ROOF ADVISORY GROUP, INC.®
INVESTMENT ADVISORY & FINANCIAL PLANNING SERVICES

INVESTMENT INSIGHT
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3rd Quarter in Review: Fed Says No Taper, Debate Over Debt Ceiling Looms

The third quarter provided no shortage of entertainment for market watchers as three key events shaped the market: rising expectations that the Federal Reserve would begin tapering their bond purchases (formally known as Quantitative Easing), a debt ceiling showdown that has the potential to rival the August 2011 debt ceiling debacle that resulted in the only downgrade of United States government debt ever, and the start of the process to select a new Federal Reserve Chairman to replace Ben Bernanke. As of the end of the quarter, two of the three issues had been addressed in a manner that the markets found favorable. The partial resolutions of these issues lead to the S&P 500 once again hitting an all-time high in September. Despite the return of uncertainty during the quarter, the S&P 500 logged a gain of 4.7%, the NASDAQ gained 10.8%, and the Dow Jones gained 1.5%.

The two main issues that saw partial resolution both occurred in September, sending markets notably higher. First, on September 16th, Larry Summers withdrew his name for consideration to succeed Ben Bernanke as the next Chairman of the Federal Reserve. Markets applauded this decision, as it was widely believed Summers was the frontrunner and that he was the most 'hawkish' of the names being considered. Then, on September 18th, the much anticipated Fed decision that most pundits felt would be the start of the Fed tapering its bond purchasing program shocked markets—there would be no taper in September as economic data had not supported the decision to do so. Markets were already on a rise from Summers' concession and the Fed decision only picked up the pace of buying, sending markets to their all-time high on the same day.

The remaining piece of uncertainty that has reared its ugly head once again is the ongoing debt ceiling saga. Treasury Secretary Jack Lew has set the date for the government to run out of operating funds as October 17, 2013. Congress has until that date to come to a resolution and avoid a repeat of August 2011, where an agreement was reached but Standard & Poor downgraded the credit rating of United States government bonds based on the worsening financial condition and continued failure to implement more fiscal austerity. Much like Roof Advisory Group did in 2011, client assets have been positioned to face potential volatility head on. Congress has a flair for the dramatic, often making eleventh hour deals that leave investors squirming. Roof Advisory Group's goal is to position your portfolio to cushion it from temporary market gyrations that may result. This is accomplished by assessing the most likely market moves, positioning the portfolio to best react to those outcomes, and by having contingency plans ready for any unexpected outcomes that may arise.

There were a few other highly publicized events throughout the quarter that had no real impact on the market. Most of these revolved around geopolitical events out of the Middle East, particularly in Syria and Egypt. While they received much media coverage, there was no significant or lasting impact on United States financial markets.

The positive news out of the Fed also impacted bond markets favorably. The benchmark yield on the 10 year U.S. Treasury lowered from its high of 2.98% in early September to stabilize near 2.62% as the quarter came to a close. Roof Advisory Group continues to forecast a long-term rise in interest rates, particularly once the Fed announces plans to begin tapering and has positioned our fixed income portfolio durations shorter than historical norms. A slight increase in money market funds has been implemented to additionally shorten overall duration for the fixed income portion of our portfolios.

In early September the decision was made to reduce client equity exposure to one-step below maximum. This move was made with a focus on locking in gains on individual positions that had long-term unrealized gains in excess of 30%. Proceeds from the reduction of equities were allocated to an ultra-short bond fund that focuses on capital preservation in a rising interest rate environment. Client portfolios remain well diversified with an emphasis on income generating, high dividend paying securities. At present, our overall allocation strategy continues to favor the incremental overweighting of equities versus fixed income. The temporary extra liquidity mentioned previously will be redeployed to capture near-term upside market moves, should that opportunity present itself once a budget/debt ceiling resolution is finally reached.