StaufferWilliams
ASSET MANAGEMENT · LLC

FEBRUARY 2013 INVESTMENT COMMENTARY

STOCKS UP + BONDS DOWN + GOVERNMENT DYSFUNCTION = BETTER THAN EXPECTED GROWTH

One month ago, in our January commentary, we touched on not allowing temporary policy flashpoints, such as the fiscal cliff, which dominated financial news reporting for many months, to materially influence investment decisions. We have espoused a similar opinion many times over the last several years. Each time, leading up to "binary" policy events here and abroad, this "steady hand approach" has kept our clients "In it to Win It" as we titled last month's commentary. This sometimes unappreciated steadiness, in the face of a predictable loud drumbeat of "experts" who come out in droves ahead of each event to tell investors to be scared, to avoid risk, and to be prepared for the worst, has absolutely rewarded our clients. Those who have relied upon us to navigate the unprecedented uncertainties over the last five years have no regrets, as they have avoided making "stupid" market timing mistakes.

Much of the focus in the investment management business is on relative performance versus market indices, but this type of benchmarking tends to ignore opportunity cost that occurs when asset allocations are changed in reaction to perceived market risks. If an investor's asset allocation in 2007 was 70% equities and 30% bonds and by 2010 that allocation shifted to 30% equities and 70% bonds, by the end of 2012 the value of the client's portfolio would have been adversely affected. The relative performance of the equity component could have outperformed the market each year, but the lower exposure to stocks would have resulted in significant opportunity cost in exchange for emotional comfort. The advisor in this hypothetical example could have proudly reported asset class out-performance each year, but his or her clients would have suffered a significant "real" economic cost resulting in a direct adverse effect on the value of their portfolio.

As we begin 2013, the more things change, the more they stay the same. We are now facing debt ceiling deadlines and "the sequester". Will either of these political crisis' end up causing real economic consequences that will require us to react to as investment managers? We certainly do not believe that the debt ceiling will be anything more than political theater. The sequester requires more attention, because it will be an economic drag to a certain degree. Anyone who has read StaufferWilliams commentary, or Curt's previous commentaries, knows that we are concerned about the chorus of voices calling for premature government spending austerity. The sequester is blunt austerity and was never designed to be implemented. Over the next month we will again see Congressional brinksmanship on full display.

We believe that there will be sufficient time to analyze and adjust to whatever decisions, or non-

decisions, are made in Washington over the next month. The stock market is already looking past this period and has started 2013 very impressively. In our opinion, the strong market ahead of these policy flashpoints means one of two things - either the mandatory spending cuts will be softened, or the country's economic growth for 2013 is shaping up to be stronger than consensus expectations, and therefore able to withstand the full impact of these cuts. Given the recent strength in the housing market, and stronger trending employment numbers, a strengthening economy may very well be why the stock market has performed so well since the beginning of the year.

We are going to keep our commentary very short this month with the thought of revisiting this subject next month when we have more clarity.

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