KIELY WEALTH ADVISORY GROUP, INC.

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BEHIND THE SCENES

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OPENING THOUGHTS

Over the last few years, we have often shared our perspectives on the surprising strength of the global economy, which is being aided by a variety of factors. Factors that include: low interest rates (or low capital costs), a better-educated yet relatively inexpensive workforce, increasing productivity from technological advances, the birth and expansion of new market-driven economies, the free flow of capital across economic borders, and a growing global middle class. Together, these underlying factors leave us feeling very optimistic about the global economy going forward. As long as these factors persist - and at present there's no reason to think they won't - we will continue to remain optimistic about the global economy and, in turn, the long-term prospects for investors and our portfolios.

In contrast to our longer-term macro perspective, individual investors often tend to focus more on the short-term and the crisis of the moment. Things like the government shutdown, the sequester, annual debt ceiling debates, and the federal deficit are front and center in many people's minds because these are the things they see on the news every day. While current events are important, it's critical to recognize they are only temporary, and in the vast majority of cases, they have very little impact on the long-run health of the economy or our portfolio's.

Things You Can Control

We spend most of our time focusing on things we can control, which leaves politics and politicians completely out of the equation. Instead of focusing on what's going on in Washington, we focus on things like strategic long term planning, proper diversification, manager selection and evaluation, and rebalancing strategies. Over the last few decades, we've learned that the things we can control have the biggest impact on our portfolios over time. Yes, we know financial markets could sell off if we have a war in Syria, or experience a long-term Government shut down. However, since no one can predict if, or when, any of these things will actually occur, making any portfolio adjustments prior to the event would be purely speculative, and more than likely off the mark. Just ask the "market timers" who got out of the market last January when we had the last debt ceiling debate.

INSIDE THIS ISSUE:

RMD REMINDER

CURRENTLY, WE ARE WORKING ON GETTING RMD FORMS OUT TO CLIENTS REQUIRED TO TAKE ONE FOR 2013

YOURS (IF REQUIRED) WILL BE IN THE MAIL WITHIN THE NEXT FEW WEEKS.

PLEASE EMAIL KATIE WITH ANY QUESTIONS YOU MAY HAVE AT katie@thekielygroup.com

They've missed out on one of the best years we've had in decades.

So, instead of trying to predict which things will lead to short term volatility, we'd rather assume short-term volatility is going to happen at some point in the future, and have a pro-active plan in place to take advantage of it. This way, we don't really have to concern ourselves with what causes short-term volatility, since we've already embraced the fact that it's going to happen. Unfortunately, most individual investors don't have diversified portfolio's, which makes it impossible to have a pro-active rebalancing plan. And since they are so focused on the here and now, they view short-term volatility as a bad thing, when in fact short volatility (if embraced correctly) is actually their friend.

Things You Can't Control

There are other things - which we don't typically write about - which also increase our confidence in stock market investing. Many of these things we have absolutely no control over, but they make a huge difference to our portfolios over time. For example, the Sarbanes-Oxley Act of 2002 was enacted in response to a variety of issues related to inadequate auditing practices that helped spawn the dot.com bubble and led to a number of high profile corporate collapses, like Enron, WorldCom, Tyco, and Adelphia. Sarbanes-Oxley (a.k.a. *The Public Company Accounting Reform and Investor Protection Act*) changed the rules governing financial reporting by public companies and required all executives to sign off on the accuracy of the information contained in their company's financial statements. As the name implies, investor protection was the goal of the legislation, and in the decade since the act became law incidents of fraud in the reporting of financial information have declined dramatically. In other words, we can now have more confidence that the record cash flows and profits being reported by corporations today are real, and not merely the result of questionable accounting practices or even outright fraud. In addition, stronger corporate boards and the new regulations governing those boards provide us with the confidence that there is a team of highly educated professionals looking out for the shareholders' best interests over time. These changes are critical, because the primary job of the board of directors of a corporation is to look out for the welfare of the shareholders...like our clients.

Just like the events of the late 1990s and early 2000s led to the creation of Sarbanes-Oxley, the subprime mortgage market collapse of 2008 led to the creation of a number of new rules and regulations governing the operation of our financial institutions (banks, brokerage firms, insurance companies, etc.) and financial markets. Although the rules themselves deal with things like derivatives and capital requirement - which are generally not well-understood by laypeople - they're intended to keep what happened to the likes of Bear Stearns and Lehman Brothers from ever happening again. In addition, although they are quite lengthy and somewhat burdensome, they give us confidence that the stock market is NOT rigged against us. We have no control over these items, but they certainly increase our confidence in our long-term equity strategies.

Our Point: We want you to thoroughly understand why we are so confident in the global economy, the stock market, and the portfolio's we construct. Most investors are worried about the day-to-day news cycle, which plays a very minor role in well-constructed long-term portfolios. We're more interested in the things like well-written laws, Macro-economic trends, and the low cost of capital. These items play a much larger role in the success or failure of our well-constructed portfolio over time.

