

# March 2013

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## Consumer Apparently Unfazed By Smaller Paychecks

### **Recent Economic Indicators**

Thomson Reuters/Univ. of Michigan Consumer Sentiment	77.6
Consumer Confidence	69.6
Existing Home Sales, Monthly Change	0.4%
New Home Sales, SAAR*	437,000
Personal Income, Monthly Change	-3.6%
Personal Consumption Expenditures, Mo Chg	0.2%
Non-farm Payroll Increase/Decrease	236,000
Unemployment Rate	7.7%
ISM Non-Manufacturing Index	55.2
ISM Manufacturing Index (PMI)	54.2
New Durable Good Orders, Monthly Change	-5.2%
Industrial Production, Monthly Change	-0.1%
Capacity Utilization	79.1
Retail Sales, Monthly Change	0.1%
CPI, Monthly Change, NSA	0.3%
CPI Core, Monthly Change, NSA	0.0%
PPI, Monthly Change, NSA	0.2%
PPI Core, Monthly Change, NSA	0.2%
U.S. Trade Deficit	\$44.4 Bil
Q4 2012 Non-farm Productivity, Qtrly Chg	-1.9%
Q4 2012 Real GDP, Quarterly Change, SAAR*	0.1%

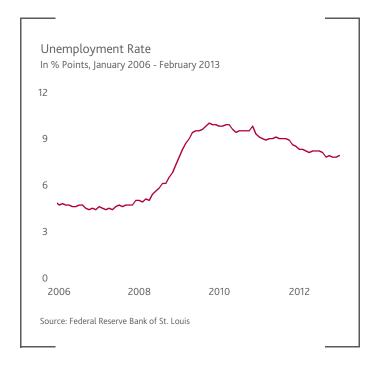
<sup>\*</sup>Seasonally Adjusted Annual Rate

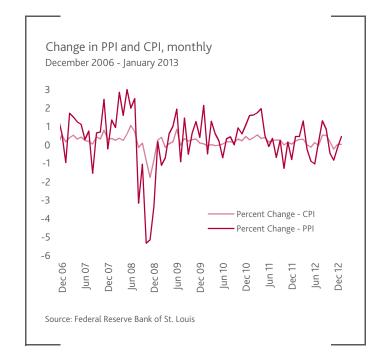
Values reflect most recent data available at the time of publication. Source: Bureau of Economic Analysis of the U.S. Department of Commerce, U.S. Department of Labor, Federal Reserve, Thompson-Reuters University of Michigan, Institute for Supply Management, National Association of Realtors, The Conference Board, U.S. Census Bureau, Bloomberg

The deadline for the sequester, \$85 billion in spending cuts, has come and passed without a deal in Washington. However, we would not be surprised if we do not notice the effects right away, if at all. We believe those hurt most will be government employees, many of which will be receiving furlough notices soon if they have not already, and government contractors as agencies cut back on spending. Eventually the average American might notice spending cuts in the form of abbreviated hours at national parks or a few more delays at the airport, but we do believe it will be a headwind for economic growth. However, ultimately we feel cuts are necessary in one form or another to begin to slow the growth in our nation's debt, which we believe is far more important in the long-run.

The U.S. trade balance narrowed much more sharply than expected in December thanks in part to a drop in crude oil imports and the reversal of the iPhone impact in November. The trade deficit shrank just over \$10 billion to \$38.5 billion – the smallest trade gap since January 2010. Exports jumped 2.1% while imports declined 2.7%. The petroleum gap narrowed \$4.7 billion to \$18.7 billion, although this is likely to reverse somewhat in the next report. The sharp decline in the trade deficit resulted in a small upward revision to the initial estimate of fourth quarter GDP. Real GDP growth was revised up 0.2%, just enough to nudge it into positive territory at 0.1%. While the number is still disappointing, momentum looks to be improving modestly going forward.

The FOMC minutes released in February revealed heightened debate over continued quantitative easing, stating "several participants discussed the possible complications that additional purchases could cause for the eventual withdrawal of policy accommodation, a few mentioned the prospect of inflationary risks, and some noted that further asset purchases could foster market behavior that could undermine financial stability." Accommodative monetary policy has been a contributing factor to the rise in stock prices, so we believe an end to quantitative easing would likely hurt equities.





