Fagan Financial Report

Registered Investment Advisors

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Outlook 2013 1
Asset Alloc Considerations 2
What You Need To Know About The Deal To Avoid The Fiscal Cliff 3
Risks To Investors in 2013 4
Largest Holdings 5
Marketing & Disclosures 6

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OUTLOOK 2013

Within our concluding paragraph from our initial 2012 newsletter penned early last year we noted in bold that "in a nutshell, we currently believe calendar year 2012 will bring more of the same as 2011 in terms of volatility and 'Maalox Moments,' but with a bias to the upside. Furthermore, we believe if we are wrong it will be because this outlook will have been too conservative. There is a real potential for a recovery in the manufacturing sector as more companies are returning jobs to our shores, a recovery in the housing market for reasons noted above and an energy boom."

Our calendar year 2012 outlook did prove a bit too conservative as most major equity indices returned low to mid-teen profits to patient investors as the headlines were dominated by political events, namely the U.S. Presidential Election, the "Fiscal Cliff" and global geopolitical issues. That said, we do not profess to be market timers but rather strive to ascertain the direction of the stock and bond markets correctly and then let the rest take care of itself. During 2012, we did and it did!

Looking forward to calendar year 2013, for equities we foresee more of the same as we experienced during 2012 and 2011, respectively with a **slow grind upward**, interrupted from time-to-time by different real or perceived crises such as the upcoming debate over the U.S. Debt Ceiling and accompanying sequestration sometime during the latter part of the first quarter; the potential for trouble in the Middle East, most likely emanating from Iran; and the never-ending "is China slowing" question. Calendar year 2013 shapes up similarly to 2012, as what were once headwinds, namely the housing and labor markets, are now tailwinds. Couple this with surging domestic energy production and you have a recipe for bringing offshore jobs back to the United States.

This thought is compelling and for this reason **we perceive the energy sector as offering investors real value.**

Many investors in company sponsored defined contribution pension plans such as 401(k), 403(b) and NY State Deferred Compensation are overweighted in the international sector (globe, ex-U.S.). International funds were all the rage two to three years ago, sporting gaudy past performance numbers that enticed legions of retail investors. They have been downright laggards since mid-2008. With international investing out of favor**, the contrarian in us suggests that it makes sense to gradually increase allocations to quality overseas investments** on a dollar cost average basis through mutual funds, ETFs, foreign stocks and domestic companies that derive the majority of their revenue and income overseas.

On the fixed income side, we believe that the risk of being in longer-dated maturities outweighs the potential benefit. For approximately thirty years bond investors have experienced enhanced returns coming from declining interest rates along with their yield. Looking to the future, we believe that this boost will no longer exist, and may perhaps provide a headwind to total returns should **interest rates gradually rise, as we suspect they will.** In anticipation of the potential for this, during Q4 2012 we were net sellers of the Payden GNMA Fund and of fixed income funds in general, choosing to move either to investments that are less interest rates sensitive such as corporate and international bonds as well as high dividend yielding investments such as REITs and high dividend paying stocks/ETFs.

As always, we believe that developing and adhering to an investment strategy, consistency, perseverance and discipline will be a winning formula for 2013 and beyond, helping you achieve your financial goals and/or secure your objectives.

ASSET ALLOCATION CONSIDERATIONS

At Fagan Associates, we manage portfolios on an individual basis. That said, all portfolios initially fall within one of the three types outlined below. After an initial allocation and if need be, the Investment Advisor (IA) can further tailor how your money is invested by placing tighter restrictions on the percentages allocated to each asset class or perhaps by requiring a specific level of income either on a dollar basis or as a percentage of your portfolio. However at no time, will the IA knowingly stray from the signed Asset Allocation Models.

As a result of past client meetings, Fagan Associates, along with the client have agreed to a range of allowable percentages into which their investable assets must be allocated. The description of which is noted below.