A New Sheriff

One of the biggest factors behind the global economic recovery has been the Federal Reserve. Their actions have directly impacted economic activity by influencing critical factors like interest rates and the money supply, which have in turn shored up investor confidence across the globe. Over the last eight years, we have been the direct beneficiaries of the strong leadership of Fed Chairman Ben Bernanke. His innovative and decisive actions following the 2008 financial collapse almost certainly saved the global economy from a second Great Depression. In addition, the guidance and information communicated by the Fed with respect to their actions during that turbulent time provided us with a number of unique investing opportunities that we were able to take full advantage of. While others were liquidating their portfolios at fire-sale prices to sit on the sidelines in cash, we were able to use the massive selloff to our advantage, by purchasing discounted bonds at fire-sale prices and rebalancing into small and mid caps which have significantly outperformed their large cap brethren during this remarkable recovery.

Mr. Bernanke's leadership over the past five years has not only succeeded in moving the global economy back away from the precipice, but he has also managed to stabilize what were previously exceedingly jittery global financial markets. The end result has been resurgence in the major global stock indexes surpassing all but the most optimistic of expectations. Obviously, we have no control over Fed policy. However, understanding how the Fed behaves and how their actions affect the global economy has benefited our clients tremendously over the past five

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years. For example, when the Fed undertook quantitative easing, we recognized it would provide a significant stimulus to the stock market, with small and mid-sized companies likely to be the largest beneficiaries. While many debated over QE's impact on inflation, deflation, and a variety of other nonsensical issues, we positioned our portfolio's to take advantage of the long-term impacts it would have on asset values. On the fixed-income side of our portfolios in particular, the managers we hired were able to purchase high quality bonds for pennies on the dollar, which generated stock-like returns in our clients' portfolios over the next several years with only a small fraction of the risk.

A New Chairman

Unfortunately, Mr. Bernanke is retiring at the end of the year, which has understandably been a cause for concern among investors contemplating a variety of possible candidates for his eventual replacement. In particular, investors have been concerned about how the strategies he introduced will play out under new leadership, especially as we begin to unwind the Fed's innovative quantitative easing program. On October 8th, President Obama alleviated much of this concern when he nominated Janet Yellen to replace Bernanke as the Fed Chairwoman. Many laypeople don't know a thing about Ms. Yellen and wonder about her background and her ability to lead the Federal Reserve. Let us put those concerns to rest right now. We have absolutely no control over the Federal Reserve, Ms. Yellen or her policies. However, if you take the time to learn a little bit more about Ms. Yellen, you'll learn that she is smart, strategic, transparent, forward thinking, and in the long run, we believe she will be very good for the financial markets and our portfolios.

Janet Yellen

Ms. Yellen is widely respected in the U.S. and abroad, and has served as the vice chairwoman of the Fed since 2010. She earned a Ph.D. in economics from Yale in 1971 under the tutelage of Nobel laureate James Tobin (who was an economic advisor to Presidents Kennedy and Johnson). She has significant public sector experience, serving as a Fed governor from 1994 to 1997 and President of the San Francisco Federal Reserve from 2004 to 2010. She has also served stints as the Chair of the White House Council of Economic Advisers and as Chair of the Economic Policy Committee of the Organization for Economic Cooperation and Development. Need more good news?

Her academic work has focused primarily on the costs and causes of unemployment—which seems especially pertinent given our country's current situation—and she has consistently called for the Fed to respond forcefully to high rates of joblessness. She argues that inflation isn't likely to emerge while the economy remains in such a debilitated state – and so far she has been right. Regarding unemployment, she has been quoted as saying "These are not just statistics to me. We know that long-term unemployment is devastating to workers and their families."

Those who are concerned about the inflationary impacts of Fed policy will be glad to learn that her public statements and past actions show she is also committed to maintaining low inflation. In a 2011 speech, she said she was, "determined to ensure that we never again repeat the experience of the late 1960s and 1970s, when the Federal Reserve didn't respond forcefully enough to rising inflation." She's been a longstanding proponent of the Fed adopting a 2% inflation target, and was closely involved in the decision to do so in 2012.

Ms. Yellen has also been instrumental in helping Mr. Bernanke craft and implement the Federal Reserve's innovative bond buying program (a.k.a. quantitative easing) making her an excellent choice to be the one responsible for eventually winding the program down. A critical component in that endeavor, will be clear communication of the Fed's policy intentions to Wall Street. In 2010, Mr. Bernanke asked her to lead an internal communications committee that has produced several innovations in the way the central bank articulates its goals and policy plans to the public. Specifically, these include providing "forward-guidance" in which the Fed makes statements about the likely future course of policy. In addition she pushed for the regular press conferences that Mr. Bernanke holds and is therefore expected to continue them as Chair. Market participants think she does an excellent job of explaining the central bank's thinking, as evidenced by two separate surveys last year where she was praised by officials at the banks that make up the primary dealers market. This is incredibly important, since many of Fed's innovative policies are going to be unwound through these same banks over the next few years.

