CLIENT NEWSLETTER Q3 2013

AMM AMERICAN MONEY MANAGEMENT, LLC

SEC Registered Investment Advisor

PO Box 675203, Rancho Santa Fe, CA 92067 | Tel 888-999-1395 | Fax 866-364-1084 | info@amminvest.com | www.amminvest.com

THE BIG PICTURE ~ DOW 64,000?

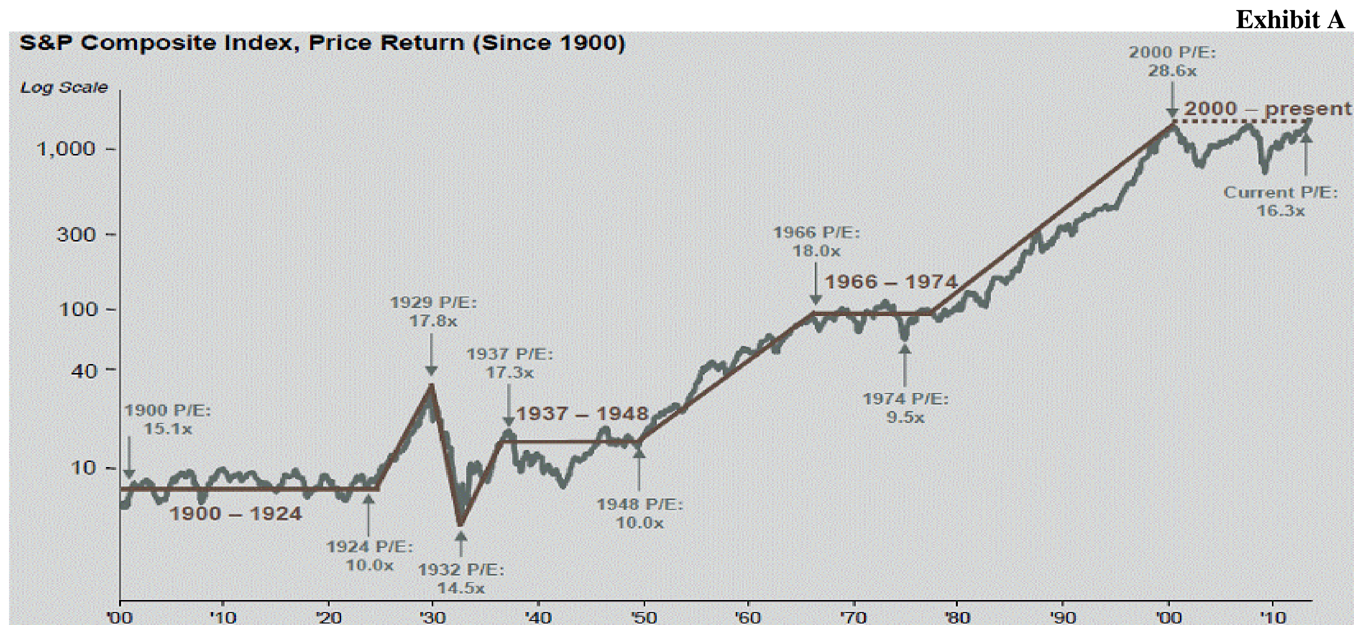
"Compound interest is the eighth wonder of the world. He who understands it, earns it... he who doesn't... pays it".
Attributed to Albert Einstein

The phrase *long-term* is ubiquitous in the investment industry leading many to take for granted its significance or, even worse, shun the concept altogether. Real wealth comes from the long-term investment in assets that can generate an above inflation rate of return. For most of us, this is an investment in financial assets like stocks, a small business and/or real estate. Regardless of the asset, the long-term component of the investment equation is important due to the significance of compound interest. Compounding allows you to earn interest on your interest which results in your money growing at an ever accelerating rate.

Unfortunately, returns on assets do not come in a linear fashion meaning that investors must accept periods of below inflation or even negative returns in order to benefit from long run compounding. While it sounds simple enough, the reality is far more difficult for almost all of us to cope with. In economics, loss aversion refers to people's tendency to prefer avoiding losses to acquiring gains. Some studies suggest that losses are twice as powerful psychologically than gains. It is as though we have been provided with the eighth wonder; but, in order to reap the benefits from it, we must fight every survival instinct we have (i.e. selling when prices go down to avoid further losses).

