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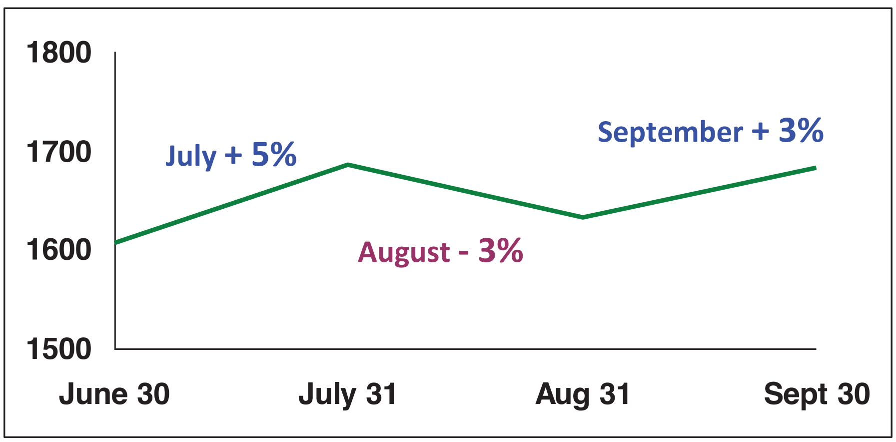
QUARTERLY INVESTMENT REPORT
September 30, 2013

Dear Investor:

Stock prices faced some rough water in August, but managed to navigate 4.7% higher in the third quarter. There were several threatening waves of contention – to arm or not to arm Syrian rebels, tense relations with Iran, ambiguity around the Federal Reserve's winding down of bond purchases, Obamacare uncertainty, and the government's failure to fund the budget and keep the lights on.

3rd Quarter S&P 500 – Increased 5%



The quarter's 5% price gain may not seem that impressive at first blush, but remember that the market's total return gain so far for 2013 is 19.8%. Despite the fact that investors still remain cautious five years after Lehman Brothers filed for bankruptcy on September 15, 2008, stock prices have climbed 40% since its collapse. Even more impressive, prices have climbed 250% from their lowest point in March 2009.

Four and a half years into this bull market, you have to wonder if this strident bull needs a rest. We know from experience how quickly bulls can turn into sheep and follow the herd without regard for an asset's value. It works both ways, pushing prices too far up or too far down. If the economy holds up and continues to improve, company earnings should stay positive. Stock prices are neither particularly expensive nor cheap, and given that bonds are a bit more overpriced than many stocks, we are comfortable, for now, with our established long-term target allocations in stocks.

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The key for us is that we think the economy is doing okay. Of course, there are risks too, so let's review both the stability and the hazards in our economy.

Stability:

- **US Growth is moderate and rising a little.**

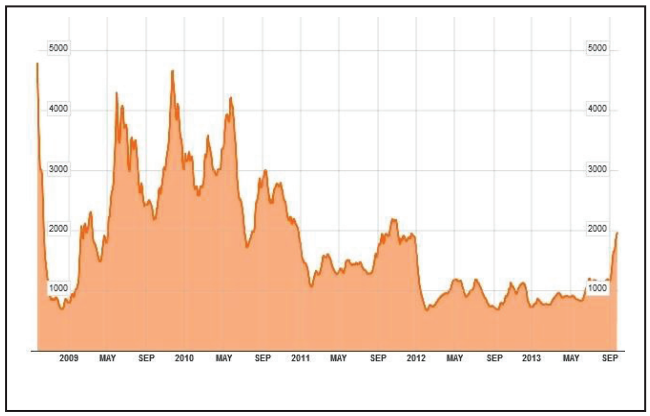
People are much wealthier than they were two years ago. Thanks to the housing and stocks recovery, net worth grew by $6 trillion in 2012 and another $6 trillion in 2013 so far. Greater wealth helps to keep consumer spending sustainable. There is still pent-up demand for cars (the average car on the road is 11 years old), houses (housing starts for single family permits are at their highest levels since 2008), and durable goods. Corporations are still sitting on a ton of cash waiting to be deployed.

- **Global economic growth is stronger.**

All major regions of the world – Japan, Europe, China, and the U.S. - have shown decent growth in the third quarter as evidenced by recent Purchasing Manufacturing Index (PMI) data.

Another index to watch, the Baltic Dry Index (BDI), tracks dry bulk cargo shipments. Cargo shipments correlate very well with international trade and growth. The BDI surged in August and looks outstanding this quarter, but to be fair we display a longer-term chart which appropriately depicts how much more growth we still need to achieve.

Baltic Dry Index – Last 5 Years



- **Unemployment continues to decline.**

Over the last twelve months we added 180,000 new jobs per month. The unemployment rate at the end of 2009 was 10%, today it's 7.3%. Unemployment isn't as low as we would like and many people have given up and stopped looking for jobs, but we think part of the reason for slower labor force growth is structural as baby boomers are retiring and leaving the work-force.

- **Corporate profits are doing fine.**

Analyst estimates for third quarter earnings growth over last year's third quarter are up about 5%. If it pans out, this is a decent number. Also, we don't expect net profit margins to change much from their historically high levels that hover around 9%.