THE GROWTH PORTFOLIO is designed for investors seeking capital appreciation with an investment time horizon of ten or more years. An investor into this portfolio is willing to accept the volatility inherent in equities and must overlook this volatility for the potential of greater gains that would have been made through an investment in either bonds or cash. After an initial period of up to twelve months to allow for dollar cost averaging, the portfolio will generally have a minimum of 75% of the total in equities with the balance in cash or a cash equivalent such as a money market. However, regardless of the parameters outlined within each model described below, Fagan Associates reserves the right, predicated upon advisor perceived market conditions; advisor perceived outlook for available investment opportunities; and/or tax ramifications of portfolio changes, to have an allocation to the asset classes described below that is less than the model dictates. The model that has been applied to your investment with Fagan Associates is noted either at the top or bottom of your year-ending portfolio statement. Please read the enclosed Portfolio Model allocation sheet and call immediately should you have any questions, concerns or need clarification regarding the allocation of your investment with Fagan Associates, Inc.

THE GROWTH & INCOME PORTFOLIO is designed for investors whose primary objective is capital appreciation with a secondary consideration for income. This secondary consideration is accomplished by an allocation of 25% to 50% of invested assets into fixed income instruments (bonds, cash & cash equivalents). The portfolio is designed for investors with an investment time horizon between five to ten years and/or investors that have a longer investment time horizon, but whose tolerance to risk is not aligned with this investment time horizon. After an initial period of up to twelve months to allow for dollar cost averaging, the portfolio will generally have a minimum of fifty percent of the account balance in the stock market and a maximum of seventy-five. However, regardless of the parameters outlined within each model described below, Fagan Associates reserves the right, predicated upon advisor perceived market conditions; advisor perceived outlook for available investment opportunities; and/or tax ramifications of portfolio changes, to have an allocation to the asset classes described below that is less than the model dictates. The model that has been applied to your investment with Fagan Associates is noted either at the top or bottom of your year-ending portfolio statement. Please read the enclosed Portfolio Model allocation sheet and call immediately should you have any questions, concerns or need clarification regarding the allocation of your investment with Fagan Associates, Inc.

THE INCOME PORTFOLIO is designed for investors whose primary objectives include income as well as a preservation of capital. The portfolio is designed for investors with an investment time horizon of less than five years or whose tolerance to risk reduces their appetite for equities. After an initial period of up to twelve months to allow for dollar cost averaging, this portfolio will have at least fifty percent of the total invested by Fagan Associates, Inc. in fixed income instruments, to include, bonds, cash and/or cash equivalents such as a money market. However, regardless of the parameters outlined within each model described below, Fagan Associates reserves the right, predicated upon advisor perceived market conditions; advisor perceived outlook for available investment opportunities; and/or tax ramifications of portfolio changes, to have an allocation to the asset classes described below that is less than the model dictates. The model that has been applied to your investment with Fagan Associates is noted either at the top or bottom of your year-ending portfolio statement. Please read the enclosed Portfolio Model allocation sheet and call immediately should you have any questions, concerns or need clarification regarding the allocation of your investment with Fagan Associates, Inc.

WHAT YOU NEED TO KNOW ABOUT THE DEAL TO AVOID THE FISCAL CLIFF

This past Tuesday, January first, near the figurative stroke of midnight, the House of Representatives passed a bill that was previously passed by the Senate, thereby averting a plunge over the proverbial fiscal cliff. What was the deal? How does it affect me? The details are provided below.

The part of the deal that will have the most immediate impact on the average American will be the expiration of the payroll tax holiday. Initially passed prior to the start of calendar year 2011 and extended through calendar year 2012, the payroll tax holiday was a reduction in the employee portion of Social Security from 6.2% to 4.2%. Therefore, given the expiration of this holiday, an individual earning $52,000 will experience an increase of $20 per week in taxes withheld to pay for Social Security.

In addition, the tax breaks enacted during 2009 aiming to benefit low-income Americans, namely the Earned Income Tax Credit, the Child Tax Credit, the American Opportunity Tax Credit and the College Tuition Tax Credit have been extended for five more years.

Many of the other changes put through as part of this "mini-deal" will impact higher wage earning Americans and Investors. As it pertains to the wage earner, income tax rates are set to rise for those earning $400,000 and filing individually and those earning $450,000 and filing jointly from a marginal rate of 35% to 39.6%. In addition to the higher tax rate, itemized deductions and exemptions for those higher-income filers will be reduced and in some cases eliminated, depending upon income.

For those with income levels above the $400,000 and $450,000 noted above, the rate of taxation on long-term capital gains and dividends will rise from 15% to 20%. In addition, to help pay for the newly legislated Patient Protection and Affordable Care Act (aka "Obamacare"), those individuals must also pay a 3.8% Medicare surtax on investment income. Finally, the rate of taxation on estates will increase form forty percent from thirty- five percent. However, the $5 million threshold remains intact.