### **Employment**

The U.S. labor market showed good improvement in February with 236,000 jobs added during the month. This number is well above expectations of 165,000 and much stronger than January's revised growth of 119,000. The private sector continues to be the sole source of hiring, while governments cut another 10,000 from the payrolls. The household survey showed the unemployment rate fell to 7.7% from 7.9% last month – the lowest level in over four years. The decrease in the unemployment rate was in part due to more people getting jobs, but was also the result of 130,000 people leaving the work force bringing the participation rate back down to a 31-year low of 63.5%. This was not as great of a report as the headline would indicate, but it was still a good report that shows hiring is picking up a little steam. Meanwhile initial jobless claims for the week ended March 2 declined 7,000 to 340,000. While this is not the lowest weekly level recently, it does appear the numbers have shifted into a lower range with the four-week down 7,000 to a recovery low of 348,750. Continuing claims also hit a recovery low of 3.122 million. It appears businesses that were hesitant to hire amid uncertainty about taxes and government spending at the end of the year seem to be making up for it now.

### Consumer Confidence & Spending

The payroll tax cut expiration effected take-home pay for Americans in January as personal income fell a dramatic 3.6%. The magnitude of the drop was higher than expected and was exaggerated by the unusually high income in December stemming from increased special dividend payouts to avoid 2013 tax hikes. The combination of one-time events resulted in the largest monthly drop in income in 20 years. So far consumers have not cut spending to adjust as retail sales for January managed to edge up 0.1% after rising 0.5% the previous month. Instead folks have reduced their level of saving which fell from 6.4% of disposable income in December to 2.4% in January. It will take additional reports to paint a more accurate picture of how consumers' spending habits will be impacted by the expiration of the payroll tax cut. Meanwhile it appears consumer

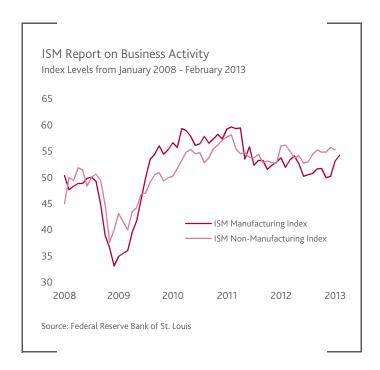
confidence has moved past the fiscal cliff uncertainty and shaken off the payroll tax cut expiration; consumer confidence rose 11.2 points to 69.6 in February.

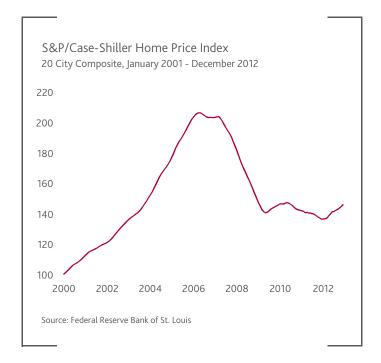
### Inflation

One of the data points we are monitoring closely is inflation, which has remained tame; we believe tame inflation is positive for the stock market. Headline inflation came in flat for January and eased to 1.6% on a year-over-year basis, while core CPI excluding food and energy rose 0.3% for the month and held steady at 1.9% for the year. The report likely understated inflation, though, as the BLS made special adjustments during the month to 31 series of underlying data. Inflation at the producer level rose 0.2%, driven higher by a 0.7% increase in food prices that included a 39% surge in the prices for fresh and dry vegetables. For now inflation appears in check, but we expect it will likely heat up in February's reports as gas prices rose every day during the month – up almost 15% for the first two months of the year.

### **Business Activity**

Industrial production slipped 0.1% in January following gains of 0.4% in December and 1.4% in November. Motor vehicle production fell 3.2% while other industries were mixed. In the context of the gains seen the previous two months, the number is not too disconcerting. Meanwhile a strong Empire State survey pointed to improving conditions in manufacturing as that index surged 18 points in February. We also received good news from the Institute for Supply Management who reported their manufacturing index rose 1.1 points to 54.2 in February and the new orders component jumped 4.5 points to a strong 57.8 reading. There was exceptional strength in back orders as well, which rose 7.5 points to 55.0. Of concern to us was the faster rate of increase for prices paid, which rose 5.0 points to 61.5 and indicated inflation may be coming to consumers in the months ahead.





