KWAG "Client Dinner Summary" Update

Every year we look forward to our year-end dinners, as they give us an opportunity to thank our clients and close friends for their continued confidence in our firm. We recognize the important role we play in your financial future, and we want you to know that we never take your trust for granted. Earning your trust is something we talk about all of the time. In fact, almost all of our discussions revolve around how we can make our practice more transparent, so our clients can not only trust what we do – but they can also verify our results in an easy to understand manner. Your honest feedback over the years has really helped in this endeavor.

The dinners – as well as a number of small breakfasts and luncheons – also provide us with an opportunity to provide a timely year-end update. We love these updates because they give us a chance to not only provide some perspective regarding the previous year's activity, but they also give us a chance to 1) provide some much needed perspective regarding our complex global economy and 2) examine how our portfolios have performed over longer periods of time. This year, our update was broken out into three distinct segments – the past, the present and the future.

The Past

Over the past few weeks, we have started most of our year-end dinners and luncheons by examining our original message four years ago – right after the credit crisis of 2008. Specifically, we said (and later wrote) that there would be serious challenges (due to increased fear driven volatility) and great opportunities (driven by incredibly low prices being driven by the enormous amount of fear). In fact, we predicted three things. **First**, we said most investors were NOT psychologically prepared for the increased volatility, which meant most investors would NOT take advantage of the fire sale prices being offered to long term investors. **Second**, we said the bounce back would be quick and powerful…and we said the bounce back would surprise even those most optimistic investors. In fact,

we provided a very specific table (in January 2009) which examined how the stock market bounced back after significant market drops. The highlights include…

- A one year overall market return of 35.1% - on average - after significant market dips.
- A three year overall market return of 20.1% - on average - after significant dips.
- A five year overall market return of 19.8% - on average - after significant dips.

In 2009, the overall stock market (which includes all nine style boxes) increased 30.7%. The three-year overall stock market return (through 12-31-2011) was 17.1%. If you include the significant rebound we've experienced in 2012 and 2013, we are well ahead of the pace regarding the five year overall stock market return. Unfortunately, we were correct in our "psychological" assessment. In 2009, (and throughout the vast majority of 2010, 2011 and 2012) the individual investor was a "net" seller of stocks, which means they missed this remarkable market run-up. Oddly, even those investors who did stay fully invested still have a hard time seeing the significant run-up in market prices. We believe this is true because many investors remain both mesmerized by the increase in volatility, and still remain too focused on the hyperbolic media. For the record, we are less than three weeks away from the four-year anniversary of the market low experienced on March 9th, 2009. A low that was driven by irrational panic and fear. That said, as of this morning, the S&P500 is up significantly more than 100% from that low point (and sitting at multi-year highs I might add), while the Russell 2000 is up over 140% and experiencing all-time highs. Now that's a bounce back!

You may be wondering about the **third** prediction mentioned above? Three years ago, we promised all of our clients and friends that we would get them through this crisis - and - we said we would do so through a common sense, educational approach that examined the "core" issues that drive long run stock market

returns. By staying fully invested, and NEVER going to cash, we have achieved this goal. There are very few (if any) advisors that can make this claim.

Let's examine some of those issues…

Our Past Updates and Newsletters

Over the last four years, we have explained (and regularly written about) the key fundamental building blocks behind this significant rise in the markets - many of which are NEVER discussed by the broader financial media. First, our goal as long-term investors is to simply buy corporate cash flows at a reasonable price. In almost every newsletter over the last four years, we have mentioned this simple goal. Since corporate America now has record cash flows, earnings and profits - which we believe will continue for some time - it should come as no surprise that small and mid-caps keep hitting all-time highs, while large-caps now sit at multi-year highs.

Second, our prediction of a market bounce back was based on the global economy. Unfortunately, most of our daily financial news is focused on our domestic problems and our domestic economy. They (the media and many investors) have lost sight of the fact that most of corporate Americas growth comes from overseas. In addition, they lost sight of what drives global growth. Many of you remember our updates regarding low input costs (like record low interest rates and cheap labor), significantly improved technology, and greater access to global markets. As long as these broader Macro-economic variables stay in place, corporate cash flows will continue to grow for quite some time.

Finally, over the last four years, we have written about and thoroughly discussed, the increase in volatility across our markets. Volatility is here to stay…so we have decided to embrace it. We would encourage you to do the same as well. In our opinion, bubbles and busts are here to stay. Thus, by pro-actively rebalancing our portfolio's, we can take advantage of both the run-up in prices and the invariable dips. We do so by purchasing sectors and managers that have had "off" years (or quarters) and paring off (or selling) managers or sectors of the market that are

overpriced. We can assure you this simple strategy is counter-intuitive to most investors who let fear, greed and emotions drive their short term decision making.