Finally, we're encouraged by the fact that Ms. Yellen is NOT intimidated by Wall Street, powerful banks, or politicians. The 2008 financial crisis helped crystallize her belief that firm rules are more effective than leaving it up to regulators to react when trouble appears on the horizon. In a speech this past June, she said the Fed might need to require the nation's largest, most complex banks to carry even higher capital cushions against losses than required by new rules set out by international regulators. This is

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something hotly contested by the big banks, of course, because it will directly impact their bottom line. Frankly, we think she's right and are glad to see her continue to stick to her guns in spite of the flak from Wall Street.

Overall, we think Janet Yellen is the best possible choice to replace Ben Bernanke. As finance professors, we respect her superb academic preparation for the position, but more importantly we respect the way she has been able to take complex economic theory out of the ivory tower and apply it to the real world for the betterment of all mankind. We're also encouraged by the fact that one of her main goals is transparency, meaning we can believe what she says and can use it to help us to act in the best interests of our clients. Fed transparency is an area where Mr. Bernanke has been a pioneer, and we're relieved to know that this transparency will endure even under new leadership.

We think the nomination of Janet Yellen bodes well for our clients over time because she places the interests of the public ahead of her own personal interests. In Washington, that's clearly a trait in short supply.

THE STOCK MARKET

The current bull market rally is now entering its 55th month. From the bottom, which occurred on March 9, 2009, large company stocks (as measured by the S&P 500 index) have increased more than 160%, while small company stocks (as measured by the Russell 2000 index) have more than tripled in value, up over 200% in less than five years. This has been amazing run, but as is typical in runs of this magnitude it has not always been a smooth ride. We saw significant (>10%) and not unexpected pullbacks in 2009, 2010 and 2011. In 2012, we experienced two smaller-magnitude (<10%) pullbacks during the summer and fall. So far in 2013 we have experienced a strong upswing in stock prices with relatively little volatility, making us somewhat cautious. No one knows when the next significant pullback will occur - but we do know it eventually will occur. We'll continue to enjoy the ride until that day comes, remaining vigilant about our rebalancing strategies, which will keep our portfolios from becoming overextended in their allocations to equities.

The Style Index Numbers

We have often written about the "size" and "value" premiums that academic research has confirmed to exist in the stock market over the long term. Unfortunately, most investors fail to capitalize on these anomalies in spite of the fact that they are both well-known and widely documented. In the case of individual investors, this is probably because they (or their advisors) are unfamiliar with the academic literature. That's too bad, because by the end of the third quarter every one of the nine style indexes we track was up more than 20% year-to-date and small and mid-cap stocks had outperformed their large cap counterparts by a significant margin, beating them by an average of roughly 6% year-to-date!

Russell Style Index Performance
YTD through 2013

Value	Blend	Growth	
20.47%	20.76%	20.87%	Large
22.94%	24.34%	25.42%	Mid
23.07%	27.69%	32.47%	Small

Even though we know value stocks tend to beat growth stocks over time, the growth indexes outperformed their value counterparts across each size category over both the third quarter and year-to-date. This outperformance has caused some portfolios to become over-weighted in growth, which is why many of you have probably noticed some minor adjustments being made in your accounts. We have been using it as an opportunity to sell what's been hot (growth) and rebalance back into value stocks while they are "relatively speaking" on sale. This is the type of proactive strategy that has been shown to have the potential to add 1% to 2% to your portfolio over time. We know there will be periods when the markets move counter to the longer-term trends and we embrace these periods, knowing this is where proactive rebalancing makes the biggest difference in a portfolio over the long-term.

Russell Style Index Performance
3rd Quarter, 2013

Value	Blend	Growth	
3.94%	6.02%	8.11%	Large
5.89%	7.70%	9.34%	Mid
7.59%	10.21%	12.80%	Small

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When we examine the style box performance over the previous one and five-year periods, the size premium appears again, with small and mid-cap stocks outperforming their large cap brethren by a fairly sizable margin - particularly over the past twelve months.

1-Year Russell Style Index Performance ending 09/30/2013

Value	Blend	Growth	
22.30%	20.91%	19.27%	Large
27.77%	27.91%	27.53%	Mid
27.04%	30.06%	33.07%	Small

On the other hand, the rebound we've seen in stocks of all sizes and styles since the market bottom in March, 2009 has been nothing short of remarkable and a testament to the innovative nature and resiliency of American corporations. When sizing up the five-year returns in the table below, keep in mind, that period includes the fourth quarter of 2008, when the credit crisis first sent the financial markets into free-fall. Again, this says a lot about the resiliency of American companies.

