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WEALTH MANAGEMENT

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FOURTH QUARTER 2013

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To Our Investors:

IN THIS REPORT

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US & World Economy

The rapid rise in the 10-year Treasury interest rate from 1.6% to 3% has rippled through the financial and real estate worlds. Bond portfolios got crushed, stocks dropped then rebounded and residential and commercial real estate appreciation has stalled. In response, the Fed has delayed the action that caused the rise (reducing its monthly bond repurchases) as they are concerned with not harming the improving economy. The financial markets are digesting all of this as well, and the 10-year Treasury yield has backed down to 2.65% for now.

Globally, the world's economic expansion continues at about a 3% rate (GDP) – a little less in the US, more in emerging countries, and just about 0% in Europe. The consensus view from Goldman Sachs, PIMCO and our SageView partner is that the economic expansion and equity prices have further to go over the next 12-24 months. Contributing factors include the rebuilding of personal and corporate balance sheets, reduced fiscal policy drag coming from the US and Europe, and the commitment of large central banks to continue to use monetary policy to quickly respond to the future economic shocks and mitigate potential "tail risks." These are seen to offset rising interest rates and Obama Care's impact. US and multi-national companies continue to operate with caution in hiring and managing capital expenses, preserving high profit margins. Smaller companies are looking hard at the 30 hour week limit to avoid mandatory healthcare coverage and tax advantages for companies with less than 50 employees.

US Stocks

Both of our favorite stock market timing newsletters (Dow Theory and Birinyi) are bullish and another (ETF Guide) remains neutral. We are fully invested, at what we believe are fairly valued stock prices, and expect continued upward bias with occasional 3-5% pullbacks. A 1750 level on the S&P 500 for the end of 2013 and 1900 for the end of 2014 seem reasonable.

Fixed Income

What a volatile last few months! Fortunately, we were able to hedge some heavily concentrated bond portfolios in April before rates rose and we reduced all long-term exposure in June and July. These tactical defensive moves protected our accounts from steep losses during the worst bond market drop in decades. We believe that the interest rate rise has stabilized over the near-term, but should advance in the quarters ahead (see below).

Why You Should Welcome Higher Interest Rates

Simply put, rising interest rates – first from the slowing of monetary stimulus and later from inflation – mean that the economy is healing and returning to “normal”.

Historically, it has taken the economies of major countries about 8-10 years to return to normal after a severe financial crisis. We have put the panic and stimulus/austerity phases behind us and are about half-way through recovery. Next comes weaning the economy off ultra-low interest rates, and lastly a return to typical business cycles, normal yield curves, higher employment and modest inflation.

Ultra-low interest rates hinder lending institutions’ ability to make money on loans. Consequently, with only a slim margin of profit (or error), lenders only loaned to the most qualified families and corporations. A case in point is that more than half of the countries’ mortgage loan rates are still above 5% because those people could not qualify to refinance. After the recent interest rate advances, last month’s Fed Senior Loan Officer Survey (SLOS) showed an easing of standards across all four major lending categories (residential, commercial / institutional real estate, and consumer loans). We are finally starting to see loans available to the average borrower at still historically low interest rates (just not ultra-low). This will start the money supply (M1 and M2) growing again, increasing this important multiplier effect in our economy.

According to Deutsche Bank’s research and forecast, the current Fed bond repurchase should start tapering by year-end and completely wind down by mid-year 2014. Given the expected increase in yield spreads, GDP and inflation, they forecast the 10-year T-Bond to reach 3.5% in the second half of 2014 and move back to a historically “normal” 4% in 2015.

This in turn will permit the Fed funds rate to increase from 0.25% up to 1%-2%, allowing cash, CDs, money market funds and other short-term investments to finally pay something. A relief to conservative savers and more cash flow to go into consumers’ pockets.

Summary

The sharp rise in interest rates this year has been painful to the bond market but is a healthy, necessary step toward normalization of the financial and real estate markets, enabling them to stand on their own without artificial government support. Optivest remains focused on these and other important trends to specifically meet our investors' individual goals through our disciplined long-term investment process.

Optivest News

Ronald Reagan Presidential Library Visit: Almost 40 Optivest clients and friends visited the Ronald Reagan Library and Museum in Simi Valley. Lunch and a private guided tour of the library and special exhibit on Abraham Lincoln were included. We had a wonderful visit! Thank you to everyone who joined us.

Until next time,

Mark Van Mourick

PS. For an insider's view of the "government shutdown" click here to read Congressman John Campbell's latest *Laptop Report*.

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