- **Inflation is stable.**

The latest numbers for core inflation, purchasing power data that excludes food and energy, were stable at a 1.8% year over year increase. Full inflation, including food energy, is at 1.5%. Full inflation was lower at this reading because energy costs declined slightly and food costs grew more slowly than core inflation items. We like to track full inflation since it more accurately accounts for all prices. The reason some

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economists care more about core inflation is because food and energy can be quite volatile and make it more difficult to establish a reliable trend.

Hazards:

- **Iran and Syria.**

Though Iran is an oil-rich country, they are unable to optimize it largely due to limitations on infrastructure capabilities. Also, the U.S. is not dependent on Iranian oil due to trade sanctions. Syria, on the other hand, doesn't have much oil. The concern though is that an ugly war in Syria (Iranian backed government versus U.S. backed rebels) could ignite the entire region and oil prices could spike.

- **Management of Federal Reserve's end to bond purchases (Quantitative Easing).**

Investors know that the Fed is close to beginning the winding down ("tapering") of bond buying. In fact, it was a surprise when the Fed didn't begin in September as expected. The sooner the economy can stand on its own, without the Fed's sleight of hand, the better. The concern is that the Fed may move too quickly when it decides to end the program. Long-term interest rates as measured by the ten year Treasury bond spiked to 3% when the Fed was expected to begin tapering. It's back down to 2.6% but can move quickly higher if investors worry that tapering winds down too fast. The 30 year fixed mortgage rate, which is based on the 10 year Treasury rate, is at 4.25% - 4.50%. Though still historically low, a move towards 5% could scare home buyers and knock the wind out of this recovery.

- **Government shutdown.**

Over the last fifty years there have been seventeen government shutdowns (the most recent was in 2011) and eight stalemates on the debt ceiling.

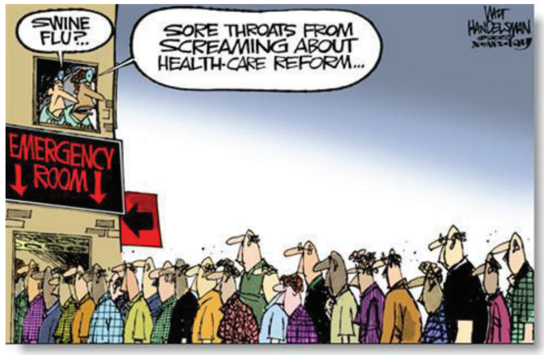
The shutdown duration is hard to predict, but likely will not last longer than a few weeks to a month. It will mean at least a short-term hit to confidence and spending. The budget wars will probably delay the Fed's taper program in October. Standard and Poor's rating services said that the current debt ceiling debate is unlikely to change their current double-A-plus rating on U.S. sovereign debt.

At least going into this shutdown of non-essential U.S. government services, U.S. economic data overall seem to point to accelerating growth. The stock market appears to be taking the shutdown in stride, assuming it will be short-lived. We remain careful to focus on long-term objectives and current valuations; though we are prepared to raise cash positions in the short-term should the shutdown appear to be extended.

Sincerely,

Ellen P. Le, CFA
President

GENERAL THINGS YOU SHOULD KNOW ABOUT OBAMACARE



- Anyone under age 65 can apply for individual coverage through their state exchange. If you already have insurance you like, you don't need to apply on the exchange.
  1. Applying online: www.heathcare.gov.
  2. Open enrollment is 10/1/13 – 3/31/14.
  3. Insurance is effective 1/1/14.
- The Kaiser Family Foundation has a nifty calculator that gives you an estimate of what your premium would be. http://kff.org/interactive/subsidy-calculator/
- If you don't have insurance in 2014 you will be fined $95 per adult and $47.50 per child (penalties will increase in 2015 and 2016).
- You will be asked if you have insurance when you file your 2014 IRS tax return. Your insurance plan (or company) will provide you with a form proving you have insurance which will need to be filed with your taxes. (People who don't have any reportable income will not be penalized if they don't have insurance).
- Exchanges will offer 4 levels of coverage - Bronze, Silver, Gold, and Platinum – that range from lowest coverage and premium to highest coverage and premium.
- Sizable income-based subsidies are available towards insurance premiums bought through state exchanges only. Assets are not considered but income from assets is.
- All insurance plans (on state exchanges or not) will have to provide standard essential coverage, accept a participant despite pre-existing conditions, and not have life-time coverage limits.
  1. EXCEPT for grandfathered plans (plans that existed since 3/23/10) that won't have to meet all the requirements of Obamacare…as long as those plans don't change their coverage or premiums drastically.
  2. Grandfathered plans will have to meet much of the new law's requirements; a few examples of what they will not have to provide:
     a. not forced to provide preventive care without cost-sharing
     b. individual plans can still impose annual benefit limits
     c. individual plans can lock out children with pre-existing conditions
- Taking subsidies out of the equation, older individuals (over the age of 50) will typically have lower premium costs than they had before and younger individuals (under age 50) will have higher costs. Also, premium costs will vary geographically depending on how many insurance providers participate and what the average costs were prior to Obamacare (DE: 3 insurance companies participating; PA: 8; NJ: 4; NY: 16). The average monthly premium in all states (and all ages under 65) for a comparable silver plan will be $328.
- Premium costs for individual insurance not bought through state exchanges will be driven higher in some states.

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