5-Year Annualized Russell Style Index Performance ending 09/30/2013

Value	Blend	Growth	
8.86%	10.53%	12.07%	Large
11.86%	12.97%	13.92%	Mid
9.13%	11.15%	13.17%	Small

Going back further in time, we see that over the past decade small and midcap stocks have averaged a combined 10.1% annually, while large cap stocks have averaged just 7.8%. Don't get us wrong, a 7.8% annual return is respectable for any asset class over the course of a decade, but the additional 2.3% annual return small and mid-cap stocks would have obviously provided a nice boost to portfolios that were properly diversified. How nice? Well, compounding a $100,000 investment at 7.93% annually over 10 years (the large-cap average) would result in a final value of $214,497. That's not bad, but the same $100,000 compounded at 10.11% over 10 years (the small and mid-cap average) would have resulted in a final value of $261,980. That's a nearly $50,000 advantage to small and mid-caps on an initial $100,000 investment over just 10 years! Frankly, it's hard for us to make a better argument for diversifying into small and midcap stocks than that.

10-Year. Annualized Russell Style Index Performance ending 09/30/2013

Value	Blend	Growth	
7.99%	7.98%	7.52%	Large
10.91%	10.78%	10.16%	Mid
9.29%	9.64%	9.85%	Small

While it's clear small and mid-cap stocks have outperformed large stocks by a sizable margin over the last 10 years, it's important to note this is NOT a random event. In fact, evidence of the "size-premium" has been around for decades now and the data is easily accessible via the internet for anyone to examine. Even so, most portfolios today are still constructed with a strong overweight in large-cap stocks and often contain no exposure to small or mid-cap stocks at all! We can only conclude that most investors and advisors are still unaware of the existence of the size premium…which means they're probably NOT aware of the performance of small and mid caps when interest rates rise…

The Size Premium and Rising Interest Rates

Since the early 1970's, we have had two five-year periods where interest rates have risen significantly. The first occurred between 1977-1981, while the second occurred between 2002-2006. During the first period, large stocks (as measured by the S&P 500) grew at an average annual rate of just over 8%. Not bad. In contrast, small-cap stocks (as measured by the Russell 2000) grew at an average annual rate of more than 25%, which is quite a significant difference! However, the five-year period from 2002 to 2006 may be more representative of the current period, with interest rates starting at a low initial level and

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expected to climb at a relatively slow and orderly pace. During this second period, large caps averaged just over 6% annually while small caps grew by more than 11%. In other words, if you believe interest rates are going to rise over the next five years—which nearly everyone does—it would seem foolhardy not to build a portfolio without significant exposure to small and mid-cap stocks.

The Bond Market

The allocation between stocks and bonds in a diversified portfolio has always been a tenuous balance. Over longer periods of time, we know stocks will outperform bonds, which seemingly implies we should have most—if not all—of our investments in stocks. On the other hand, over shorter periods the financial markets can be volatile and almost anything is possible, which is why keeping money invested in lower volatility assets like bonds is a prudent approach. For example, we know the stock market averages a 10-15% dip every year, and sometimes the dip can be even larger. Investing part of your money in bonds, which are far less volatile than stocks, helps offset the fluctuations in your stock holdings, making your overall portfolio less risky. But beyond simple risk reduction, there's another reason holding bonds makes sense for nearly all investors. Since we know the stock market experiences significant dips on a relatively frequent basis, any money allocated to bonds can be used as "dry powder" to take advantage of these dips and buy when things are on sale. Over the past year, we have seen a significant rally in stocks, without a typical 10%-15% dip. This only serves to increase the likelihood a dip will occur, which makes the money allocated to bonds in your portfolio that much more attractive.

In addition to risk reduction and buying on dips, many investors also have monthly cash flow needs and require an allocation to bonds in order to avoid being forced into selling stocks following a sharp decline. Bond values are more stable and often negatively correlated with stocks, making them an invaluable asset class for investors who need to generate monthly cash flows from their portfolios. Bonds should be viewed as a portfolio's "safe assets" and as a way to preserve capital in order to meet short and intermediate term cash needs. Stocks, on the other hand, are a portfolio's "risky assets" and best used to provide growth of capital over the longer term. Because stocks are more volatile, they aren't a reliable option for meeting short or intermediate term cash needs. A good rule of thumb for stocks is to have at least a five-year window before any of the money invested in them will be need to be converted to cash.

The bottom line is, bonds and bond funds continue to play an important role in ALL client portfolios - even those that are positioned more aggressively.

The Challenges

For several years now, we've been saying that the period we're currently in is as challenging as it's ever been for fixed income investors. We've also stressed that this doesn't mean investors should abandon bonds and bond funds in their portfolios, because they serve critical functions in terms of managing risk, generating safe, short-term cash flows, and as reservoirs of capital to take advantage of stock market dips.