### Housing

We are beginning to see early indications the housing market recovery is slowing down. The NAHB housing market index fell for the first time in ten months to 46, with home builders citing uncertainty in the job market, a shortage of available lots and stringent credit standards as limiting factors. The report's traffic component fell four points to 32, pointing to weaker sales in the coming months. Housing starts fell 8.5% in January following a sharp 15.7% increase the previous month, but permits continued to trend upwards climbing 1.8% for the month. Finally, sales of existing homes rebounded slightly up 0.4% for January to a 4.92 million annual pace. The National Association of Realtors continues to point to low supply as a limiting factor to sales activity, which at 4.2 months is the lowest level of housing inventory since 2005. The housing recovery was a key driver of the stock market in 2012 and one of the sets of economic data we are watching closest right now. The weakening in housing data reinforces our decision at the beginning of the month to reduce our overweight to equities.

### World Economy

China reported both exports and imports rose more than expected in January. Exports rose 25.0% from the previous year while imports jumped 28.8%, giving the country a trade surplus of \$29.15 billion. There were five extra working days during the month this year as compared to last year, but the gains were still above forecasts. The data suggests both domestic and foreign demand is strong and China's economic growth rebound remains on track. Despite the increased economic activity, inflation in the country actually moderated to an annual rate of 2.0% from 2.5% in December. Things are looking grim over in Europe as the region posted its worst economic performance in almost four years. Gross domestic product fell at a 2.3% annual pace in the fourth quarter, which was worse than expected and pushed the euro-area deeper into recession. Portugal's economy shrank for the ninth consecutive quarter, but contraction was also seen in the larger countries like Germany, France and Italy. The recent appreciation of the euro has put a strain on exports in the eurozone as their goods become more expensive on the global market.

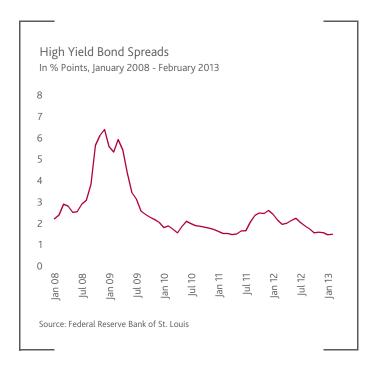
## Fixed Income Markets Rally with the Exception of International

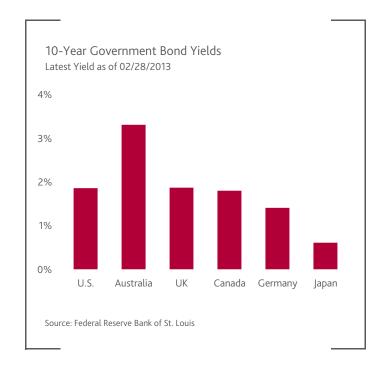
Fixed Income Current Yields	2/28/2013		
3 Month U.S. T-bill	0.11%		
2 Year U.S. Treasury		0.25%	
5 Year U.S. Treasury		0.75%	
10 Year U.S. Treasury		1.86%	
30 Year U.S. Treasury		3.06%	
Total Returns	1 Month	YTD	
Barclays U.S. Aggregate	0.50%	-0.20%	
Barclays U.S. Govt./Credit	0.50%	0.13%	
Barclays U.S. Municipal Bond	0.30%	0.72%	
Barclays U.S. Corp. High Yield	0.53%	1.88%	
Barclays U.S. Long Credit A	0.91%	-1.35%	
Barclays U.S. Treasury 20+ Year	1.28%	-2.64%	
Barclays Global Aggregate	-0.95%	-1.85%	
Barclays Emerging Markets	-0.25%	-0.90%	
1 Month and YTD data as of: 2/28/2013			
Values reflect most recent data available at the time of publication.  Source: Morningstar, Inc., U.S. Department of the Treasury, Barclays Capital			

Despite the recent rally in bonds, some investors feel the fixed income markets are at risk for a correction. In his annual letter to investors in February, Warren Buffet said, "bonds should come with a warning label" because such low-yielding investments could produce negative returns after taking into consideration the impact of inflation. Dan Fuss, whose Loomis Sayles Bond Fund beat 98% of its peers over the last three years, said in a recent interview that the fixed income market is "the most overbought market I have ever seen in my life in the business." However, by comparison, bond bulls argue the Fed's pledge to keep short-term interest rates near zero along with their \$85 billion per month bond buying program will keep interest rates anchored near recent levels. Fed Chairman Bernanke indicated in recent congressional testimony the central bank is prepared to continue buying bonds at its present pace, dismissing concerns that record-low interest rates will spark inflation or asset-price bubbles.

