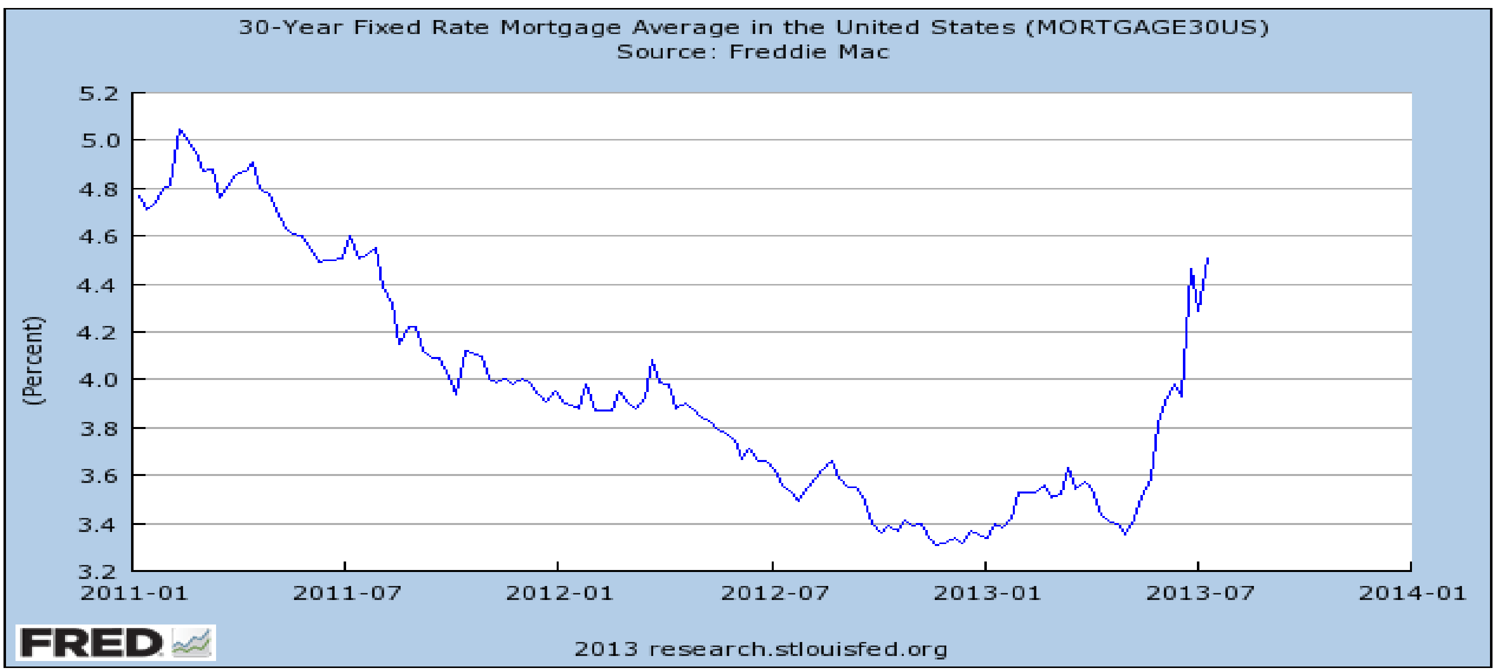
Yanni & Associates Investment Advisors, LLC
Second Quarter 2013 Client Newsletter

Review of the Markets:

	2Q13	2013
S&P 500	2.91%	13.82%
S&P Mid-Cap	1.00%	14.59%
S&P Small-Cap	3.92%	16.19%
Morgan Stanley's EAFE (International Stocks)	-0.98%	4.10%
Barclays US Aggregate (Bonds)	-2.32%	-2.44%

Economy – The biggest news for the quarter was the Federal Reserve (The Fed) announcing they are planning on reducing their bond-buying program later this year and expect to fully end it by mid-2014. The Fed's ongoing monthly purchases of $85 billion Treasury and mortgage bonds have helped artificially keep long-term interest rates at record lows. Reductions in this quantitative easing strategy (QE3) will likely force longer-term interest rates higher (mortgages and other consumer & business loans). The Fed plans on maintaining low short-term interest rates for another few years. As a result of the announcement, average 30-year mortgage rates spiked by approximately a full percentage point. Keep in mind, QE3 is the third round of quantitative easing that has increased the Federal Reserve's balance sheet from approximately $700-800 billion to nearly $3 trillion, on top of lowering short-term interest rates to near zero. This will mark a historic time for years of unwinding stimulative monetary policies.