One of the biggest challenges for us, especially given the stellar performance of our bond managers over the last several years, is managing investor expectations. Given the credit market constraints we currently face, investors simply need to dial down their return expectations for the fixed income portions of their portfolios. Expecting bonds to generate returns that are significantly above the rate of inflation over the next several years is probably unrealistic given the current interest rate environment. In today's low interest rate environment, there are no "safe asset" investments that can be expected to generate outsized returns. There will be no shortage of financial products designed to make investors think otherwise, of course, but there is no free lunch when it comes to risk (and return). Most of the exotic fixed income investments will be designed to enrich the people creating and selling them, not the unfortunate investors who buy them. Chasing returns in a low interest rate environment is tempting, however, and it will no doubt get many investors into serious trouble. Wall Street is littered with the bones of portfolios destroyed by greed and impatience...

The good news is that properly managed bond portfolios can generate respectable returns in rising interest rate environments, and we think we have best stable of bond fund managers and business. While we don't expect outsized returns, we do expect returns that will not only keep pace with inflation, but also provide a reasonable return over and above inflation. At the same time, however, our bond portfolios will continue to provide the kind of safety and limited volatility that we count on. After all, safety and limited volatility is why we'll bonds in the first place.

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Economic and Emotional Lessons

Four months ago, in mid-June, Ben Bernanke laid out his plan to begin tapering the Fed's controversial bond buying program known as Quantitative Easing. His remarks were precisely what Fed watchers and investors had been expecting to hear, yet the financial markets reacted as if they were caught completely off-guard. This was perplexing to us because Bernanke's comments simply reiterated what the Fed had been signaling for over a year, and were nearly identical to those made by the President of the San Francisco Federal Reserve a month earlier— which were met with no market reaction whatsoever.

What we saw in response to Bernanke's remarks was an inexplicable knee-jerk reaction to "old news" that had already been impounded in bond prices. In fact, the reaction was so sharp that, like lemmings headed to the sea, there was no shortage of investors willing to jump and participate in the selloff before actually assessing the facts. Surprisingly, institutional investors were first ones caught up in the frenzy, but by July and August individual investors were dumping bonds as well. What they failed to recognize was that the selloff had been triggered by a speech that contained only "old news" and therefore based purely on emotion rather than information. In the third quarter the smart money began stepping back in and buying, which sparked a significant rally in bonds, leaving the panic sellers out in the cold…again.

The lesson we can take from all of this is that sometimes the market ignores the context of the message and hears only what it wants to hear. Certainly nothing Mr. Bernanke said was the kind of revelation that should have sent markets into a tailspin. While Mr. Bernanke said the Fed might begin tapering the scale of their bond buying program later this year, he also made certain to stress that the Fed doesn't plan to cease buying bonds altogether until the middle of 2016, at the earliest! Additionally, the only reason they are currently contemplating these actions is because they believe the economy may be approaching the point where it is strong enough to continue growing without as much stimulus—which should have been good news. After the dust finally settled the market eventually recognized it for what it was, and we've seen significant rallies in stocks and bonds over the past month.

During the quarter, our convertible bond fund (ANNPX) increased 7.5%, and is now up 19% for the year. Loomis Sayles Strategic fund (NEFZX) increased 3.2%, and is now up almost 7% for the year. Our floating rate bond fund (OOSYX) increased 1% for the quarter and is now up over 4% on the year, and Bill Gross (PTTRX) and Jeffrey Gundlach (DLBTX) both had positive third quarters. We would not be surprised to see the recovery in bonds continue into the fourth quarter or even beyond.

The Silver Lining

If the recent bout of volatility taught us anything about our bond portfolios, it's this: **Patience, Diversification, and Steady Management are what matter.** When you examine the big picture within the context of the last few months, the importance of having an excellent mix of fixed-income funds run by an equally excellent group of managers becomes quite clear. We've always been confident our fixed income portfolios would be able to weather any interest rate spikes well, and the things we've experienced so far this year have only served to reinforce that confidence. In contrast to the performance of our core bond funds, the Barclay's U.S. Long-Term Treasury Bond Index has **lost 9.44%** year-to-date. Ouch…

THE ECONOMY TODAY

Over the past few months, we have continued to receive a number of questions about the profitability of corporate America, the high unemployment rate, our country's debt problems, the Government shutdown and the gridlock in Washington. Given the 24/7 media were confronted with today, we can't say we're totally surprised. What is surprising to many is just how little things have changed since our last newsletter. To illustrate, we'd like to respond to the majority of those questions by reiterating our thoughts from three months ago.

In our opinion, we believe both the bond and stock markets overreacted to Mr. Bernanke's June press conference and we expect much of this overreaction will be corrected in the coming quarter. In fact, as we write this, much of the correction has already occurred. The truth is, we don't believe the overall economy is a strong as the Federal Reserve estimates make it appear, and we believe there is a fairly good chance the Fed will be forced to postpone tapering until early next year, thereby acting to keep rates stable and perhaps even falling through year-end.