What hasn't changed is our government's propensity to spend everything they have and then some as evidenced by the fact that this deal did not address the debt-ceiling, set to be reached later this month or early next month. According to Americans for Tax Reform, "in 1982, President Reagan was promised $3 in spending cuts for every $1 in tax hikes" and "in 1990, President George H.W. Bush agreed to $2 in spending cuts for every $1 in tax hikes." Although not any of the spending cuts were enacted, according to the Congressional Budget Office, this recent deal "cuts only $15 billion in spending while increasing tax revenues by $620 billion – a 41:1 ratio of tax increases to spending cuts."

Although a step in the right direction, this recent deal, one which we will assign a grade of C+, lacks the courage and leadership so necessary for these times, times where homes and businesses across the U.S. have been tightening their belts and are looking for their government to do the same. We agree with Former Senator Alan Simpson and Democrat Erskine Bowles, authors of a report hailed from both sides of the political aisle, detailing steps necessary to place the United States back on the path to financial health, who observed that "the deal approved today is truly a missed opportunity to do something big to reduce our long-term fiscal problems, but it is a small step forward in our efforts to reduce the federal deficit. Washington missed this magic moment to do something big to reduce the deficit, reform our tax code and fax our entitlement programs."

RISKS TO INVESTORS IN 2013

Historically, Americans are naturally an optimistic lot, usually choosing to see their glasses half-full rather than half-empty. However, sound investment practice requires one to continually evaluate what dangers lie-in-wait for their portfolios and proactively develop a strategy to deal with these potential pitfalls should they become a reality. With this in mind, we decided to list five potential roadblocks to your investment nirvana during calendar year 2013 and how different assets classes might react to one or more of these occurrences.

In our opinion, the ***number one*** risk investors are assuming is ***interest rate risk***, explained in Investopedia as "a major risk to all bondholders. As interest rates rise, bond prices fall and vice versa. The rationale is that as interest rates increase, the opportunity cost of holding a bond decreases since investors are able to realize greater yield by switching to other investments that reflect the higher interest rate." Keep in mind that interest rates are near fifty-year lows so that there is much risk in holding longer-dated bonds relative to the potential reward, keeping in mind what was noted immediately above that bond prices fall as interest rates rise. Bond prices have been rising almost in a straight line for over thirty years as interest rates have fallen. The risk is now that interest rates will rise and the value of your individual bond or bond mutual fund (including government bond funds) will fall.

The ***second*** risk that may negatively impact your portfolio during calendar year 2013 is one that we are becoming all too familiar with and that is ***political risk***, defined as the potential for wild short-term negative fluctuations in stock prices due to changes in the political structure of a country. Usually associated with emerging markets, we can broaden this loose definition to include the potential for wild short-term negative fluctuations in stock prices due to the unwillingness or incapability of our government to deal with the debt ceiling and on the back burner, entitlement programs. Though these are initially political rather than economic issues, at some point in time, unbeknownst to anyone, stock and bond investors may both suffer losses should we not begin to tackle these issues. That being said, historically these are short-term losses as a dropping stock market forces politicians to act.

The ***third*** risk we perceive that investors may be assuming is being ***underinvested in the stock market***. Historically, as a secular bear market wears on the psyche of the average individual, he/she has less faith that investing in the market is a prudent method of long-term wealth accumulation. This ultimately leads to an underweighting in stocks near the end of a bear market and an overweighting toward the end of a bull market. The U.S. stock market is in the thirteenth year of relative benign returns which over the past five years has been marked by unprecedented amounts of assets being withdrawn from stock funds. If history is any guide, these investors which are most likely going to bonds are doing so to their own detriment.

The ***fourth*** risk is ***an economic slowdown in China, the Far East and/or Europe***. Given the fact that we are entering the fourth year of a modest recovery, a slowdown in the global economy will weaken our exports and in turn, domestic demand. Given the fact that the U.S. Transport Average (trucks, rail and shipping) sits at or near record highs, this is not currently being factored into the market. However, keep an eye on these economies as like the United States, their recoveries are somewhat fragile.

