2013 4th Quarter

Braziel & Associates

PERFORMANCE WEIGHTED ASSET ALLOCATION REPORT

James A. Braziel, CFP®
Registered Principal, NPB

James H. Braziel, CFP®
Registered Principal, NPB

1074 East Avenue, Suite L | Chico, California 95926
(530) 895-3344 | (800) 675-3344 | Fax (530) 895-3141

ADVISORS' THOUGHTS

This **past year saw the US stock market shift into high gear** while investments that benefit when there is a concern of economic problems were left behind. A gradually increasing optimism that the US economy is improving backed by the actual data of improved economic conditions led investors to shed fixed income investments and increase their stock holdings for the first time since the great recession. This result **fit well with the positioning of your investments** as we were **underweight bonds relative to stocks throughout 2013**.

A look at the table to the right illustrates how dramatic the difference was between stocks and bonds. The US stock market as represented by the **S&P 500 gained 29.60% last year**, the largest gain yet in this economic expansion. **Developed foreign stock markets also performed well** with the **MSCI EAFE gaining 19.42%**. However, the promise of high growth emerging market stocks was disappointing again last year with the MSCI Emerging Markets losing 5.43%.

The **growth in US stocks contrasts with the losses that occurred in the bond market.** The Barclays Intermediate Treasury Bond lost 2.77% while the **Barclays Long Bond Index suffered a double digit decline of 13.39%.** Other parts of the bond market that were less sensitive to interest rate increases did fare better than these government bond indices, however the overall theme of strong stock returns and weak bond returns remained.

TOTAL RETURN THROUGH 12/31/2013

	3 Mo.	6 Mo.	12 Mo.
DJIA	9.56%	11.18%	26.50%
S&P 500	9.92%	15.07%	29.60%
MSCI EAFE	5.36%	16.89%	19.42%
MSCI Emerging Markets	1.54%	6.63%	-5.03%
Barclays Inter-term Bond	-1.02%	-0.68%	-2.77%
Barclays Long-term Bond	-2.95%	-4.87%	-13.39%
SPDR Gold Shares	-9.41%	-2.51%	-28.33%
iShares Silver Trust	-10.48%	-1.37%	-36.30%

Source: Wall Street Journal and Morningstar Principia
Does not include reinvestment of dividends

DJIA: A price weighted average of 30 stocks.

S & P 500: A market value weighted index of 500 stocks.

MSCI EAFE: A stock market index designed to measure the equity market performance of developed markets outside US and Canada.

MSCI Emerging Markets: A stock market which captures large and mid cap representation across 21 Emerging Market countries..

Barclays Capital Treasury Intermediate-Term Bond Index: An index comprised of US Treasury securities with maturities between 2 and 10 years.

Barclays Capital Treasury Long-Term Bond Index: An index comprised of US Treasury securities with maturities of 10 years or longer.

Barclays Capital Treasury Long-Term Bond Index: An index comprised of US Treasury securities with maturities of 10 years or longer.

SPDR Gold Shares: An exchange traded fund that represents the price of gold.

iShares Silver Trust: An exchange traded fund that represents the price of silver.

(Continued on Page 4)

Recently you may have been hearing a lot about Bitcoin and wondered what all the chatter has been about. Is it "real" money, a new technology, a video game, or something else?

Bitcoin is a form of digital money that may be used to make online purchases, and in some cases through retail outlets, as long as the vendor has agreed to accept bitcoin as a payment method. Individuals who wish to transact in bitcoins will register for the software program or mobile application that allows the user to send and receive bitcoins. Of course receiving the software does not come with free bitcoins as those must be purchased through various online exchanges where you can buy bitcoins for US dollars or there is a process called "mining" that allows someone to earn bitcoins.

It is a **decentralized peer-to-peer payment network** that is powered by its users with no central authority or middlemen. In other words, **unlike other currencies that are issued by a government, such as the US Dollar, bitcoin has no such government backing**.

Central to any currency being accepted between two parties **is the belief by both parties that the currency being used has value** and will continue to hold value. In essence, the two parties must "trust" the backing of who issues the currency. In the case of bitcoin, without a government or central authority backing it, where does this "trust" come from?