From a demand perspective, according to a recent report from the Treasury, foreign interest in U.S. government debt remains robust. Foreign investors bought a net \$29.9 billion of Treasuries in December, up from \$26.4 billion the month before, with China and Japan adding to their record-high holdings of \$1.2 trillion and \$1.12 trillion, respectively. Also driving demand for safe-haven U.S. government debt were several developments in the eurozone suggesting that although the sovereign debt crisis has eased, it remains a legitimate concern. In particular, European Union economists reported they expect a second year of contraction in 2013 for the region. At the same time, European banks said they would repay far less than expected of the funds they borrowed from the European Central Bank, indicating the banking system in this area has not yet fully recovered.

We believe a key factor that will determine the direction of interest rates remains with the actions of the Federal Reserve. Stronger U.S. economic data could compel the Fed to slow its bond-buying program sometime during the second half of the year. Recently





released minutes from the FOMC's January policy meeting revealed a heated debate among central bankers concerning the end of this program even before unemployment reaches the previously established bogey of 6.5%. Because the Fed's recurring bond purchases have driven interest rates artificially low, an end to this program could lead to a sell-off in government debt. We continue to recommend the sale of U.S. Treasuries and TIPS, given the poor risk/return characteristics associated with these securities.

### Corporate

Despite growing anxieties of a sell off due to valuation concerns, the investment grade corporate sector finished the month higher by 0.77%, bringing year-to-date returns to -0.13%. However, should U.S. Treasury yields climb higher, some strategists feel investors may begin a rotation out of bond funds, particularly investment grade corporates, later this year. These strategists feel the trigger for this will revolve around poor returns relative to other asset classes. Another leg higher in 10-year U.S. Treasury rates to 2.5% could incent market participants to transition out of high-grade funds due to resulting NAV losses. Such a modest increase in interest rates is clearly plausible since at 2.3%, yields could be high enough to cause a surge in what is known as mortgage convexity hedging, driving rates even higher. In a low interest rate environment, mortgage bondholders often hedge prepayment risk by purchasing long-dated Treasuries. When a strong upsurge in rates begins these bondholders no longer need the hedge so they sell Treasuries, which is expected to have a snowball effect on bond rates.

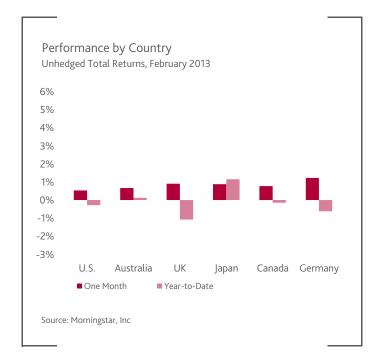
High yield bonds rallied again gaining 0.51% for the month, brining year-to-date returns to 1.86%. However, in a sign the rally may begin to fade, short interest on large ETFs investing in junk bonds has risen to levels not seen since October 2007. Because the recent rally has pushed yields to record low levels, managers including BlackRock, PIMCO and several hedge funds have warned that valuations on lower rated paper are approaching extreme highpoints. At the same time, analysts feel the large short interest positions point to

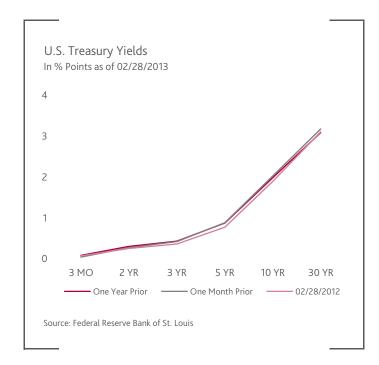
investors' inability to sell sizable positions. Given these concerns, we continue to recommend diversifying exposure to high yield by transitioning to short-duration mutual funds and ETFs.