We understand that the *glass half full* view of the future is always hardest to take when times are difficult. By most measures, times have not been easy since the start of the Millennium. The developed world continues to struggle with sub-par economic growth and above average unemployment, while two major stock market downturns since 2000 have not helped investor confidence or sentiment. Exhibit A* shows the US stock market (S&P 500 Composite Index) since 1900, highlighting the most recent "consolidation" period from 2000 to the present.

Exhibit A



*Source: Factset, J.P. Morgan Asset Management.
Past performance is not indicative of future returns. Chart is for illustrative purposes only.

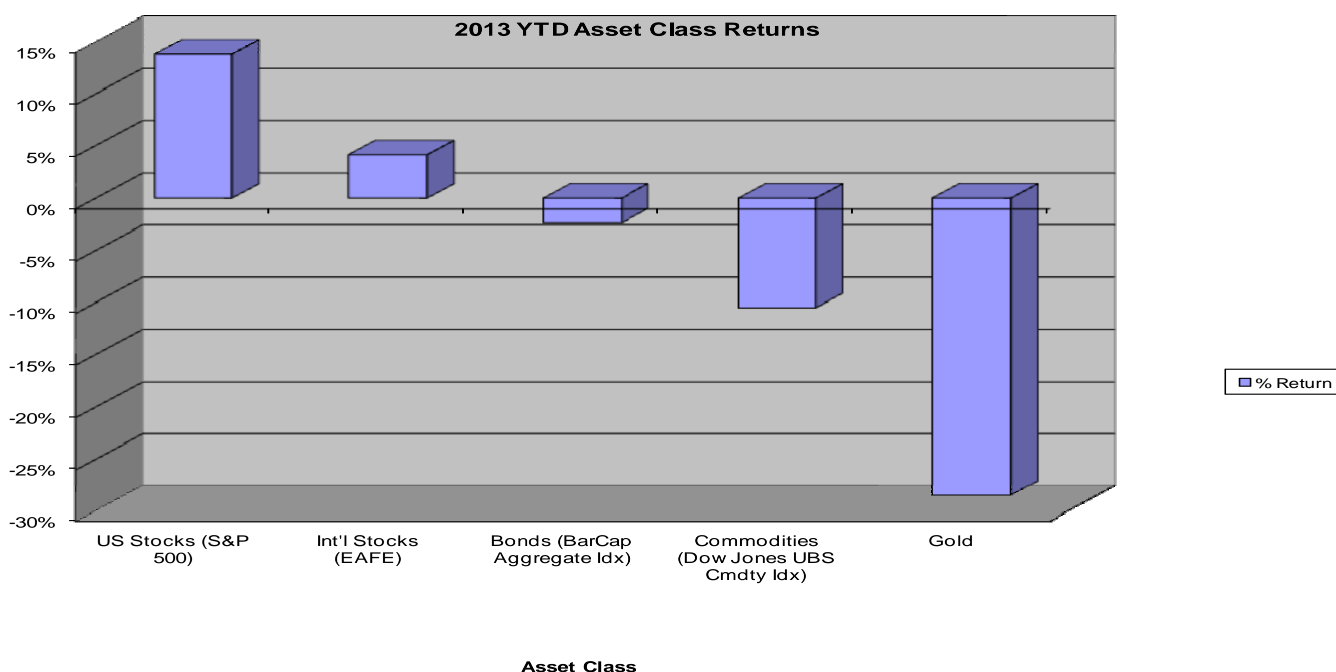
(OVER)

(The Big Picture cont.)

Over 113 years that included two world wars, a great depression, countless recessions and the recent lost decade of the 2000s, US stocks compounded at an average annual rate of 9.55%. ***Compounding the Dow at 7.55% (2% points lower than the last 113 years) from current levels would yield a value of more than 31,000 in ten years, and more than 64,000 in twenty years.*** Whether or not the market does better or worse, we continue to view the odds as very high that stocks will be higher 10 and 20 years from today. Along the way, we are sure to experience recessions, natural disasters and other events to stoke our loss aversion instincts. Whatever speed bumps might come our way (and they are sure to be plenty), we will continue to recommend that investors stay focused on the long-term as this will continue to provide the best opportunity for real wealth creation.

WHERE WE ARE INVESTING CAPITAL NOW*

The returns for major global asset classes were lopsided in the first half of 2013. On the plus side, domestic (S&P 500) and international stocks (EAFE) enjoyed positive gains of 13.8% and 4.1% respectively. Most other major asset classes were down. Year-to-date through June 30th, gold declined 28.4%, commodities (DJ-UBS Commodity Index) were down 10.5%, and bonds (Bar Cap Agg Index) lost 2.4%. The recent action underlines the futility of short-term investment positioning. At the end of 2012, there was significant concern about the potential effect of the budget sequestration on the overall economy and, by extension, the stock market. Investors seeking to *hedge* this short term risk by reducing stock exposure and *increasing* exposure to *safe* assets like cash, bonds or even gold have found themselves underinvested in the asset that performed the best in the first half of the year (US stocks).



