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

Review of the Markets:

	4Q13	2013
S&P 500	10.51%	32.39%
S&P Mid-Cap	8.33%	33.50%
S&P Small-Cap	9.83%	41.31%
Morgan Stanley's EAFE (International Stocks)	5.71%	22.78%
Barclays US Aggregate (Bonds)	-0.14%	-2.02%

Economy – The final third quarter GDP was revised sharply upwards from 3.6% to 4.1%; this compares to the 2.5% growth in the second quarter and 1.1% in the first quarter (again, calendar year 2012 Real GDP growth was 2.2%). While we do not have final figures yet, calendar year 2013 is shaping up to have been a fairly healthy year for overall economic growth. The December Unemployment Report continued its slow decline falling to 6.7%; that is down from 7.8% in January. This latest unemployment report came with significantly skewed figures as there were only 74,000 jobs created in December, well below expectations of 200,000; the reason the unemployment rate dropped was due to a decrease in the labor force by nearly 350,000 people. Year-over-year inflation, as measured by the Consumer Price Index, was last reported at 1.5% in December.

Equities – **On October 10th, we moved client accounts to a short-term overweight in stocks.** Essentially, we shifted a small portion of our clients' assets from their bond positions into stock positions. This move proved to be advantageous as the S&P 500 was up 10.51% for the quarter. The rationale behind that move was for three reasons:

1. From a technical (charting) perspective, the stock market was re-touching a trough level for the third time in less than four months. Each time in the past it had done so, the stock market quickly rallied afterwards.

2. We believed the stock market drop in late September and early October was a partial result of headline political risk due to being 10 days into the 16 day government shutdown. We believed the stock market would move higher upon the resolution of the two-week government shutdown.

3. Fundamentally, we did not believe corporate earnings would mirror the stock market retreat due to the first two reasons above.

We do plan on unwinding that position in upcoming weeks and moving back to being neutrally-weighted stocks. To note, this past year the S&P 500 was up 32.39%, which was its best year since 1997 and fourth best since 1975!

From a valuation perspective (according to Factset), the S&P 500 is trading at a forward Price-to-Earnings Ratio (P/E) of 15.4. While the stock market can trade much higher-or-lower, a general P/E between 14-16 is a comfortable range.

Fixed Income – The Bond market (as measured by the Barclays US Aggregate) had a negative return of -2.02% for the year. The bond market actually started off positive for the year returning close to 1% through April. In May, the Federal Reserve first started making comments about unwinding its bond-buying strategy known as QE3. Immediately afterwards, long-term interest rates spiked by approximately 1% sending the bond market into a frenzy ever since. On December 18th, the Federal Reserve announced it would start to reduce its bond-buying program starting January, 2014. It will wind down and ultimately cease bond purchases this year (which we believe will cause long-term interest rates to rise), as long as economic indicators stay on track. Further, the Federal Reserve reiterated its plans to maintain short-term interest rates near zero until the unemployment rate falls to around 6.5% or the inflation rate exceeds 2.5% a year; most market analysts do not expect short-term interest rates to rise until at least 2015. However, given the last unemployment figure of 6.7%, matters suddenly became more complicated for the Federal Reserve. Our forecast for the bond market is for muted or even possible negative returns.

2014 Forecast:

We are forecasting another positive year for the stock market, but not to match the 30+% return from 2013. The economy continues to grow, unemployment continues to slowly decline, and inflation continues to remain tame. **Overall, we do not see any major risks of a recession on the horizon**.

While we are forecasting a positive year for the stock market for 2014, it may come with volatility. Our biggest reasons beyond the stock market retesting highs each day or continual political squabbling are as follows:

1. Long-term Interest Rate Rise - Longer-term interest rates are forecasted to rise in 2014, which will undoubtedly put downward pressure on corporate profits. Further, if mortgage rates rise, that could put pressure on housing activity. Finally, higher interest rates could cause investors to swap lower risk fixed-income assets from riskier assets (such as stocks). We believe this rise in interest rates will take place over the course of several months, not in the panic / spike-driven manner it happened in the summer of 2013.

2. General Economic Weakness – While the economy continues to grow, unemployment has proved to be difficult to reduce (aside from December's "skewed" figure). If earnings start to slip, it could trigger a negative shift in market sentiment and could prove that current valuations may be unsustainable.

3. Presidential Cycle – Historically, the second year of the Presidential cycle where mid-term elections are held, has produced volatile and sometimes sharp pull-backs in stock market returns.

Yanni & Associates Investment Advisors, LLC Firm update:

We are extremely pleased to announce Mark's wife (Robin) delivered their triplets; Ajax Salvatore, Nico Robert, and Francesca Geraldine Yanni were all born on December 9th.

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

● *Pittsburgh Tribune-Review, For many, debt load outpaces savings, Thomas Olson, November 9, 2013*

● *Pittsburgh Post-Gazette, Stock market continues to thrive since the end of federal shutdown, Len Boselovic, November 19, 2013*

YAIA has now surpassed its seven year anniversary! Also, YAIA is now managing approximately $46 million with clients across 14 different states. For the second time since our inception, in 2014, YAIA is hiring an outside Compliance Firm to conduct a "mock-audit" to ensure our YAIA remains compliant with the Pennsylvania Securities Commission.

Current 2014 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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