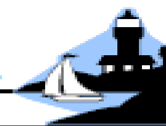


July 2013

About Beacon Financial Advisors Ltd.

Beacon is an independent fee-only advisor with a clear mission statement: To provide our clients long-term value-added financial counsel and investment performance with *exceptional service.*

Beacon is a Registered Investment Advisor with the US Securities and Exchange Commission.

Beacon's Advisors

MARCEL HEBERT has a B.S. in Finance, an M.B.A., and is a Certified Financial Planner (CFP) licensee and a Chartered Financial Analyst (CFA) charterholder.

JOSH HEBERT has a B.S. in Accounting, an M.B.A., and is a Certified Internal Auditor (CIA) and a Certified Financial Planner (CFP) licensee.

Please remember to contact Beacon Financial Advisors, Ltd. if there are any changes in your financial situation or investment objectives, or if you wish to impose, add, or modify any reasonable restrictions to our investment management services. A free copy of our FIRM BROCHURE (Form ADV, Part 2) is always available upon request.

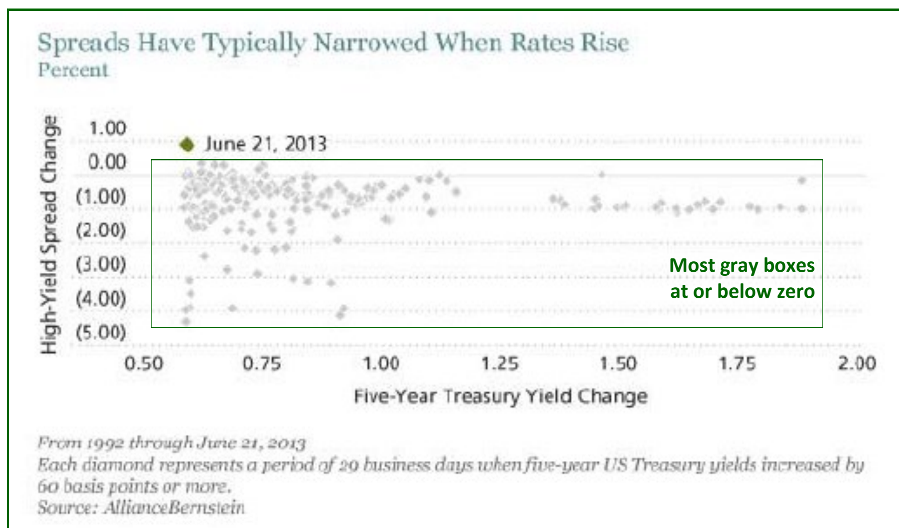
An important note: Where reference is made in VIEW to Beacon's relative performance, or individual mutual fund performance, it applies to fully invested portfolios for the period. Actual results vary among clients, as risk tolerance levels and the timing of asset purchases & sales are unique to each of our clients. Each client's unique results are revealed in the performance reports inside their Investment Review. Clients are urged to compare the custodians (Schwab Institutional et al) account statements with Beacons reports.

"In regard to politics, I have always liked Lily Tomlin's line, in paraphrase:
'I try to be cynical, but I just can't keep up.'
Having been in Washington D.C. now for almost 11 years, I feel that way quite a bit."

- Ben Bernanke at Princeton University's June 2 commencement

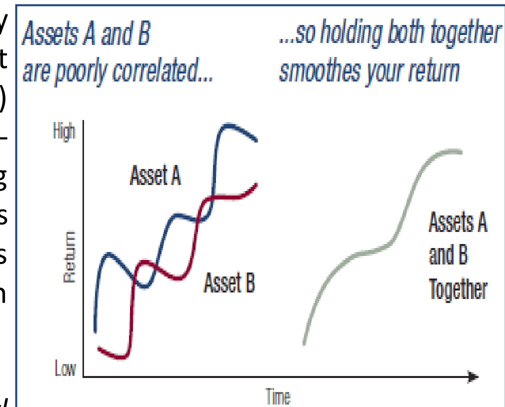
Who knew Federal Reserve Chairman Ben Bernanke was such a funny guy? Apparently, according to media reports, those attending Princeton's 266th Baccalaureate ceremony thought so. Among Mr. Bernanke's "10 suggestions" to students was: *"Call your mom and dad once in a while. A time will come when you want your own grown-up, busy, hyper-successful children to call you. Also, remember who paid your tuition to Princeton."*

