July 25, 2013

RE: 2nd Quarter 2013

The second quarter of 2013 was most noteworthy in that little changed with regard to measurable economic statistics. Unemployment, GDP, consumer spending etc., continued to slog along at rates that were neither very good nor very bad. In spite of lackluster numbers, the bond markets showed clear signs of what is likely to happen when the Federal Reserve decides to "taper" their aggressive buying of bonds and mortgages.

Anticipating a reduction in quantitative easing, the fixed income markets, particularly long-term government bonds, suffered significant losses in the 2nd quarter. Among various indexes to include equities, only fixed income markets showed clear signs of decline in value.

INDEX	2ND Quarter 2013	Year to Date	LATEST 12 MONTHS
	%	%	%
Domestic Equity			
S&P 500 Index	2.91	13.82	20.60
S&P 500/Citi Growth Index	2.48	12.04	16.78
S&P 500/Citi Value Index	3.36	15.73	25.04
Dow Jones	2.92	15.20	18.87
Russell Midcap	2.21	15.45	25.41
Russell Midcap Growth	2.87	14.70	22.88
Russell Midcap Value	1.65	16.10	27.65
Russell 2000	3.09	15.86	24.21
Russell 2000 Growth	3.74	17.44	23.67
Russell 2000 Value	2.47	14.39	24.77
International Equity			
MSCI ACWI ex US	-2.90	0.27	14.14
Domestic Fixed Income			
Barclays Gov/Credit Interm. Bond	-1.70	-1.45	0.28
BofA ML 0-3 Year Treasury	-0.06	0.02	0.29
BofA ML Muni 1-3 Year	-0.18	0.24	0.61
Consumer Price Index	0.26	0.78	1.76
Cash Equivalents			
Citigroup 3-Mo. Treasury Bill	0.02	0.03	0.08

Normally we focus on the quarter corresponding with client reports. In this case the second quarter discussion would be inadequate if a discussion of the subsequent July rally in bonds was not discussed.

The July rally in fixed income markets may not be surprising given the markets demand for income and safety. However, it does not bode well for the bond market in the long run. In spite of nearly universal agreement among investors believing rates will rise, there is a stubborn resistance to foregoing income in favor of other asset classes. Even sudden steep declines in bond prices resulting from only a suggestion from Ben Bernanke regarding tapering, seems to have been quickly forgotten.

The bull market in bonds is showing clear signs of "resisting" lessons of history with regard to historical interest rates. A market always treats irrational thinking dramatically. In retrospect, irrational thinking is always apparent after a bubble has burst and a panic has exhausted itself.

In the late 1990s unsustainable growth rates for technology and Internet stocks were assumed to be normal and simply part of a "new economy." The fallacy of "new economy" growth rates obviously proved to be unsustainable.

Investors, driven from their bad experience in the equity markets, placed bets on real estate and drove prices to unsustainable levels. Fueling the real estate bubble were low interest rates along with relaxed lending standards. The result was predictable, dramatic and swift. Perhaps the bubble was not predictable but the probability of a "crash" should have been feared. Instead giddiness and intoxicating returns fueled greed. Like the equity market bubble, the real estate debacle could have been avoided.

In the case of the current bond market, greed is not the driving force. This time fear dominates. Since the end of the previous bear market in bonds in 1981, each time a crisis faced the Federal Reserve, the "cure" was in lower interest rates. It worked wonderfully well until now. In spite of interest rates well below historical norms, the economy remains sluggish.

Normally the economy would react quickly and very positively to easy money. It clearly has not this time. In the meantime many buyers of fixed income are behaving like potential victims indicating they have no choice but to buy at current rates. All bubbles produce victims regardless of their motivation.

The unprecedented action on the part of the Federal Reserve to reduce interest rates and stimulate the economy has only partially succeeded. Interest rates are low, but the economy has not sufficiently recovered. The result for fixed income investors is the Fed has provided a sense of false security to the bond markets. This sense of false security has caused a belief that investing for income has nominal risk because the Fed has said they will not raise rates until the unemployment rate is 6.5% or lower.

Meanwhile the economy is becoming dependent on economic "life support" through abnormally low rates. The longer artificially low rates are kept in place, the fear of what happens when rates move higher will likely grow.

It appears the Fed will err on the side of keeping rates low, which increases the likelihood of inflation over the longer term.

Investing in bonds appears to be a lose-lose proposition with each passing day. The markets indicate otherwise. The market seems to be saying it is different this time.

Our guide is history, which clearly states: It is never different this time.

Our fixed income strategy remains very defensive both in the near and long term. Our equity outlook is very positive. Our only caution is an increasing likelihood for a correction.

Curran Investment Management is grateful for your trust in us. Kevin and I welcome your opinions and invite you to call us to discuss your portfolios.

Curran Investment Management® is Defining Quality.®

Sincerely,

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In the second quarter of 2013, the following changes were made in the portfolios we manage.

Buy/*Increase*	**Sell/*Decrease***
Core Equity Portfolio	
	Celgene Corporation (CELG)
	Mastercard Incorporated (MA)
Mid Cap Portfolio	
Boston Beer Co. Inc (SAM)	Global Payment Inc (GPN)
United Therapeutics Corporation (UTHR)	CR Bard Inc. (BCR)
Small Cap Portfolio	
Flotek Industries (FTK)	*Boston Beer Co. Inc. (SAM)*
Geospace Technologies Corporation (GEOS)	*Atwood Oceanics, Inc. (ATW)*
Proto Labs Inc. (PRLB)	*Balchem Corp (BCPC)*
PowerShares S&P Small Cap Utilities (PSCU)*	*OpenTable, Inc. (OPEN)*
Astronics Corporation (ATRO)	Lufkin Industries Inc (LUFK)**
Medifast Inc (MED)	*J2 Global, Inc. (JCOM)*
Cirrus Logic Inc (CRUS)	*Synaptics Inc (SYNA)*
MTS System Corp (MTSC)	*Bio Reference Laboratories Inc. (BRLI)*
Cyberonics Inc (CYBX)	*Questcor Pharmaceuticals, Inc. (QCOR)*
InvenSense, Inc (INVN)	*rue21, Inc (RUE)*
Santarus, Inc (SNTS)	
HCI Group Inc. (HCI)	
Growth & Income	
Coach, Inc, (COH)	BHP Billiton (BHP)
Apple Inc (APPL)	Emerson Electric (EMR)
Rayonier Inc (RYN)	Westpac Banking ADR (WBK)
Portfolio for Income	
PowerShares 3X Short 25+ YR Treasury Bond ETN (SBND)	*iShares Barclays TIPS ETF Bond (TIP)*
SPDR Barclays Capital Convertible Secs ETF (CWB)	
International Portfolio	
Michael Kors Holdings Limited (KORS)	Eni S.p.A. (E)
Universe Top Performers Portfolio (earliest to latest)	
Proto Labs, Inc. (PRLB)	SolarWinds Inc. (SWI)
Nu Skin Enterprises Inc. (NUS)	Sturm Ruger & Co. Inc. (RGR)
Mercardolibre, Inc.(MELI)	Catamaran Corporation (CTRX)
Santarus, Inc (SNTS)	Novo Nordisk A/S (NVO)

*PowerShares S&P Small Cap Utilities (PSCU) was first purchased and then further increased in weight.
**Lufkin Industries Inc (LUFK) was first decreased in weight and then sold completely.

Note: The following portfolios had no changes: Portfolio for Growth and International ETF.