### Municipals

Similar to last month, the Barclays Municipal Bond index rose, gaining 0.30% for the month, as demand outweighed supply and prices were buoyed by a stronger Treasury market. Looking forward, the sequestration or Budget Control Act (BCA) will put into place automatic procedures to reduce discretionary and mandatory spending. If fully implemented, these reductions will take place by automatically canceling, or sequestering, a portion of the budgetary resources for most discretionary programs as well as for some activities that generate mandatory spending. While the direct impact on municipals will be limited to sectors and issuers (such as Build America Bonds) dependent on federal spending and payments, the likely drag on GDP growth could trigger downward pressures on highgrade municipals in the short-term.

On a positive note, Fitch Ratings recently revised California's outlook to positive from stable, while affirming its A- rating. "The positive outlook reflects the fiscal management improvements instituted by California in recent years, which when combined with two successive years of structural budget progress have enabled the state to materially reduce budgetary borrowing" Fitch said in its news release. The report continued to state "Eventual rating action would be linked to the state's demonstrated willingness to restrain spending growth and progress reducing budgetary obligations." We feel this revised outlook along with Standard & Poor's upgrade of California from Ato A in January represent compelling reasons to remove the state from our "do not buy" list.





### International

The Barclay's Global Treasury ex-US index fell 1.83% on an unhedged basis, but gained 0.58% on a local currency basis, consistent with a weaker U.S. dollar against other major currencies. Many safe-haven countries and several sovereigns gained in their local currencies with Canada, France, Germany, Australia, the United Kingdom, Japan, Spain and Ireland posting gains for the month. Italy (-1.90%) posted the only loss amidst large eurozone countries as a recent general election substantiated the high level of political divide in the country, fueling investor concerns of prolonged governmental instability.

Meanwhile, ECB President Draghi's commitment to remain accommodative along with a deal to ease Ireland's funding needs over the next 10-years boosted demand for higher yielding eurozone government debt. Draghi also said inflation risks remain muted as central bank policy makers kept interest rates unchanged at 0.75%. At the same time, Spain retained its investment grade rating from Fitch Ratings, which said the country's debt will peak below the key level of 100% of GDP, and the government still has room to maneuver in the event of further shocks. Although the country's rating remains lower than that of other large advanced European economies, Fitch believes Spain's government maintains access to additional sources of fiscal ammunition to further stimulate the economy. Largely attributable to very competitive risk premiums relative to German bunds and an improving economic landscape, Spanish bonds have outperformed most other sectors in the fixed income markets, returning 2.44% year-to-date.

### Supply/Demand Dynamics in the Municipal Bond Market

While the basic tenet of supply and demand affects all financial markets to some degree, it is particularly influential in the municipal bond market as supply can become uneven and demand relies on a relatively narrow band of buyers. Since the muni market correction in late 2010 and early 2011, demand for bonds in this space has been very strong, while supply has been low to moderate. This trend, along with declining U.S. Treasury yields, has pushed muni prices higher and yields lower.

From a supply perspective, tight municipality budgets combined with onerous pension and health care obligations have led to a low level of new supply coming to the market, despite historically low interest rates. At the same time, demand remains robust, particularly from retail investors who typically hold securities for long periods, which reduces volatility.

Despite the short-term effects the U.S. government's sequestration may bring to the market, we feel current supply/demand metrics will favorably influence the muni space over the course of at least the next year. For investors seeking tax-free income, we believe municipal bonds continue to offer attractive risk/return characteristics.