The soon-to-be-former FED Chairman may have a future in stand-up at university campuses after his gig at the FED, but it won't be because the bond market likes his recent routine. In mid-May Mr. Bernanke *merely* made comments about *one day* tapering the FED's bond-purchasing program (i.e. Quantitative Easing or QE), and many bond owners ran for the hills and pushed interest rates higher (see p. 5 Bond returns). In **Beacon's** 2013 Q1 VIEW, we featured how bond prices move opposite interest rates. Yield spreads—the extra return for owning bonds *other than* "safe" US Treasuries—normally move opposite interest rates. When rates have risen, spreads narrow and credits* outperform Treasuries (generic name for all non-Treasury bonds like those from corporations). To illustrate, AllianceBernstein constructed the chart to the right showing the many instances since 1992 when, in one-month periods, the yield on 5-year Treasuries rose by 60+ basis points (6/10th of 1%). All the gray boxes indicate the change in the yield spread. The vast majority of yield spreads are at or below zero, meaning yield spreads narrowed (declined). The *only time* spreads widened (increased) was the May 13-June 21 period (green diamond upper left) following Mr. Bernanke's comments. While the rise in interest rates pushed bond values lower, it left yield spreads for credits much more attractive. Another way of saying it is we think we'll recover those Q2 losses back sooner or later.



Beacon's Approach to Risk Management & Discussing the Long/Short Equity Strategy

In **Beacon's** SEC regulatory filing Form ADV, we expanded on our view of how to manage investment risk for you our clients. On pages 17-18 of the ADV we discussed the 3rd of three dimensions of asset allocation (i.e. diversification)—correlation—the degree to which assets in your portfolio move in concert with, or opposite of, each other. By selectively deploying and mixing weakly or poorly correlated, "risky" assets in a portfolio, the overall result to the entire portfolio can be something **"less risky"** (see chart on right). But there are times and events that try the patience of investors (we call them periods of "market stress") when diversification appears to fail—at least in the short run. The most recent period, the Great Recession of 2007-2009, witnessed a breakdown in which many investors panicked and a great "flight to safety" ensued. Selling everything that was remotely liquid, many investors sought the perceived safety in short-term US Treasuries. In times like this correlations rise dramatically and assets that are good diversifiers in normal times move down together. This happened in 2008 when all asset types except short-term US Treasury securities moved down in value. It was only in the aftermath from March 2009 on that asset values recovered fully.



Beacon is continuously researching ways to manage investment risk. Sometimes it involves introducing a *tactical* asset class into your portfolio like REITs, international bonds, or commodity-linked assets. Other times we introduce a new concept partner in an existing *strategic* asset class like US Large Cap stocks. This latter approach is our current focus. We are researching an approach that involves "short" stock positions along with "long" ones—the so-called Long/Short Equity Strategy also known as an absolute return strategy. Presently all of **Beacon's** stock fund partners are "long" only managers meaning positive investment returns result only from increases in stock prices. In contrast, a "short" stock position gains if the stock declines. This approach broadens the playing field for research-driven stock managers. As a balanced, global manager, **Beacon's** goal is reducing or smoothing investment risk especially during those times of "market stress" (see above).

In addition to researching long/short strategies generally, we are also looking into which approaches we believe are best suited to your portfolio. We want to make sure we hire a proven manager and/or management team because empirical research demonstrates clearly that successful long/short absolute return strategies require effective research and good tactical decision-making. For instance, it is feasible to use passive stock investing in "index" funds in a portfolio where there is little or no research. Lots of investors use funds that mimic non-investable indexes like the S&P 500 Index or the Barclays Aggregate Bond Index. However, to succeed with investing in stocks (long) and against stocks (short) at the same time requires a disciplined research approach.