Bonds: The recent rise in rates has caused some to question whether or not they should hold any bond exposure. First and foremost, this is an asset allocation question. Older clients with shorter investment time horizons should likely hold some degree of bond exposure. While investment grade bonds do not offer lucrative returns from current levels, they are considered a "flight to safety" asset that will generally hold up well during periods of stock market and economic stress. For example, the only major asset class that provided a positive rate of return during the 2008 stock market crash was US Treasury Bonds. For younger clients, we view a small "underweight" allocation to bonds as appropriate but not necessary if their risk tolerance can allow for a purely stock oriented asset allocation.

(Where We Are Investing Now cont.)

The sharp rise in interest rates that began in May has caused the prices on bonds of all kinds to fall. For some time, we have discussed what we see as an inevitable rise in interest rates from generational lows, and how we have been positioning the bond portion of portfolios accordingly. Most notably, our inclusion of floating rate notes via the Blackrock Floating Rate Fund (BFRAX) has provided some support for the bond portion of a portfolio as these investments can actually increase in value in a rising rate environment. In Q3, we plan to increase our exposure to this fund while simultaneously selling our position in the Templeton Global Bond Fund (TPINX). We may also take a position in a vehicle that actually shorts treasury bonds, which should provide further protection in the event of a continued rise in rates.

Diversifying Assets: We have included gold and a broad commodities basket in client portfolios for some time, both as an inflation hedge and as a portfolio diversifier. Neither asset is highly correlated with stocks or bonds, which allows us a degree of diversification that we do not get from a traditional stock/bond portfolio mix. With inflation expectations tame, gold has lost some of its luster with investors. In our opinion, the selling in gold is overdone, and we remain comfortable holding a modest position where appropriate in client portfolios. While gold will never match stocks as a wealth creator, it has acted as a preserver of wealth and a store of value since the dawn of man. We view the odds as beyond slim that the price of gold remains depressed forever, thereby permanently impairing the capital of gold owners.

Stocks: As discussed above, while there is a place for both bonds and alternative assets in a diversified portfolio, we feel strongly that stocks remain the best bet for real growth and wealth accumulation over the long-run. This growth potential comes at the cost of higher volatility and greater uncertainty related to the timing and amount of future gains. Unlike bonds that have stated coupons (interest rates) and maturities, the stock investor really does not know when their stock will "mature" (i.e. provide the rate of return that they expected when making the initial purchase), if at all. As daily participants in the financial markets, we can tell you from our experience that the 80/20 rule seems to apply: 80% of the gains come 20% of the time. Because of this inherent uncertainty, it is important for investors in stocks to have both patience and a healthy tolerance for shorter-term volatility.

We continue to tilt domestic equity exposure towards large cap dividend paying holdings and smaller growth oriented funds, where applicable. Even with the recent uptick in rates, yields on investment grade bonds remain at historically low levels which we feel has caused many investors to seek the higher yields provided by select dividend paying stocks. Additionally, dividends provide a cash return to investors while they wait for price appreciation. In addition to dividend paying stocks, we are currently favoring exposure to both financial and technology oriented issues. History suggests that these sectors should hold up well in a rising rate environment.

**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 in greater detail.*

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. We can also provide you with a current copy of our SEC Form ADV Part II, at your request.

As always, it is a great privilege to be entrusted with the stewardship of your retirement and investment assets.

Your Portfolio Management Team

Gabriel Wisdom
Managing Director

Michael Moore
Chief Investment Officer

Jim Rhodes, CFA
Executive Director

Glenn Busch
Portfolio Manager

Adele Canetti
Portfolio Manager

Robert Frazier
Investment Advisor

Bryan Case
Investment Advisor

John Nyaradi
Investment Advisor

Vicki Ohara
Operations Manager

Lili Waters
Administration

AMERICAN MONEY MANAGEMENT, LLC

14249 Rancho Santa Fe Farms Road
PO Box 675203,
Rancho Santa Fe, CA 92067

Tel: (858) 755-0909 Tel: (888) 999-1395 Fax: (866) 364-1084 E-mail: info@amminvest.com

www.amminvest.com