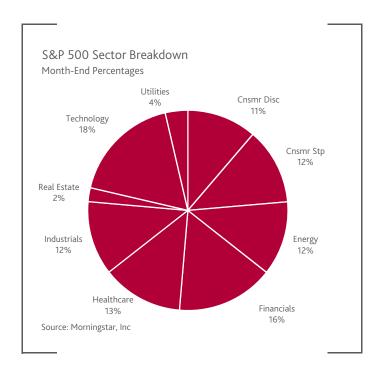
## Domestic Markets Continue Their Move Upward

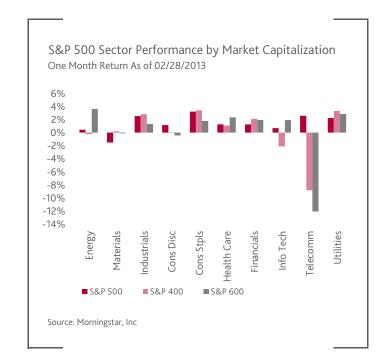
Total Returns	1 Month	YTD	
Dow Jones Industrial Average	1.76%	7.77%	
S&P 500	1.36%	6.61%	
NASDAQ Composite	0.76%	4.87%	
S&P 100	1.42%	6.04%	
S&P 400 MidCap	0.98%	8.27%	
S&P 600 SmallCap	1.41%	7.27%	
Russell 2000	1.10%	7.43%	
MSCI EAFE	-0.92%	4.32%	
MSCI EAFE Small Cap	1.12%	6.41%	
MSCI Emerging Markets	-1.24%	0.13%	
1 Month and YTD data as of: 2/28/2013			
Values reflect most recent data available at the time of publication. Source: Morningstar, Inc.			

Most major stock markets were positive again in February after a very strong start to the year in January. The S&P 500 index hit a major milestone as it crossed the 1500 mark late in January for the first time since 2007. The index stayed above that level for most of February except for a couple trading sessions when investors became concerned about election results in Italy and spending cuts in Washington. Continued strong economic data helped keep domestic markets in positive territory for the month.

The total return for the Dow Jones Industrial Average in February was 1.8% with the index closing at 14054.49. The broader S&P 500 Index returned 1.4% for the month, finishing at 1514.68. The technology heavy NASDAQ Composite Index ended the month at 3160.19, posting a return of 0.8% despite a 14% decline in Apple stock.

As the S&P 500 Index has reached the 1500 level, we are reminded of the two other times in history that this has occurred: in 2000 before the bursting of the tech bubble, and in 2007 before the housing market crisis. The good news, according to S&P Capital IQ, is the market is trading near 14x expected forward four-quarter earnings compared to 27x in the third quarter of 2000 and 20x in the third quarter of 2007. While earnings growth is generally below the levels seen during those time periods, higher EPS growth is expected in 2013. In addition to the overall growth rate in Q412 for S&P 500 company earnings coming in at about 6.8%, ahead of analysts' estimates, improvement in revenue growth for the quarter to 4.7% from 0.4% reported in the third quarter of 2012 is equally encouraging.





### **Domestic Equity**

Consumer Staples (+3.2%), Telecomm Services (+2.6%) and Industrials (+2.5%) were the strongest S&P 500 Index sectors in the month of February. Within Staples, Constellation Brands soared 37% on news the company will gain full control of the Corona brand. Heinz increased 23% following the announcement of the acquisition by Berkshire Hathaway and a private equity firm. Within Telecomm Services, Verizon rose 6.7%, while AT&T and Sprint were both up over 3%, rebounding from weakness in January. Strong manufacturing data helped boost Industrials stocks like Eaton (+8.8%) and Dover Corp (+6.5%). Sectors that underperformed the S&P 500 Index included Materials (-1.5%), Energy (+0.4%) and Information Technology (+0.7%). Cliffs Natural Resources (-32%) fell on weak earnings and a dividend cut. Declining commodity prices hurt Freeport-McMoRan (-9.4%) and US Steel (-6.5%). Volatile energy prices negatively impacted Noble Corporation (-11.6%) while a poor production outlook weighed on Newfield Exploration and its shares declined 21.6% for the month.

According to S&P, mid cap equities underperformed both large cap and small cap in the month of February. Both the S&P 500 Index and the S&P Small Cap 600 Index returned 1.4% compared to returns of only 1% for the S&P MidCap 400 Index.

Value outperformed growth in mid cap and small cap stocks, while returns were equal for value and growth in the large cap space. The outperformance of value style investing can once again be attributed to the lower concentration of information technology stocks in the value indices. The S&P MidCap 400 Value Index (+1.7%) was higher than the S&P MidCap 400 Growth Index (+0.3%). Similarly, the 1.7% return for the S&P SmallCap 600 Value Index was better than the S&P SmallCap 600 Growth Index return of 1.2%. Year-to-date, mid cap value stocks have shown the best performance (+12.6%), while large cap growth equities have lagged (+5.2%).