What can you expect? If we decide to implement a long/short absolute return fund into your portfolio, as always we'll send you an *Investment ALERT*. ■

BEACON'S VIEW:

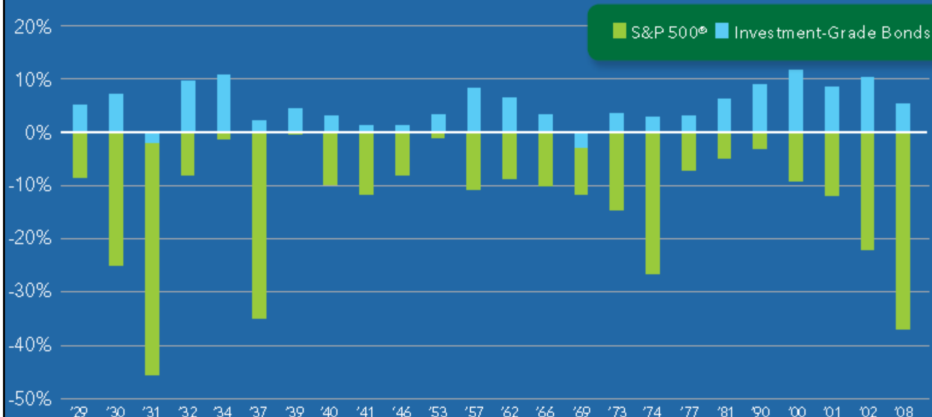
"We believe your greatest risk is exhausting your money before exhausting your time. While we cannot eliminate declines in the value of your total portfolio over short periods (volatility), we emphasize the long term benefits of diversification and steadfastness to your plan as the best ways to manage your greatest risk."

Our STOCK and BOND Fund Partners 2013 Q2

"Sell in May and go away" would not have worked in 2013 as **stocks** continued to advance. However, *"sell in June and avoid a swoon"* would have. The S&P 500 Index peaked all-time on May 21 before slumping nearly 6% by June 24. Despite that dip, however, the venerable index still advanced in Q2 by nearly 3%. Year-to-date stocks have enjoyed a splendid half-year advancing by double digits.

The "fly in the ointment" for portfolio returns in Q2 was **bonds** as interest rates continued their year-long rise. Negative returns in Q2 vanished slight gains in Q1 and resulted in mid-year losses for all types of bonds including US Treasuries, municipals, and credits. Roughly one year ago the 10-year Treasury yield was about 1.4% and as of this writing it is over 2.5% (see p. 1 for discussion of interest rates and yield spreads). What's driving interest rates higher? After all, the FED has not changed their 0% interest rate policy essentially retaining their "anchor" on the short end of the yield curve. We think the bond market is essentially asking what a "normal" yield curve looks like, and what interest rates will be when the FED (eventually) lessens its' role.

As **Beacon** devoted much of our Q1 VIEW to the relationship between interest rates and bond prices while underscoring the key role of bonds in a diversified portfolio (see chart below, Remember why you own bonds). We discussed that often when interest rates rise the backdrop is an improving economy. That appears to be the case now as FED Chairman Bernanke's comments about easing (or ending) it's bond-buying easing plan was in the context of a healthier economy. Going forward we think there remain attractive sectors in the bond market. But like a man with his head in the ice box and his feet in the oven (see Statistician joke below), that doesn't mean all bonds and all yield points will do well. Among all our bond managers, we continue to avoid the long end of the yield curve where interest rate risk is greatest. In the credit sectors, Dodge & Cox contends there remain attractive long-term opportunities in parts of the corporate bond industrials and financials sectors. They and MetWest also like parts of the mortgage-backed securities market as mortgage rates have risen and government policy (Obama Administration) is focused on increasing refinancing opportunities for borrowers.



The municipal bond sector had a rough two-month stretch, despite improving conditions at the state and local levels, as fears of rising interest rates drove selling of bond funds. AllianceBernstein thinks the higher interest rates will attract institutional money managers that are crossing over from taxable bonds to take advantage of the inexpensive values in the municipal market. AllianceBernstein and Fidelity are both constructive on select municipal bonds on both a relative and longer-term basis. With bonds, time tends to heal, because earning higher interest rates has historically overwhelmed price declines. We expect to recover those Q2 losses sooner or later. Plus, bonds are the *"anchor to windward"* for temperamental stocks, as the chart on the left reminds us all. ■

Statistician: a person with his head in an ice box and feet in an oven saying that on the **average** he feels fine.