While we do expect the economy to continue growing, there are a variety of economic headwinds at present to confront, including continued weakness in the European economies, slowing growth in China, and the ongoing sequester in Washington. We think these could potentially slow the economy more than what the Federal Reserve currently expects and force them to maintain a more accommodative stance for a much

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longer period of time. (Note: Bernanke admitted as much during a July 11th Q&A session at an economic forecasting conference.) If this occurs, interest rates could actually be expected to fall from current levels through year-end, causing bond prices to recover most if not all of what they lost in June. The bottom line is that we continue to believe bonds play an important role in virtually everyone's portfolio and that another interest rate spike like we saw in June is unlikely, at least through year-end.

When we talk amongst ourselves at KWAG, we find it paradoxical that when the Fed began their quantitative easing program a few years back, it was met with much fear and trepidation among market pundits over how it would all work. Many market pundits even wondered whether this might be a case of the cure being worse than the disease. Now all of that has subsided, and we know quantitative easing worked pretty much exactly as the Federal Reserve intended it to - by helping the economy dig out of the deep hole we had dug for ourselves prior to the Great Recession. But now the pundits are at it again, which is kind of ironic. Because quantitative easing worked so well, the Fed is now contemplating winding it down, only to be met with another bout of fear and trepidation, only this time over the program being wound down as opposed to starting up.

Perhaps the best lesson from this is that fear and trepidation are ubiquitous on Wall Street and a good rule of thumb for investors is to only become concerned when the market appears to be unconcerned. If you get caught up in all the hype and emotion and find yourself running with the herd, you're only setting yourself up to get trampled. Instead, savvy investors should recognize market emotions for what they are, and look past the short-term hysterics to underlying economic fundamentals, since over longer periods of time it is the fundamentals that drive the markets, not emotion.

The good news is, all of the fundamentals that we have discussed in previous newsletters (like low interest rates, low inflation, a productive workforce, relatively cheap or inexpensive labor, improving technology, reduced trade barriers and a growing middle class) remain in place. Thus, fundamentally, we still believe well-diversified portfolios that are proactively managed make the most sense for the vast majority of investors.

Of course, we still receive a large number of questions about our countries deficit, which remains an emotional topic for many, regardless of political affiliation. A while back we wrote an article that examined the 10 reasons why we don't get too excited about our deficit. Given the unusually high number of questions we continue to get from both new and long-time clients, we felt it would be a good idea to dust it off, update it here and there, and reprint it. Please keep in mind that we don't like having running deficits. Like many of you, we would rather have a balanced budget or even a budgetary surplus. However, we've got to play the hand we've been dealt, so it's important to approach the process with some rational "perspective" on the issue.

The Deficit

Important things to keep in mind when thinking about the national debt and federal budget deficits:

1. Don't mix politics and your portfolio. All of you should know this already, but sometimes it's easy to forget. In our line of work we can't afford to let politics cloud our judgment, so we remain politically neutral and pay virtually no attention to Washington's crisis of the day. In contrast, there are people who make their living exploiting crises. Good examples would be fear mongers like Peter Schiff (regular contributor to FOX News and a regular critic of the Fed) and Marc Faber (well-known for decades now as Dr. Doom). We're not sure how either stays in business, because their track records as investors are abysmal. Then there's the one and only Porter Stansberry. His 2010 video "End of America" panicked some of our clients to the point they wanted to sell out of stocks altogether. Last time we checked, America is still here and the last few years have been very (very) good to our clients. Think about the unfortunate people who listened to Mr. Stansberry in 2010. They've missed out on one of the most significant bull markets in history. Oh, by the way, this is the same Porter Stansberry who was fined $1.5 million by the SEC in 2003 for disseminating false stock information. Remember, people like those mentioned above make their living selling fear and they will go to any length to make the sale.

2. If the issues with the budget deficit are so dire, **why hasn't the market tanked**? If we assume people on Wall Street are moderately intelligent, and we assume that the national debt numbers are known to everyone (you can Google the Debt numbers right now) then we also have to assume that all these moderately intelligent people don't think the debt issues are all that severe. Like we have always said, it is NOT the known things that cause market crashes. It's the unknown things that catch our markets off guard. The debt situation is very well known and thus not a threat to the market or our economy.

3. Debt needs to be viewed in the context of something...like GDP. When a bank looks at a person's debt levels, they compare it to their income levels and net worth. Right now, the Congressional Budget Office estimates the deficit this year will be just 3.9% of GDP,

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compared with over 10% in 2009. Even more encouraging is their estimate that by 2015 the deficit will be down to just 2% of GDP. In other words, deficits have declined dramatically and are expected to continue to do so. In addition, the economy is growing faster than the debt level is increasing. In the longer term we still need to address expected future shortfalls in Social Security and Medicare, but at least for the immediate future the debt picture looks a lot brighter than it has in a number of years.