### International Equity

Developed International equity indices underperformed domestic markets in February. The broad MSCI EAFE Index of developed markets declined 0.9% in U.S. dollar terms for the month, as weakness in France (-3.4%), Germany (-3.9%) and the UK (-2.5%) was partially offset by a 2.7% return for the Japan MSCI Index. Southern European nations such as Italy (-12.6%), Spain (-5.9%) and Portugal (-8.4%) suffered from uncertainty over Italian elections and continued austerity programs in those countries.

The total return for the MSCI Index for Emerging Markets was also negative (-1.2%). Investors took profits in Chinese stocks (-3.9%) after a strong run in the prior four months. India (-7.3%), Russia (-5.6%) and Brazil (-2.5%) were also weak, while Korea (+5%) bounced back from a 4.8% decline in January. Equity owners in India sold shares after the index hit a nearly two-year high in January.

## Alternatives Lag Broader Markets for the Month

Price Change	1 Month	YTD	
Dow Jones UBS Commodity Index	-3.16%	-0.69%	
Oil	-5.76%	0.22%	
Copper	-4.30%	-1.56%	
Gold	-5.05%	-5.83%	
NAREIT-All REITs	1.09%	5.25%	
NAREIT-Industrial/Office	1.83%	7.57%	
NAREIT-Residential	1.22%	3.61%	
S&P Global Property Ex-US	0.57%	3.91%	
HFRI Emerging Markets Index	0.22%	3.51%	
HFRI Fund Wtd Comp. Index	0.14%	2.67%	
HFRI Equity Market Neutral	0.73%	1.99%	
HFRI Event Driven	0.06%	2.38%	
HFRI Market Defensive	-1.72%	-0.64%	
HFRI Merger Arbitrage	0.04%	0.26%	
HFRI Short Bias	-0.27%	-3.42%	
1 Month and YTD data as of: 2/28/2013			
Values reflect most recent data available at the time of publication. Source: Morningstar, Inc.			

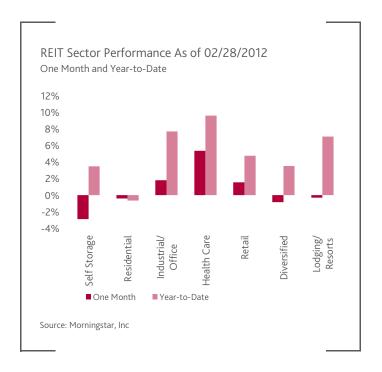
### Overview

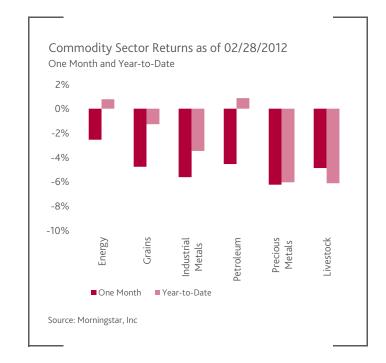
Commodities, Hedge Fund and Real Estate all trailed the S&P 500 for the month of February. Oil, precious metals and agriculture all fell. Hedging ended the month in the black, but posted mixed results across strategies. Outperformance of REITs last year has begun to cool off.

### Commodities

The Dow Jones UBS Commodity Index dropped 4% last month. Both Brent Crude and WTI oil prices fell in February after a three-month rally; Brent settled at \$111.38/barrel, down 3% in February, and WTI at \$92.05/barrel, down nearly 6% during the month. The Energy Information Administration announced U.S. liquid fuel consumption fell for the sixth time in the past seven years in 2012, falling 2.1% from 2011 figures. Consumption peaked in 2005 and has yet to get back to that level. Distillate fuel prices dropped the most in 2012 as lower demand for heating oil due to mild winters and a decrease in rail traffic both lowered overall consumption.