According to the website bitcoin.org, "Much of the trust in Bitcoin comes from the fact that it requires no trust at all. This means that anyone has access to the entire source 'computer' code at any time. **Any 'software' developer in the world can therefore verify exactly how Bitcoin works**. All transactions and bitcoins issued into existence can be transparently consulted in real-time by anyone." The claim is that because anyone can review what is happening that it is not possible for someone to cheat the system.

Part of what can be reviewed on the Bitcoin network is a **shared public ledger called the "block chain" that contains every transaction ever processed, allowing a user's computer to verify the validity of each transaction**. Anyone can **process transactions using specialized hardware and earn bitcoins for providing this computing service**. This process is called **"mining"**.

Mining has become very competitive in the past year with the **huge increase in the value of each bitcoin**. As the use and awareness of bitcoins has spiked in the past year so has its price. According to Blockchain.info, the **price for 1 bitcoin in early 2013 was below $20 (US Dollars) and has recently been trading above $1,000 (US Dollars)**. As the price has sky rocketed so has the demand for mining bitcoins, resulting in miners requiring ever faster and faster machines in the race to solve the mathematical calculations to process bitcoin transactions and securing the network.

Bloomberg Businessweek's January 13 to 19, 2014 cover story, "Bitcoin Rush" depicts a person named Joel Flickinger as a bitcoin miner. He is a software engineer and IT consultant, who now spends his day bitcoin mining. He has purchased $20,000 of computer equipment for this endeavor. However, even this is not enough computing power alone without pooling his computer with others in a group called Give Me Coins to have a better shot at being the first to verify transactions and solve the math calculations to earn bitcoins.

This all sounds somewhat surreal and begs the question **why someone would use bitcoins** over traditional payment methods. There appear to be **several reasons why some have chosen to use bitcoins** over other forms of payment. **Patrick M. Byrne, Chairman and CEO of Overstock.com** (an online retailer with $1.1 billion of revenue in 2012) expressed some of these in their recent announcement that they would soon start accepting bitcoin. In their case, **Mr. Byrne said**, "We are doing this for both business and philosophical reasons." Under the business reasons he cited, "I believe that by **being the first major online retailer to accept bitcoin, we will tap into a significant group of loyal consumers**, and as a result our share of the overall market will grow." He **also stated** that, "…the **cost of carrying out credit-card**

transactions is roughly 2 percent. Given that our net margin is also approaching 2 percent, the **avoidance of such fees will make bitcoin sales that much more profitable**." Note that with bitcoins, there is no fee paid to a bank or credit card company for transactions although there can be very small fees users may choose to pay to miners to speed their transactions.

Probably **more interesting** than the stated business reasons are the **philosophical reasons Mr. Byrne gave**. He said, "**I believe limited government is a better business model** for our nation than is unlimited government (and limited government has the additional benefit of being consistent with our Constitution). Among the **many vices of authoritarianism is that it can sustain itself only by offering more things to more people than it can actually deliver, and one way it makes up the difference is by debasing its currency**."

He goes on to say, "I am agnostic regarding the future value of bitcoin. I merely feel bitcoin is a viable medium of exchange that Overstock.com should embrace to better serve our customers, and that the U.S. should embrace to create a robust, viable alternative to our current monetary institutions." In the case of Overstock.com they have touched on a nerve that many Americans feel their country has been mismanaging their finances and they are concerned about a decline in the value of the US dollar.

In addition to these legitimate business or philosophical reasons there is another group that has embraced using bitcoins: criminals. Because transactions are not cleared through financial institutions they have appealed to drug trafficking and other crimes. Even though each transaction is verified between sender and receiver of bitcoins, the identity of the parties is not known by any government or other authority.

There also appears to be a group of businesses who tend to be more tech savvy and without any philosophical motivation (besides profit) that are using bitcoins. This is represented by the Sacramento **Kings recent announcement that they will start accepting bitcoins** in their store and will soon allow ticket sales using bitcoins. The Kings are owned by Vivek Ranadive, Founder, Chairman and CEO of TIBCO Software Inc. (a leading software company in Silicon Valley with 1 billion in revenues), and considered a visionary in the technology world.

The Bitcoin phenomenon took off in 2013 and has continued into 2014. And while one should not abandon US dollars or their credit card, there may actually be a new way, using bitcoins, that some choose to make a purchase.

