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THE BIG PICTURE ~ REVISITING 5 INVESTING PRINCIPLES

As we enter 2013, we thought it would be a good idea to review our core investing principles. These are truly big picture items that every investor should remember when investing in the capital markets, regardless of time horizon or risk tolerance. Most investors have a longer-term "end game" for their investment, whether it is to fund a more comfortable retirement, a charitable cause, a college education, a big ticket purchase, leaving money to heirs, etc. Yet, too often, we find the investment decision making process muddied by short-term news and issues completely out of our control. We believe the following core investing principles ring true in any market or economic climate and should help all investors successfully navigate the financial markets and improve the odds of achieving their long-term goals.

1. **The first and most important decision is asset allocation: how much should be invested in stocks, bonds, real-estate, commodities and other assets**? This is the critical investing question and is often overlooked or given short attention. The development of our clients' investment strategies begins with this question and should be inclusive of their total financial picture (not just the assets we have under advisement). Investors with longer time horizons (10+ years) should consider a greater weighting towards stocks vs. bonds and vice versa. Additionally, the introduction of non traditional assets like commodities, precious metals and absolute return strategies should provide more diversification and *smoother* (i.e. less volatile) returns over time.

2. Volatility is not risk. Volatility (measured by the S&P Volatility Index or VIX) is commonly used as a barometer of risk since spikes in volatility usually occur around perceived periods of risk and uncertainty in the market (9/11, Debt Ceiling Debate of 2011, etc). We believe investors should define true risk as the likelihood of a permanent loss of capital. There are many ways to permanently lose capital: buy shares in a stock that goes bankrupt, play roulette in Vegas, significantly overpay for any asset, etc; however, we do not view market volatility as one of them. In fact, as item A below shows, periods of extreme market volatility (VIX > 40) tend to coincide with excellent buying opportunities.

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(The Big Picture cont.)

3. The price you pay determines your return. The lower the price paid on an investment, the higher the return. As simple as this sounds, it becomes more difficult to do in practice, as investments are generally "low priced" when there is significant uncertainty and fear in the market. Ultimately, we believe the best way for an investor to reduce real risk is to invest at fair or value prices (i.e. don't overpay for anything). Our view is that if an investor purchases a quality investment (i.e. low probability of bankruptcy, default, etc) at the right price then they are not only managing risk (by not overpaying) but also improving their odds of higher returns.

4**. Time is your ally, but returns are not linear.** The most basic definition of investing is to forgo consumption today for the opportunity to consume/have more in the future. Consider that since 1950 the average annual return for stocks was 10.8%, while a more conservative allocation of 50% stocks and 50% bonds would have annualized a very respectable 8.9%*. Nevertheless, over the same time frame, both stocks and bonds endured several multi-year periods of negative annualized rates of return, most recently the "lost decade" from 1999-2009 when the S&P 500 annualized at *negative* .95% per year. So while investors (even those with a more conservative portfolio allocation) should be able to achieve respectable rates of return over time, these returns are not linear.

5. You can't predict the future. Another seemingly simple rule, yet all too often investors focus too much on trying to predict short-term economic and market outcomes (most recently which way the fiscal cliff will go) and do not focus enough on long-term fundamentals and valuations. Uncertainty is a fact of life in the financial markets. Waiting for more "clarity" almost always means paying a higher price (possibly violating principal #3).

The key takeaway from our core principals is that investing is a long-term game: do your best to develop an asset allocation strategy appropriate to your risk tolerance and time horizon and adjust as circumstances change, focus on paying a fair or value price for investments, manage real risk but don’t fret volatility, and stop waiting for the end of uncertainty. As your investment advisor and money manager, we will continue to follow these principals to help you meet your goals and objectives in 2013 and beyond.

Where We Are Investing Capital Now*

The current investment landscape is one marked by historically low interest rates, massive support from global central banks via various forms of money printing, and a general mistrust among the investing public. After two major market declines in the same decade (-49% from 2000-02 and -57% from 2007-09) many investors have chosen the path to "safety" provided by investment grade bonds. With the yield on 10 year U.S. treasuries (a proxy for the highest quality bonds) at a mere 1.7%, we would argue that overweighting these securities violates several of the investing principals above. Most notably principal #3 as the price paid for treasuries today is likely locking in a negative real (after inflation) rate of return. Our focus across all client portfolios, even those with a mandate calling for mostly fixed income (i.e. bonds), is to position for an inevitable rise in interest rates and inflation. Below, we provide a brief analysis on where we are investing capital now across the three primary asset classes.

