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

Review of the Markets:

	3Q13	2013
S&P 500	5.24%	19.79%
S&P Mid-Cap	7.54%	23.23%
S&P Small-Cap	10.73%	28.66%
Morgan Stanley's EAFE (International Stocks)	11.56%	16.14%
Barclays US Aggregate (Bonds)	0.57%	-1.89%

Economy – The economy continues its moderate growth rate finishing up 2.5% for the second quarter after rising 1.1% for the first quarter (again, calendar year 2012 Real GDP growth was 2.2%). The latest Unemployment Report (September figure) continued its slow decline falling to 7.3%; that is down from 7.8% in January. Year-over-year inflation, as measured by the Consumer Price Index, was last reported at 1.5% in September. Due to the government "shutdown", more recent economic figures have not been released.

The significant news items for the quarter were the following:

1. For the past few months, the Federal Reserve attempted to be transparent with potentially reducing its quantitative easing bond-buying program this past September (aka "tapering"). As we highlighted in our second quarter newsletter, speculative news of this actually caused long-term interest rates to spike by about one full percent during the summer months; short-term rates were not affected. As economists were forecasting a September "tapering", it came as a bit of a surprise that the Federal Reserve actually chose to delay its actions for a while longer. It is our belief that the Federal Reserve will begin this reduction in its bond-buying program at some point in the fourth quarter or shortly thereafter. For many years and in an effort to stimulate the economy out of The Great Recession, the Federal Reserve has incorporated several different unconventional methods of stimulative monetary policies (including non-traditional "quantitative easing strategies") that have led to both short-and-long-term interest rates artificially falling to historical levels.

   In its recent September meeting, the Federal Reserve also lowered its 2013 Real GDP Growth Projection from 2.3%-2.6% to 2.0%-2.3% and its 2014's figures from 3.0%-3.5% to 2.9%-3.1%. Prior to this reduction in GDP growth estimates, the Federal Reserve's estimates were higher than most major economist's consensus figures. Ben Bernanke continues to explain that all Federal Reserve actions are dependent upon a variety of economic figures (mainly Real GDP growth, inflation, and unemployment) reaching certain productive, yet sustainable levels.

2. President Obama nominated Janet L. Yellen to succeed Ben Bernanke heading the Federal Reserve. Ben Bernanke will officially step down from his second four-year term on January 31st, 2014. Dr. Yellen will become the Fed's first Chairwoman. She has extensive experience and has been with the Federal Reserve since 2010; it is believed she will provide a "smooth" transition in existing monetary policies.

3. Syria and its alleged chemical warfare on its rebels were at the forefront of the news for several weeks. Fortunately, the Syrian government has permitted International inspectors to visit various sites within its country; a peaceful resolution was pleasantly received.

4. As we approached quarter-end, the government's budgetary issues took the forefront of the news and led to considerable volatility in the stock market. We communicated with clients that we were confident the government would find some sort of resolution prior to the October 17th deadline. As a result of this ongoing budgetary debacle, the stock market has dropped and 30-day Treasury Bills (which are the so-called "risk-free rate") have risen substantially commanding a higher premium for a potential default scenario.

Equities – The equities market once again provided above-average returns for the quarter with the S&P 500 finishing up 5.24%. If it were not for the government's budgetary issues making the headlines in the last week of the quarter, returns would have been even higher. The ongoing political debacle continued into the fourth quarter causing stock market returns to fall approximately 5% from their peaks. **As news of a potential deal started to make headlines on October 10th, we moved client accounts to a short-term overweight in stocks.** We believe the stock market's recent drop was a result of headline risk of political nonsense, not underlying fundamentals.

According to Factset, the S&P 500 is trading at 14.3 times 12-month forward earnings-per-share (EPS) estimates. This is based on October 15th's S&P 500 close of 1,698.06 and Factset's 12-month forward EPS estimate of $118.75. We are interpreting that forward P/E as meaning the S&P 500 still has a bit of room to grow, but is approaching fair value.

Fixed Income - Fixed Income Returns were very muted returning 0.57% for the quarter. Year-to-date, returns are down approximately 2%. As we have been discussing with clients (particularly retirees), we may be on the verge of upcoming muted returns or even negative returns for the general bond market. Consistent with prior newsletters, we have over-weighted floating-rate bonds in an attempt to protect principal in the event of a potential bond recession. We have maintained our positions in individual bonds as well as high-yield bonds, but did sell out of our traditional bond funds (where interest rate exposure is high) back in June. We are not recommending holding traditional bond funds, unless other alternatives are unavailable.

As we have been communicating to our clients (particularly retirees), we are in a bit of a quandary at this time. This is because the stock market is trading near its all-time high, but yet we have a cautious outlook on the bond market. Overall, we are much more bullish on the stocks in relation to bonds. While we are continually monitoring the markets and our client accounts, we believe it is important for our clients to understand where our economy is currently situated and that future tactical portfolio adjustments will probably be made.

Yanni & Associates Investment Advisors, LLC recent quotes in various publications:

● Pittsburgh Business Times, *Which out-of-town bank is most likely to enter southwestern PA, Patty Tascarella, August 23-29, 2013*

Current 2013 Portfolio Recommendations:

- Overall – "**slight" over-weight stock exposure for our clients' asset allocations with respect to their customized individual guidelines**.
- Within equities - **neutral-weight stance on "growth" and "value".**
- Within equities – **neutral-weight small / mid-capitalization stocks in relation to large capitalization stocks.**
- Within equities – **under-weight international stocks relative to domestic stocks**.
- Within fixed-income – **over-weight to shorter maturity/duration vehicles, while favoring floating-rate bond funds, high-yield, and individual bonds.**

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