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FINANCIAL ASSET MANAGEMENT CORP.

A REGISTERED INVESTMENT ADVISOR

Investment Review & Outlook
2nd Quarter 2013

It appears that the smooth sailing of the first quarter ended and volatility has returned to the investment markets.

The widely-quoted S&P 500 index of large company stocks gained 2.36% for the quarter and is up 12.63% since January 1. The Russell 2000 small-cap index was up 3.08% in the second three months of the year, posting a 15.86% gain in the year's first half. The technology-heavy NASDAQ Composite Index was up 4.15% for the quarter, and has gained 12.71% for its investors so far this year.

The broad-based EAFE index of larger foreign companies in developed economies fell 2.11% in dollar terms during the second quarter of the year, and is up just 2.18% so far this year. The EAFE Emerging Markets index of lesser-developed economies dropped 9.14% for the quarter.

Bonds experienced a very difficult first half of the year, with much of the damage coming in the past 30 days. The Barclay's Global Aggregate bond index is down 4.83% so far this year, and the U.S. Aggregate index has lost 2.44% of its value in the same time period.

Higher yields, of course, means a decline in value for those holding bonds; in aggregate, government bonds with maturities of 10 years or longer lost an average of 10.8% of their value since the beginning of May. This was a shock for investors who saw Treasury market gains of 32.9% in 2011 and 11.7% in 2010.

The economic news has been mixed; Europe, particularly Southern Europe, is still mired in recession, and there has been turmoil in China as the country's leaders try to rein in the so-called "shadow banking system" – meaning lenders who are not officially sanctioned banks. In the U.S., home prices experienced the largest price rise in the history of the S&P/Case-Shiller price index in April, and over the past year, the index tells us that home prices have risen 12.1%. Growth remains slow in the overall U.S. economy with job creation still not at a pace that will lead to stronger growth. It takes time to repair economies that were devastated in the 2008-2009 downturn and we are probably three quarters of the way through this period.

This is the kind of market environment that many professional advisors least enjoy for a variety of reasons. First, the turmoil over the past month makes it clear that investors are making investment decisions – and moving market prices – based on emotions rather than logic. The initial panic following Fed Chairman Ben Bernanke's comments about ending its QE3 stimulus program seems to have subsided. However, when market values drop precipitously based on a single speech about a hypothetical Fed action that would only be taken due to improved fundamentals; you know that investors are not thinking rationally.

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The other reason professional advisors dislike the current state of the markets is the way diversification looks right now. Whenever U.S. stocks are delivering positive returns while everything else – international stocks, bonds, real estate, commodities and all the other pieces of a prudently constructed portfolio – are falling, investors will ask questions like: "The S&P 500 is up 14% so far this year, but my portfolio is only up 6%. What are you doing wrong?"

The truth is, no professional can pick the one winning asset out of the myriad of options every year (or half year), and no prudent professional would ever try. There will always be one asset that returns more than the others and that winning asset will always be different. Yet American investors hear about the S&P 500 (and the Dow, and other U.S. large stock indices) on the nightly news, so they are most likely to question the competence (or sanity) of their advisor when the U.S. stock markets are booming and everything else is lagging – exactly the situation we have today.

Eventually, some other investment will take the lead, diversified portfolios will look better relative to the U.S. stock indices, and professional advisors will look like geniuses. That, too, will be a naive view of the situation, but it will be a more pleasant one for those of us who believe in the long-term value of diversification.

As always, we appreciate your continued confidence in us. Please feel free to contact us with any questions you may have.

The FAM Team