

Financial Management Group Economic & Investment Outlook 2014

2013 – Where We’ve Been

The year 2013 closed with US equities having experienced positive results not seen in almost two decades. The chart below illustrates investment returns for each of the various indices:

Index	4th Qtr.	2013	3 year*	10 year*	20 year*	Description
S&P 500 Index	10.51%	32.39%	16.18%	7.41%	9.22%	Large-Cap Stocks
Russell 1000 Growth	10.44%	33.48%	16.45%	7.83%	8.52%	Large-Cap Growth Stocks
Russell 1000 Value	10.01%	32.53%	16.06%	7.58%	9.71%	Large-Cap Value Stocks
Russell 2000 Growth	8.17%	43.30%	16.82%	9.41%	7.40%	Small-Cap Growth Stocks
Russell 2000 Value	9.30%	34.52%	14.49%	8.61%	10.64%	Small-Cap Value Stocks
MSCI – EAFE	5.75%	23.29%	8.66%	7.39%	6.08%	International Stocks
MSCI – Emerging Market	1.86%	-2.27%	-1.74%	11.52%	5.70%	Emerging Market Stocks
Barclay’s Aggregate Bond Index	-0.14%	-2.02%	3.26%	4.55%	5.74%	Domestic Bonds

*Denotes returns annualized as of December 31, 2013.

Despite concerning headlines relative to high unemployment, fiscal policy showdowns, and rising federal debt costs, US markets continued to rise substantially. Internationally, most markets performed well, with the exception of emerging markets, an asset class which was due for a respite having outperformed all other markets over the last 10 years. Most notable, however, were the lackluster returns provided by “safe haven” investments such as money markets, bonds and certain alternative investments, which significantly underperformed during 2013.

MISSION

To place our clients’ interests first, to provide comprehensive financial planning and investment management, and to be a premier provider of innovative and timely strategies that ensure every client meets their established lifetime goals and objectives.

2014—Where We're Headed

Multiple challenges remain for the US and international economies, but continued growth is nonetheless anticipated, likely translating to positive investment returns for another year. Although it is difficult to fathom a repeat of 2013, a number of positive news stories that are not typically addressed in mainstream media should provide traction, including the following:

- US and multi-national companies continue to record very strong earnings.
- The amount of cash sitting on the balance sheets of most major companies is at a record high level, which will at some point be deployed and will likely have a positive impact on economic growth.
- Valuations for equities are still relatively low, for most US and non-US companies.
- Inflation, if and when it manifests, typically results in strong equity returns, and provides negative headwinds for the traditionally more conservative investments such as fixed income.
- Housing starts and auto sales, two of the largest drivers of economic growth, have still not yet returned to pre-2008 levels, and as they recover, will likely provide additional fuel for a continued economic recovery.
- Shale gas exploration and production is a game changer for economic development in the US, resulting in more jobs, and stabilizing economic forces as it relates to energy prices.
- Consumer confidence (sentiment) remains low, typically a contrarian indicator, and most often coincides with a period of improving equity markets.
- Although market highs are being set for indices such as the S&P 500, little growth has been experienced for the longer period, from 2000-2013, representing one of the longest periods of flat line growth in US equities, and is one of the contributing factors for attractive equity valuations.
- Recession in most European countries is over and these economies are just starting to experience the early stages of a recovery.

Portfolio Structuring Remains Overweight Equities, Underweight Fixed Income

Since the early stages of the economic recovery in 2009, FMG has positioned portfolios with an overweight to US and non-US equities. The benefit has been stronger portfolio returns, with four out of the last five years having provided double digit returns, even for the most conservative of portfolio allocations.

In environments where equities outperform their more conservative fixed income counterparts, it is not uncommon for investors to begin chasing investment returns and rotating most of their assets to last year's best performers, eliminating those areas that are providing a "drag" to the overall portfolio. Although we have been a strong proponent for overweighting equities for the last five years, it is never wise to abandon an asset class due to

temporary performance. Even fixed income, which will likely be challenged again this year, and beyond, deserves a significant weighting as a means of mitigating risk. A disillusioned “market timing” strategy is never prudent, having proven futile time and again, and is evidenced in Nobel-prize winning research, referred to as the *Modern Portfolio Approach to Investing*, which we implement on behalf of our clients. Investors need to know that unexpected events, and associated market volatility, can indeed manifest at any time, and the allocations to more conservative asset classes will reduce erosion that would otherwise occur.

Non-traditional Alternative Investments Provide Specific Asset Allocation Benefits

After extensive research and due diligence, FMG began in 2007 to add alternative investment strategies to the portfolios. Many are available only to institutional investors, but we have arranged to provide these alternative investments for our clients in order to supplement the traditional forms of equity and fixed income investments. These alternatives are selected based upon their risk characteristics and exhibit low correlations to the performance of traditional equity markets. Some holdings are intended to be conservative in nature, protecting the portfolio during periods of volatility, while others are intended for long term growth, but will experience larger upward and downward movements during shorter periods of time. The specific benefits derived from these allocations are increased diversification and diminished portfolio volatility, creating an environment where clients can “win by not losing” with their investments.

Prudent Portfolio Management Integrated with Comprehensive Financial Planning Provides the Best Long Term Results

As previously described, we advocate a proven Nobel Prize-Winning Approach for managing our client’s investment portfolios. By maintaining consistent exposure to a diversified array of 15-20 individual asset classes, client investment portfolios will have every opportunity for growth and by making tactical shifts, over and above periodic rebalancing and profit taking opportunities, we seek to add value, especially during periods of elevated volatility.

At FMG, our team of financial planning and investment management professionals works closely together to ensure opportunities are not overlooked for adding value to your financial situation. In our opinion, wealth building and preservation must include not only investment management, but also financial planning activities such as cash management, debt management, tax planning, risk management, college funding, retirement planning, and estate preservation.

Our Firm Has Been Recognized Nationally as We Continue to Grow from Satisfied Clients and Professionals Who are Willing to Refer Us

Our efforts at FMG are best utilized when we are focused on providing the highest level of service to our clients. As we continue to grow, we are able to make available additional resources and enhance the value of those services provided. We have capacity for accepting new clients and appreciate when we are referred to others.

Please feel free to make an introduction to colleagues, family or friends by offering at no charge, an introductory consultation to determine if and how we might be able to assist them with our comprehensive wealth management services.

We look forward to serving you in the New Year and welcome discussing further with you our current *Economic & Investment Outlook* for 2014. Please feel free to contact us at any time by telephone at 513-984-6696 or via our website at www.fmgonline.com

Happy New Year!

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