The ***fifth*** and final risk is ***an escalation of tensions in the Middle East*** resulting in a spike in oil prices. Recognize that, every $10.00 rise in the per barrel cost of oil translates into an additional $30 billion in higher energy prices and reduces Gross Domestic Product by nearly 0.25%. Stocks would react inversely to substantially higher energy prices.

23 Years Serving the Investors of the Capital Region

Largest Holdings Regardless of Asset Class					
Ranked by Market Value as of December 31st, 2012.					
Percent of Total Assets Managed	***Company Name***	***Symbol***	***As of Dec 31st, 2012***	***As of Nov 30th, 2012***	***As of Oct 31st, 2012***
10.50%	Cash & Equivalents		1	1	1
4.61%	Payden GNMA Fund	PYGNX	2	2	2
3.63%	SPDR Dividend ETF	SDY	3	3	4
3.15%	Apple Computer	AAPL	4	4	3
2.87%	Loomis Sayles Bond Fund	LSBRX	5	5	5
2.71%	MetWest Tot Ret Bond Fund	MWTRX	6	6	6
2.33%	DoubleLineTotal Return	DLTNX	7	7	8
2.28%	PIMCO Total Return	PTTDX	8	8	7
2.11%	General Electric	GE	9	9	9
1.87%	MasterCard, Inc.	MA	10	10	10
1.83%	Nike, Inc.	NKE	11	12	13
1.82%	Conoco Phillips	COP	12	11	11
1.74%	PIMCO Diversified Income	PDVDX	13	16	15
1.70%	Ridgeworth High Income	STHTX	14	13	12
1.67%	Visa, Inc.	V	15	15	16
1.59%	Altria Group, Inc.	MO	16	14	17
1.56%	iShares Barclays TIP Bond	TIP	17	17	14
1.38%	Celgene Corporation	CELG	18	18	18
1.19%	JP Morgan Chase	JPM	19	20	19
1.15%	Google, Inc.	GOOG	20	19	20
1.05%	Exxon Mobil	XOM	21	21	21
0.99%	EMC Corporation	EMC	22	23	23
0.98%	Verizon Communications	VZ	23	22	22
0.95%	Permanent Portfolio	PRPFX	24	24	24
0.87%	Ebay, Inc.	EBAY	25	25	27
0.80%	Schwab 1000 Fund	SNXFX	31	26	25

Portfolio Concentration: Top 25 holdings represent 56.51% of the Assets Managed at Fagan Associates as of December 31st, 2012.

Largest Mutual Fund Holdings as of December 31st, 2012.		
Domestic Equity Funds	***International Equity Funds***	***Hybrid/Fixed Income/ Muni Fund/ETF***
Parnassus Equity Income Fund	Oakmark Global Select	Payden GNMA Fund
Schwab 1000 Fund	Harbor International Fund	Loomis Sayles Bond Fund
Dow Jones U.S. Broad Mkt Index	Tweedy Browne Global Value fund	MetWest Total Return Fund
Oakmark Fund	Vanguard International Growth	Double Line Total Return Fund
Scout MidCap Fund	TR Price International Stock Fund	PIMCO Diversified Income

DISCLOSURES AND MARKETING INFORMATION

The enclosed report is provided to you as a service. You also receive reports from the broker dealer, bank or other qualified custodian that holds and maintains your investment assets. You are urged to carefully review and compare official custodial records to the account statements or other reports that Fagan Associates provides. Fagan Associate's reports may vary from custodial statements based on accounting procedures, cost basis, reporting dates, or valuation methodologies of certain securities.

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Presentation is prepared by: **Fagan Associates, Inc.**

Portfolio Holdings: The specific stocks named in this presentation are examples of the securities held in Fagan client portfolios and may not be representative of current or future investments of those portfolios. You should not assume that investments in the securities identified were or will be profitable. We will furnish, upon your request, a list of all securities purchased, sold or held in the portfolios during the 12 months preceding the date of this presentation.

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•"The Record Review" – an outline of our column that appears in the Troy Record every Sunday.

• "Widely Helds" – a look at the price action and news releases from the most widely held stocks.

•A spotlight on one or some of our **mutual fund holdings or EFT holdings.**

•A look at the upcoming week, including economic data and earnings reports.

•Monthly notable changes to our investment portfolios after the close of the prior month.

* Periodic interviews with other industry professionals, including mutual fund managers, insurance professionals, accountants & attorneys.

* Periodic interviews with local men and woman making news that affects our lives.

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