The price of gold declined by 5% and silver fell nearly 10% in February. A possible reason for the recent downward trend in precious metals prices is the optimistic outlook for a bargain in the U.S. budget talks, which seem to be progressing as President Obama met with key lawmakers this week. Ed Meir, metals analyst at INTL FCStone, wrote this week, "Should an accord be reached, we could see yet another round of selling in gold, as the 'deficit prop' that has been instrumental in the bullish argument for the precious metal will look somewhat more wobbly." Gold ETFs saw the biggest single-month outflows on record in February, indicating demand for the metal is continuing to fall as equity markets continue to rally despite increased volatility. As more alternative investment options are appearing in the marketplace there is a push by some governments to steer investors into other vehicles; India, for example, the world's biggest gold customer, recently introduced inflation-linked bonds to attract investors away from gold. With rates staying so low in the U.S. it is difficult for domestic investors to justify buying treasuries over





gold, but we believe that sentiment should change as the rate environment in the U.S. shifts in the coming years.

Finally agricultural commodities fell across the board, led by an 8% decline in wheat prices. Analysts say this can be attributed to heavy February snowfall across the Midwest providing much needed protection and moisture to winter wheat crops which brightens the outlook for spring and summer harvests, pushing prices down. Unfortunately much of the wheat crop went into winter dormancy under poor conditions after the drought this past summer, so many are still pessimistic about wheat supply in the coming year. Wheat prices jumped nearly 20% in 2012, so this correction comes as a welcome event to some, but the price decline may be short lived as supply concerns continue to linger and new potential export opportunities arise.

### Hedge Funds

Hedge funds held overall returns in positive territory last month, however, good performance from equity, credit and volatility strategies was overshadowed by losses from macro, managed futures and commodity funds. The HFRI Fund Weighted Composite Index posted a gain of 0.14% for the month and is now up 2.67% so far in 2013. February marked the 8th gain in the last nine months, led by Relative Value Arbitrage and Equity Hedge strategies, according to data from Hedge Fund Research (HFR). Fund of Hedge Funds performed in-line with the overall industry, as the HFRI Fund of Funds Index gained 0.13% last month. Building on a strong January gain of 3.3%, Equity Hedge funds also contributed to industry gains last month, with the HFRI Equity Hedge Index gaining 0.5% as U.S. equities approached record levels. For the year, the HFRI Equity Hedge is now up 3.84%. The HFRI Event Driven Index also posted gains, albeit modest, in February, marking its 9th consecutive monthly gain. According to HFR, Macro strategies detracted from industry performance, with the HFRI Macro Index posting a decline of 0.7%. Quantitative, trend-following CTA strategies led sub-strategy declines, with the HFRI Macro: Systematic Diversified CTA Index

posting a decline of 1.1%, with negative contributions from long commodity and short equity positions. Kenneth Heinz, President of HFR, stated the resurgence of investor risk appetite and optimism "drove hedge fund performance gains across credit, equity and arbitrage strategies, and enabled over \$100 Billion in financing to be raised for M&A transactions." Heinz went on to note that as equity markets reached all-time highs, investors began "actively allocating to the hedge fund industry for a number of reasons, including expectations for an end to quantitative easing, historically tight credit markets, opportunities in macro currency strategies, and the potential for destabilizing developments in Syria and Iran."

### **REITs**

Real estate investment trusts (REITs) are in unfamiliar territory. U.S. REITs returns slightly underperformed the broader equity market in the first two months of the year. Despite a plague of problems in residential real estate since 2008, commercial property stayed strong, leading to significant REIT outperformance in the years since. On a total returns basis, the FTSE NAREIT All REITs Index gained 1.29% in February and the FTSE NAREIT All Equity REITs Index gained 1.24%, while the S&P 500 was up 1.36%. Year-to-date through February, the FTSE NAREIT All REITs Index has gained 5.63% while the FTSE NAREIT All Equity REITs Index is up 4.94%, in comparison to the S&P 500 posting returns of 6.61%. Commercial mortgage and health care REITs had the industry's strongest returns in February, posting total returns of 6.71% and 5.35%, respectively. The mortgage REIT sector posted gains of 1.65%, up slightly more than the equity REIT returns. Shopping center and free standing retail REITs also showed strong gains for the month, posting total returns of 3.80% and 5.37%, respectively. Their performance ran counter to concerns the payroll tax cut would reduce consumer spending, according to NAREIT.

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