4. If the deficit is killing the country, as some people claim, then **where's the evidence** of this? The government is still able to borrow all it needs - at extremely low rates - which implies there are plenty of borrowers lined up to buy our bonds. Yield spreads remain low, meaning the federal debt is not crowding out corporate or municipal borrowing. Core inflation is nonexistent. So, where is the smoking gun? We're not sure we see one.

5. From a macro-perspective, we know the debt/GDP ratio improving and **the economy is improving on almost every front**. In addition, we're rapidly becoming one of the largest producers of oil and natural gas in the world, and sit on what may be the biggest reserves of natural gas on the planet. In early 2009 we wrote that the economy would emerge slowly from the financial crisis and would take a while to gain traction. This is precisely what we've seen for five years now. We're not setting any records for economic growth, but given the severity of the financial crisis we didn't expect to. What's more important is that we're continuing to see real, measured growth across all sectors of the economy.

6. The longer this **bull market** continues, the closer we get to the inevitable market dip in the 10% to 15% range. Remember, dips like this are normal and occur almost every year…on average. When a normal dip finally does occur, market pundits (like those folks in our first point above) will come out of the woodwork to say it signals THE END of the world, inevitably pointing to the national debt load and Federal Reserve policy. In reality, market dips are normal and healthy. It would be nice if it could experience a normal dip without the pundits trying to scare bejeezus out of people.

7. Remember, we're not investing in the federal government, **we're investing in well run corporations**. As a result, rather than focusing on the deficit we should focus on corporate cash flows (and profits), since that exactly what we're purchasing when we buy (and own) a share of stock. We're also investing in the bright people who run those successful global companies. If we were investing in the finances of the federal government, or the politicians who ultimately determine what those finances will look like, we'd be very worried about our portfolios. Fortunately, we're buying well-run global companies instead—companies with healthy income statements, health balance sheets, and very low debt loads.

8. At this point, the average stock is trading at a price-earnings **(P/E) ratio of around 16** times earnings, which is just a little above the normal P/E of about 15. If we experienced a normal market dip it would obviously bring us back to normal P/E levels. However, we could also get back to normal P/E levels, without a market dip, if corporate earnings grow faster than normal. Coming out of recession we would expect to see corporate earnings begin to pick up momentum, which seems to be what Wall Street is expecting. We still think we're overdue for a normal 10% to 15% market dip, but we sometimes go several years without one, so only time will tell if it occurs this year.

9. We frequently hear concerns from clients **China controlling our national debt** and therefore our economy, yet most people have no idea how much U.S. debt China actually holds, even though you can easily Google it. If you do, you'll discover that most U.S. debt is actually held by American's, at roughly 70%. Japan is the biggest foreign holder of U.S. debt, at 8%, and China is second at 7%. All the other countries in the world combined hold the final 15%. In other words, China holds a relatively small percentage of our debt and the fears of China controlling our country through our debt are grossly overblown. There is the small point that ownership comes through stocks - not debt holdings. Of course, we don't want the facts to get in the way of a good story.

10. Our Point: We see no immediate cause for concern regarding the national debt, especially as long as the deficit continues to shrink relative to GDP. We would prefer a balanced budget. Who wouldn't? But the realities of Washington politics are such that balance budgets almost never occur. Frankly, given the hand the economy was dealt four years ago, we think we're on the right path.

Overall, we believe a number of positive factors are currently in place to allow the stock market to continue to move higher throughout 2013 and into 2014. We do expect volatility to increase, particularly if the gridlock in Washington continues to create situations like we've seen recently. In the long run, we believe the prospects for stocks remain excellent. However, investors need to be prepared for possible turbulence over the near-term. If your goals and time horizon have NOT changed, we don't think it makes sense to make any adjustments to your portfolio's target allocation at this time. However, if your

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goals or time horizon have changed, please contact us immediately so we can sit down and discuss your situation and, if warranted, develop a new course of action that will better address your needs.

Client Dinners

During the last week of January, we will be holding our annual client appreciation dinners. This is always our favorite time of year, as we get to thank everyone for your continued confidence in our services. As usual, at the dinners, we will deliver a brief "state of the union" address that examines the previous year's key events, and then we'll look ahead to the opportunities and challenges we see in 2014 and beyond. If you have any questions or topics you would like us to address at the dinners, please e-mail or call them in so we can make sure to get them on the agenda. In the meantime, please don't forget to RSVP for any (or all) of the dinners below. Please mark your calendar and make your reservations as soon as possible by calling our office in Greenville, NC (877-366-5623) or email Angelique at asmith@thekielygroup.com.

A Final Note

As usual, if you have any questions about this update, our newsletter, your accounts or our managers, please feel free to call or e-mail us at anytime. The recent referrals are much appreciated and we thank you for your continued confidence in our firm and our services. As we go forward, we remain committed to continuing to refine and improve our proactive strategies and portfolios. As always, our goal is to provide each of our clients with the best possible mix of assets given their particular situation. 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.