Diversifying Assets: We have changed very little in our diversifying asset strategy over the last twelve months. Our primary focus with these assets has been to provide an inflation hedge to client portfolios. Research suggests that periods of low but rising inflation (something we feel is indicative of the current environment) should benefit a broad basket of commodities. To this end, we have invested in broad based commodity exchange traded funds (DJP/DBC) that we feel offer a good inflation hedge in the event of rising inflation down the road. Additionally, we have continued to allocate capital to both Gold and Silver bullion via a closed end fund that invests directly in these precious metals.

(Where We Are Investing Now cont.)

Bonds: The biggest challenge facing conservative savers and investors today is getting a fair return on their money while ensuring minimal risk to underlying principal. Given our view of 10 year treasury returns discussed above, we do not view this as a fair return. Still, conservative investors, especially those with a shorter time horizon, cannot necessarily afford the volatility that comes with investing in higher return issues. Volatility may not be true risk, but if you have a short time horizon you may not be able to wait for volatility to work in your favor. For this reason, we have focused the core of a conservative bond portfolio in higher quality, shorter maturity (i.e. lower interest rate risk) bonds, blended with smaller positions in more aggressive floating rate notes, unconstrained bond strategies and emerging market / international bonds in order to boost overall portfolio yield. While the yields on shorter-term bonds are relatively low, the nature of the short-maturity, typically < 5 years, should allow us to reinvest the proceeds at higher yields in the future.

For less conservative growth and balanced accounts, we continue to invest in floating rate notes, unconstrained strategies and international bonds but have maintained minimal exposure to low yielding investment grade bonds. Floating rate notes are tied to an adjustable rate like LIBOR; as rates increase so shall the yield on these notes. Unconstrained bond strategies focus on generating returns in any environment so they can adjust their sensitivity to rising interest rates and inflation, invest outside the US dollar with a portion of their portfolio, and short (i.e. bet against) various sectors of the bond market.

Stocks: We remain optimistic about stock returns over the long-run. Over the short-run the uncertainty cloud related to the "fiscal cliff" appears to have cleared, and global stock markets have responded with a nice bounce to start the year. Still, it is only a matter of time for a new uncertainty cloud to roll in (forthcoming debate over the debt ceiling?) that could create a more favorable entry point for clients with investable cash. In the meantime, long-term valuations remain reasonable relative to history (see table below) and most other financial assets; so, we intend to hold current exposure to stocks across portfolio strategies.

S&P 500 Valuation Measures**

	12/31/2012	1 year ago	3 year avg.	5 year avg.	10 year avg.	15 year avg.
Price to Earnings	**12.5**	11.8	12.6	12.8	14.2	16.7
Price to Book	**2.3**	2.1	2.1	2.2	2.5	3
Price to Cash Flow	**8.5**	8.1	8.4	8.4	9.7	11
Price to Sales	**1.2**	1.1	1.2	1.1	1.3	1.5
Dividend Yield	**2.4%**	2.3%	2.2%	2.1%	2.1%	1.9%

**Source: Standard & Poor's, FactSet, J.P. Morgan Asset Management

We continue to tilt domestic stock exposure towards large cap dividend paying holdings and smaller growth oriented funds, where applicable. Internationally, we have focused the majority of our stock exposure in Emerging and Frontier markets which we believe have a better risk-reward profile over the long-run. Additionally, while these markets together represent approximately 50% of Global GDP, they carry only a 13% weight in the MSCI All Country World stock market index. We believe most investors have underweighted these markets relative to their weight of Global GDP and that demand for these markets will likely increase over time. Finally, we have continued to hold a relatively small position in Europe via exposure to the iShares Germany ETF (EWG). While we view Germany as the strongest country in the EU, we may add broader exposure to Europe in the months to come if a buying opportunity presents itself.

** Individual accounts will vary based on the client's stated objectives, risk tolerance, and time frame. We manage several different portfolio strategies, so not every client has exposure to the securities listed above. In addition to growth and/or income oriented asset allocation strategies, we also manage more concentrated equity portfolios that generally carry a higher degree of risk and volatility. Please contact us if you want to discuss your portfolio strategy or any of your investments in greater detail.*

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2012 Performance Review

For the calendar year 2012, the S&P 500 gained 16%, International stocks (EAFE) gained 17.9%, Bonds (BarCap US Aggregate Index) gained 4.2% and Commodities (Dow Jones Commodity Index) declined -1.1%. While 2012 was a strong year for domestic and international stocks, the annualized returns for these assets over 5 and 10 year periods remain below their long-run averages. While volatility and uncertainty will likely be with us for the foreseeable future, we still view these assets as providing long-term investors with the best chance at maximizing returns over time.

Enclosed is a copy of our Privacy Notice. We can also provide you with a current copy of our SEC Form ADV Part II, at your request. ***Should you have any questions regarding your investment account (s), or if there have been any recent changes to your investment and/or retirement objectives, please do not hesitate to contact our office.***

As always, we thank you for entrusting AMM to help you achieve your investment and retirement objectives.

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