The apparent viability of bitcoins as a purchase payment method does not mean one should invest in bitcoins. The meteoric rise in the price of a bitcoin has led some to dream of riches. However, as it stands today **investing in bitcoins is highly speculative** and is an area almost everyone should avoid. From our perspective, **we do not view bitcoins as an investment that is appropriate for your managed accounts**.

OUR NEW WEBSITE!

We are excited to announce our **new website** will be going live in February. The web address will remain the same at www.theplanners.net.

Our website has an overview of the services we offer for both individuals and business owners. Once the website is up and running, we will be posting a blog and video segments of timely planning and investment information.

We invite you to view the website and **we welcome your feedback**.

Jim, Jim, Carol and Sandi

The largest dichotomy that appeared was between the stock market and precious metals. **Gold and silver saw huge losses in 2013** at the same time the stock market was thriving. The largest gold Exchange Traded Fund (ETF), **SPDR Gold Shares fell 28.33%** and the largest silver ETF, **iShares Silver Trust lost 36.30%**. It appears people gave up on the thesis of a collapsing US economy and US dollar that might be bullish for precious metals and with hyper inflation nowhere to be found; the great exodus from gold and silver was on.

The **conditions for the continued US expansion appear to be in place**. The Conference Board Leading Economic Index (LEI) increased 0.1% in December, following a 1.0% increase in November, and a 0.1% increase in October. For the final 6 months of 2013 the leading economic index increased 3.4%, much faster than the 1.9% increase in the first 6 months of the year. According to the Conference Board, "Recent improvements in the composite indexes suggest that the expansion in economic activity should continue and might even moderately pickup in the months ahead." The LEI has now risen nearly unabated since the beginning of 2009 and is now near pre financial crisis levels.

One area of strength has been in US manufacturing. The Federal Reserve Board reported Industrial production rose 0.3% in December, its fifth consecutive monthly increase. In the fourth **quarter of 2013 industrial production advanced at a robust annual pace of 6.8%**, the largest quarterly increase since the second quarter of 2010 with gains being widespread across industries. **Industrial production has now surpassed its pre-recession peak in December 2007**. US manufacturing has gained strength against the rest of the world in part because of rising wages outside the US relative to modest wage growth in the US. Higher wages outside the US have magnified the importance of the cost of shipping to the point where some manufacturing is actually returning to the US.

Maybe the strongest **vote of confidence for the US economy comes directly from the Federal Reserve**. On December 18th they voted **to begin reducing (tapering) their bond buying purchases known as Quantitative Easing (QE3)**. Their first reduction was for $10 billion to lower their monthly purchases from $85 billion to $75 billion per month. Since their meeting Fed officials have indicated they would like to steadily reduce their purchases in 2014 until they no longer are purchasing any government bonds. The first Quantitative Easing (QE1) began in late 2008 at the depths of the great recession and was put into place to stimulate the US economy. The fact that the **Federal Reserve now believes the US economy is strong enough to eliminate this stimulus** bodes well for the continued expansion.

The **improving economic expansion has led to strong corporate profits in 2013**. S&P Capital IQ in their Lookout Report dated January 10, stated the consensus estimate for year over year earnings growth in the 4th quarter to be 5.7%. **Earnings per share (EPS) are projected to be $27.87 that would set a new record level of EPS for the S&P 500 Index**. This would be the seventh consecutive quarter of record EPS for the S&P 500 Index, and bring 2013 earnings to an estimated $109.01 for the third consecutive yearly record for earnings.

The **biggest area of concern** may be that the US economy has been doing so well and the stock market grew so rapidly in 2013 that **investor expectations may be too high coming into 2014**. It is important to highlight that earnings are estimated to grow 5.7% in the 4th quarter of 2013 from the 4th quarter of 2012, while the S&P 500 increased 29.6%. When stock prices increase faster than earnings, investors are showing an increased confidence about the future. Although the market does not appear to be overvalued, nor does it appear to be undervalued anymore. Furthermore, **there has not been a meaningful correction in stock prices for nearly two years**. Yet Market corrections **are expected and normal**. No one can predict precisely when they will occur, how long they will last or how severe they will be but it would not surprise us at all to see a market correction in the first half of 2014. That being said, **should the fundamentals of the economy continue to expand and improve, any downturn should be temporary** and healthy for the overall Market in the long run.