While economic growth is perhaps not quite as strong as we would like to see, we fully agree with the Federal Reserve's decision to start this "tapering" process (they did hedge themselves by indicating it's still based on future economic reports). Unfortunately, this news ultimately punished the bond market (the general bond index was down -2.32% for the quarter). The equities markets were also punished, but not as severely. As a result of this news, we eliminated all of our traditional bond holdings, REIT positions, and temporarily trimmed our equities exposure. While we are holding a bit higher cash position than normal, we have begun redeploying it back into equities as well as floating-rate bond funds. The equities markets quickly reversed course and have surpassed their all-time highs. As we have mentioned before, we are much more comfortable with the stock market compared to the bond market at this point. If we are truly entering an extended period of rising interest-rates, investing clients' assets into traditional "safe" investment vehicles will become a challenge. As mentioned above, we continue to favor floating-rate bond funds, which hold short-term, senior, floating-rate bank loans. We plan on reinvesting our clients' remaining cash over the next several weeks.

About a week after the Federal Reserve made their last announcement, final First Quarter 2013 GDP growth was reported at 1.8%, which was below an expected 2.4% estimate. The biggest downward revision was to personal consumption. This comes on top of Fourth Quarter 2012 GDP growth being 0.4% and calendar-year 2012 GDP growth being 2.2%. Surprisingly, the equities markets reacted positively with possible expectations the Federal Reserve will be forced to delay their planned reduction in the bond-buying program. Most economists' expectations are for a much stronger second half of 2013.

Consistent with GDP, second quarter corporate earnings (according to Factset) are expected to grow modestly at 0.7% (revenue growth at 0.9%). At the beginning of the second quarter (March 31st), the anticipated quarterly earnings growth rate was at 4.2%; since then, virtually all sectors have lowered their earnings expectations. Again, consistent with anticipated GDP growth, Analysts expect earnings to grow 8% for the upcoming third quarter (with revenue growth of 3%) and 13% for the fourth quarter (with revenue growth of 1.3%). It appears as if Analysts have very lofty projected earnings growth with fairly muted anticipated revenue growth.

In other economic news, the latest unemployment report came in at 7.6%. According to the last Federal Reserve announcement, they believe the unemployment rate will fall to 7.2-7.3% by year-end, and then to 7% by mid-2014 (at which it would begin to end its stimulative bond-buying program). Further, upon reaching 6.5% unemployment (projected in 2015), the Federal Reserve then plans to potentially start raising short-term interest rates (through the Federal Funds Rate and Discount Rate). Given that the number of new 60- to 69-year-olds is rapidly increasing, retirees alone will bring down the unemployment figure even if the job market does not improve. Again, the Fed's potential actions assume inflation comes closer to its 2% target and other economic reports continue to be positive. It should also be noted that Ben Bernanke will complete his term as Chairman of the Federal Reserve at the end of 2013.

While we have been adding back to stock positions and continue to believe the stock market has a bit more room to grow, our main concerns are:

1. How will corporate profits be affected by a rise in longer-term interest rates?

2. If we are entering an extended period of rising interest rates, will this result in a prolonged bond recession?

3. If the Federal Reserve decides not to unwind the various quantitative easing strategies (or unwind too slowly), will this create the next "bubble"? While economic "bubbles" can come in different forms, the most common under this type of scenario would include a general asset bubble; one example could be the stock market being bolstered for several years of accommodating monetary policy & quantitative easing strategies.

4. Will the U.S. experience deflation? Deflation is the decline of the price of goods and services. As businesses and people spend less, prices tend to drop, and they tend to delay purchases. Widespread deflation has never been a good thing. While a potential deflation scenario more frequently being discussed, we believe it has a low probability of actually occurring.

We surely do not want to sound pessimistic in a period such as today; however, we do need to point out that the Dow Jones Industrial Average has risen by 3,000 points (about 25%) in eight months. As we have mentioned in recent meetings with our clients, the last few years of stock market returns have been above historical averages. From a charting perspective, the equities markets continue to show signs of support at these levels. Also, the current forward price-to-earnings ratio on the S&P 500 is 14.49; this is based off the July 15th closing price of $1,682.50 and a 12-month earnings-per-share estimate of $116.12. As noted in last quarter's report, we believe the stock market has a bit more room to grow, but is approaching fair value.

Matthew A. Yanni, CFA, CFP®
Principal & Chief Compliance Officer
Yanni & Associates Investment Advisors, LLC
2000 Corporate Drive, Suite 450
Wexford, PA 15090

office – (724) 940-0310
cell – (724) 612-5944
www.yanniassociates.com
matt@yanniassociates.com