Enjoy the remainder of the fall and enjoy this cool crisp weather…

~ Joe and The Gang at KWAG

2014 Kiely Group Client Appreciation Dinner Schedule

Ocean Isle, NC | Monday, January 27th | Sea Trails Convention Center | 6-8PM

Greenville, NC | Tuesday, January 28th | Brook Valley Country Club | 6-8PM

Asheville, NC | Thursday, January 30th | Asheville Country Club | 6-8PM

To reserve your seat, please call our headquarters office at 877-366-5623
or your specific advisor. If you would like to register via email, please email Angelique at
asmith@thekielygroup.com

We encourage you to bring a friend and/or someone who would like to hear our educational message.

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The Kiely Group Pay It Forward Program

The Kiely Group has teamed up with the:

Greenville Pet Food Pantry

Sometimes the ability to feed a pet is the one thing that is standing between a person keeping that pet in a loving home and feeling there is no option but to leave them in a cold harsh shelter.

The Pet Food Pantry's goal is to help pet owners facing financial challenges keep the promise they made to their pets to love and care for them forever by providing free pet food through donations at no cost to pet owners who are struggling financially and cannot afford to feed their pets.

Ways You Can Help!

· Donate dry or wet dog food
· Donate dry or wet cat food
· Cat litter
· Sponsor a pet food drive in your church or organization in your area (see email below)
· We also gladly accept Wal-Mart & PetSmart gift cards

Donations can be dropped off at the following locations:

Kiely Wealth Advisory Group
1290 E. Arlington Blvd
ECU College of Business
Bate Building 3419
Matt Holder Hair Dressing
4th Street, (3rd floor)
Tipsy Teapot
409 S. Evans St. Greenville

We hope you will join us making a difference in the lives of pets and the people who love them.

For more information, please contact Kristen Below at:
kbelow@thekielygroup.com

THE GANG AT KIELY WEALTH ADVISORY GROUP

Left to Right: Brownie Cordell; Katie Burr; Joe Kiely; Kellie Kiely; and Scott Below

****IMPORTANT DISCLOSURE INFORMATION***

Performance results *represent results reported by each reflected mutual fund during the corresponding time period. Kiely Wealth Advisory Group, Inc. ("KWAG") currently utilizes these mutual funds in managing actual client portfolios. However, the individual mutual fund performance results* ***do not*** *reflect the results of any specific KWAG client portfolio or any KWAG composite.*

Past performance *may not be indicative of future results. Therefore, no current or prospective client should assume that future performance will be profitable, or equal either the performance results reflected or any corresponding historical index. The historical index performance results are provided exclusively for comparison purposes only, so as to provide general comparative information to assist an individual client or prospective client in determining whether the performance of a specific investment meets, or continues to meet, investment objective(s). It* ***should not*** *be assumed that any account holdings will correspond directly to any comparative index. The performance results do not reflect the impact of taxes.*

Please Note*: the individual depicted mutual fund results* ***do not*** *reflect the results of any specific KWAG client portfolio or any KWAG composite.* ***For reasons including*** *variances in portfolio account holdings, market fluctuation, and any account contributions or withdrawals, the performance of a specific client's account may have varied substantially from the indicated reported mutual fund results. In addition, the above results only reflect the results as reported by each respective mutual fund company. Portfolios managed by KWAG would also incur a KWAG advisory fee, the deduction of which would result in decreasing the reported performance results.* ***For example:*** *a KWAG advisory fee of 1% compounded over a 10 year period would reduce a 10% return to an 8.9% annual return).*

Please Remember: *In the event that there has been a change in a client's investment objectives or financial situation, he/she/it is encouraged to advise KWAG immediately. Different types of investments and/or investment strategies involve varying levels of risk, and there can be no assurance that any specific investment or investment strategy (including the investments purchased and/or investment strategies devised or undertaken by KWAG) will be either suitable or profitable for a client's or prospective client's portfolio.* ***In addition****, the mutual funds depicted are funds that KWAG may utilize and/or recommend as of specific date, and are subject to change without notice* ***Accordingly****, no client or prospective client should assume that the above reflected mutual funds serve as the receipt of, or a substitute for, personalized advice from KWAG, or from any other investment professional.* ***Information*** *pertaining to each depicted mutual fund is set forth in each respective fund's prospectus, a copy of which is available directly from each mutual fund company or from KWAG upon request.*

All performance results *reflect the performance results reported by each respective mutual fund to Morningnstar****,*** *and have not been independently verified by KWAG. KWAG also maintains all information supporting the reflected mutual fund performance results.*

Information pertaining *to KWAG' advisory operations, services, and fees is set forth in KWAG' current disclosure statement, a copy of which is available from KWAG upon request.*