when one considers that the events of last year included Congress's fiscal cliff standoff and sequestration in the first quarter, significant tax increases and a spike in longer term interest rates mid-year, and the government shutdown and the commencement of the taper from Fed bond purchases in the fourth quarter. All of these events are reason enough to give investors pause, yet they continue to go head long into US stocks because they are viewed as the only viable investment alternative. Bond investments pay little interest and are subject to interest rate risk. The real estate debacle is still on peoples' minds and economies around the world appear worse off than our own.

From a strategic standpoint, we have been conservative and sold stocks as their valuations rose and hit price targets. A market correction is overdue and likely to be of greater magnitude at the current higher market valuations. Over the course of 2013, the median price to earnings ratio (PE) of the Value Line stock index increased from 15 to almost 19. With valuations creeping higher there is a narrower margin for error in the performance of the economy and the stock market. It is now even more important to buy with discipline to both protect the gains we have achieved and to position portfolios for gains in the future.

Peter Lynch, the long retired, but legendary portfolio manager of the Fidelity Magellan fund is known for saying that if one spends "more than 13 minutes analyzing economic and market forecasts, you've wasted 10 minutes." Lynch's quip is relevant to the current environment. We find little reason to fixate on the economy. There will be ups and downs, but it will continue along its slow growth path much as it has for the past four years. Our time is better spent and our returns will be maximized, if we can find great investments. At present, we have our eyes set on a number of opportunities that meet our investment criteria and look promising for inclusion in the portfolio. Their time will come.