KWAG September Update

Good Afternoon. It's amazing what a difference a year makes. At this time last year, we opened the third quarter update looking to salvage a few positive outcomes after a brutal few months. In 2011, the third quarter began innocently enough, with a mild rally in July. But as time wore on, the specter of a potential U.S. default and the political dysfunction in Washington dominated the airwaves, spiking market volatility and driving stocks into a steep decline. By quarter's end, the S&P 500 was down 14% and the Russell 2000 was down a staggering 22%. Yikes!

As we noted at the time, dips of that magnitude are common and nothing out of the ordinary. We also noted there were no signs of overt concern or panic on Wall Street, suggesting this was a temporary overreaction to short-term events. In fact, corporate earnings continued to come in above expectations and most analysts were upbeat about the prospects for the remainder of the year. At the time, we figured we could largely mitigate the effects of increased volatility and even use it to our advantage if we: 1) remained patient, 2) stuck to our long term investment plans, 3) kept our emotions in check, and 4) looked for the inevitable new opportunities that panic selling creates.

Patience and the Rally

As we all know now, the stock market rallied throughout the fourth quarter of 2011, finishing the year essentially flat. The rally continued into the first quarter of 2012 and through the end of April. In fact, the rally had been so significant we warned our clients (and readers) to expect another normal market pullback, which we felt would be healthy for the market overall and therefore beneficial to long term investors. As if on cue, we experienced a very typical market decline of nearly 10% during May and into the first few days of June. Since that time, however, the market has climbed steadily, with very little volatility.

Third Quarter 2012

As we said at the outset, it's amazing what a difference a year makes. Last year, we were coming off one of the worst quarters since 2008 and enduring a significant spike in volatility. This year, volatility is half what it was then, and the market has rallied to multi-year highs. For the quarter ending September 30, the S&P 500 rose by more than 5.7%, while the Russell 2000 increased 4.9%. Year to date, (through September 30), the S&P 500 is up over 14%, while the Russell 2000 has gained 13%.

The News Gets Better

It's obviously been a good year so far for stocks, but the news gets even better when we examine the bond market. As most everyone knows, the Federal Reserve has engaged in a third round of quantitative easing, commonly called QE3. On the flip side, relatively few people understand how QE3 actually works, so there is plenty of misinformation and a fair number of conspiracy theories making the rounds. All one needs to know about QE3, however, is how the markets have reacted, and for bond investors it has clearly been a major positive. Our two largest bond fund holdings have increased 10.3% (NEFZX) and 9.1% (PTTRX) through the end of September. These are terrific numbers for bond funds anytime, but to see performance like this in the midst of the lowest interest rates in history is truly phenomenal and, to be completely honest, have far exceeded even our "best case" expectations.

Since the first nine months of 2012 have been nothing short of fantastic, it's only natural to wonder what the final quarter has in store. At this point, there are a number of concerns on the horizon, but nothing we haven't known about for months and it's nothing that the market hasn't already taken into consideration. That's not to say that surprises couldn't arise—they can at any time. However, given what we know right now, the biggest concern is that we've come so far so fast that we may be due for another normal pullback.

The Upcoming Newsletter

The quarterly newsletter and your accompanying statements will go out on or around Thursday, October 18th. In the newsletter, the overriding theme will be the role of "expectations" and how they impact the way we view the globe, the economy, and our portfolios. A number of people are clearly focused on the upcoming election and wonder how the results will affect the stock market. The truth is we don't think it will have much of an impact, regardless of the results. We realize there's been plenty of drama on the campaign trail, but on Wall Street the response has been little more than a collective shrug. The truth is, markets are driven by factors mostly unrelated to the political climate. We now live in a global economy, where macroeconomic events beyond the control of our politicians largely drive long-term corporate cash flows. You might not think this after listening to the cacophony of campaign ads this election season, but politicians tend to grossly overestimate their ability to positively impact the profitability of companies—and their opponent's proclivity to do the opposite. We're NOT saying the election isn't important, because it clearly is important. What we are saying (and what Wall Street is clearly echoing) is that it will have relatively little effect on the companies we own.

During the course of the newsletter, we'll go cover a number of important global macroeconomic factors that collectively suggest that the stock market is still the best place to be for long-term investors. We'll also examine the U.S. economy, Fed policy, corporate cash flows, high frequency trading, the global slowdown, China, the election, our deficit, inflation, volatility, housing, the fiscal cliff and more! There is never a shortage of economic information to cover, especially in this ever-changing global environment.

We hope you enjoy our upcoming newsletter and find it educational. As always, we look forward to your valued feedback.

Our Dinners

One last item. We have already reserved rooms to set up our annual client appreciation dinners for late January, 2013. We really enjoy the year-end "state of the union" dinners and look forward to seeing everyone again. It's never too early to mark your calendars and make your reservations, by calling our main office in Greenville, NC (252-439-1888) or emailing your personal advisor.

The Kiely Group Client Appreciation Dinner Schedule 2013

Sunset Beach, NC Monday, January 28th | Sea Trails Convention Center 6:00-8:30PM

Greenville, NC Tuesday, January 29th |Brook Valley Country Club 6:00-8:30PM

Asheville, NC Thursday, January 31st | Country Club of Asheville 6:00-8:30PM

In Closing

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 appreciate all of your continued referrals.

- ***Joe and The Gang at The Kiely Group***

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