The Present

Remember, our primary goal as long-term investors is to purchase corporate cash flows at a reasonable price. Today, we can do just that. Prices are still relatively low, even after this recent run-up. In fact, in our 3rd quarter newsletter of 2011 we outlined seven reasons why we felt this was true. Today – sixteen months later - six of the seven reasons still exist today. First, we said our domestic economy was gaining steam and now pointed firmly in the right direction. Second, we said the Federal Reserve would continue to provide significant stimulus for this expansion to continue. Third, we noted high "insider buying" which has continued through the first quarter of this year. Fourth, we noted the higher than normal pessimism, which tempers stock prices. (Note…we also love seeing analysts lower their expectations.) Fifth, P/E ratios remain historically low, which means the price we are currently paying for cash flows is still low. Sixth, many discount models show stocks selling at 10-15% discounts. Finally, we noted how high stock dividend yields were/are relative to interest rates on bonds. Unfortunately, dividend paying stocks now trade at significantly higher multiples to other stocks, so we are NOT increasing our dividend paying stocks right now.

Some Healthy Reminders

During our meetings, we always like to provide healthy reminders to all of our clients and friends. Specifically, we think it always good to reiterate what we DO and DON'T invest in.

- We are NOT investing in a dysfunctional government or political party.
- We are NOT investing in our government deficit.
- We are NOT investing in the unemployment rate.
- We are NOT concerned with short-term changes in price or normal dips.
- We ARE investing in extremely profitable companies.
- We ARE doing so through fantastic managers

- We ARE long-term investors who do NOT try to time short term market swings.

The Future

Each year, we try to provide our thoughts on how we envision the markets growing over the next one, three and five years. The truth is, it's impossible to predict short-term movements in a market, which are driven by impossible to predict global events (i.e. weather, political or structural). That said, there are a number of structural macro-economic variables in place, which will make it much easier for corporate America to succeed (and grow) going forward. Thus, we remain very optimistic about corporate America's future. However, we want to remind everyone (again) that the stock market very rarely goes straight up. So although we think the next five years will be rewarding, they will not come without the typical bumps along the way.

Last year - during our 2012 dinners and luncheons - we decided to provide a number of prognostications for the coming calendar year. These prognostications follow below. We want to reiterate, these prognostications are just that…prognostications. Nobody honestly knows what our financial markets will do from year to year. These are really just best guesses…based on well-known information, which is untainted by the media.

Our Prognostications for 2012

- We predicted double-digit returns in the stock market in 2012.
- We predicted small and mid-cap stocks hit all-time highs in 2012.
- We predicted above-average volatility.
- We predicted a 10% to 20% market dip at some point during the year.
- We predicted all-time highs in S&P500 cash flows in 2012.
- We predicted a 2.0% - 2.5% growth rate in domestic GDP.
- We predicted a 4.0% - 4.5% growth rate in global GDP.
- We predicted interest rates would remain low for all of 2012.
- Then we predicted that they would increase somewhat.

- We predicted inflation would remain muted for all of 2012.
- We predicted low single digit returns for “normal” interest only bonds.
- We predicted high single digit returns for “discounted” and “convertible” bonds.
- We predicted Europe would not collapse. In fact we predicted the ECB help.
- We predicted real estate would bottom in a number of markets…but remain stagnant.
- We predicted a few global surprises.
- We predicted transparency would increase, thus increasing confidence levels.
- We predicted a significant increase in more cases against those who caused 2008.
- We predict that the federal budget will NOT be balanced – No surprise here.
- However, we did predict that the size of the deficit would be reduced in 2012.
- We predict investors will lose sight of corporate cash flows and be “net” sellers stocks in the second half of the year, as the election process heats up.

As it turns out, we were pretty accurate on most accounts in 2012. We did NOT have above average volatility and interest rates did not start to rise in any significant way. In addition, “discounted” bonds provided double-digit returns this past year! Basically, our “bad” predictions never panned out. We don’t believe we’ll be as lucky this year on all three of those accounts. At our dinners, I provided another list of prognostications for 2013. To find those prognostications, simply go to the previous paragraph and insert 2013 for 2012. Next year, at our annual year-end dinners, we’ll go over our prognostications to see which of these 20+ predictions came true.

Our point: None of the above prognostications are really earth shattering in their content. These prognostications provide a common-sense examination, of what

we believe are realistic expectations of our financial markets over the next year. Last year was a calm year in the markets – relatively speaking. We would be surprised if the relative calm occurred again. We believe stock investors will be adequately rewarded for their patience. Bond investors, on the other hand could be in for a tough year.

Tax Documents and Thank You

We would like to take this opportunity to also remind you that our Kiely Wealth Tax Documents are being mailed this week and will go out no later than Friday, February 15th. TD Ameritrade's tax documents will be in the mail by Wednesday, February 20th. If you need anything regarding your investment tax documents, please email your advisor or Katie Burr for assistance.

As usual, if you have any questions or concerns regarding our updates, your portfolio or any of our investment strategies, please feel free to contact us immediately. We always look forward to hearing from you and thank you for your continued confidence in our firm. The recent referrals are much appreciated. As you know, we remain 100% committed towards your financial well-being at all times. If you need anything or your goals or time horizons have changed, please do not hesitate to call or drop an e-mail to set up an appointment. We are here to serve your financial needs, whatever they may be. Again, we thank you for your continued confidence in our firm and look forward to the rest of 2013!

- ***Joe and The Gang at KWAG***

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