Fagan Financial Report

Registered Investment Advisors

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OUTLOOK 2014

For calendar year 2013, the stock market as represented by the Standard & Poor's 500 experienced its best year since 1997 and its sixth best year since 1950 by rising 29.60%, excluding dividends. While conducting this research we also looked at what happens during the subsequent quarter and year following gains of more than twenty percent in the S&P500. Of the eighteen such periods, stocks declined during only four periods during the following quarter with the worst performance being a negative 6.50% in Q1 2068. Furthermore, of the eighteen such periods, stocks declined only three times during the following year with the worst performance being a negative 11.81% during 1962. Therefore, if history is any guide, the stock market has a 77.78% chance of rising during Q1 and 83.33% chance of rising for all of calendar year 2014. Both numbers are above the long-term averages of 62.50% and 75.00%, respectively. Our belief is that the momentum of the stock market is a reflection of the underlying economy. This is also evidenced by the fact that there have been 16 times over the prior 64 years when stocks fell over a calendar year. When this occurs the stock market has fallen during the following quarter 8 times or 50.00% of the total possibilities. Over the following year stocks fell just three times, but by an average of 22.04%.

It is with the above in mind as well as our belief that the U.S. economy is moving forward at a modest pace that we project an upward bias to both equity prices and bond yields for all of calendar year 2014.

Stocks advance during 2014, but for obvious reasons not nearly as much as 2013. We are thinking somewhere in the order of high single digits, including dividends. Although valuations are somewhat rich given the tepid revenue growth, corporate earnings are on sound footing and with the economy picking up, the aforementioned revenue growth may surprise to the upside. Many are predicting that 2014 will be a stock pickers market. We agree to a certain extent, but would not abandon broad equity exposure in order to maintain a certain degree of correlation to the overall market.

For calendar year 2013, the Vanguard Total Bond Market Index Fund (VBMFX) fell 2.26%, the first decline for this fund since 1999 when it fell 0.76% on a total return basis. We believe that for calendar year 2014 bonds will once again underperform equities and cash but not nearly as dramatically as 2013. We are thinking somewhere around a loss of 1.00% on a total return basis and are recommending short- to intermediate-term corporate bonds as well as issues that contain some credit risk for a portion of your fixed income portfolio. Once again, maintain diversification with some government and agency bonds/funds, but in this environment, less than you might on an historical basis.

Early in 2014, we believe Washington will repair some of the wounds they inflicted on themselves and upon America as they negotiate a budget and a deal on the debt ceiling. However, those wounds will reopen later this year in the form of the mid-term elections. The result may lead to a pullback in stocks during the summer months.

We abhor making long term predictions and believe that portfolios should evolve with the objectives and needs of the client and in accordance with the environment in which we find ourselves. The longer we look out the more variables are introduced which reduces the effectiveness and conviction of that projection. That said, we believe that if we get the general direction of a move correct, the magnitude of that move will take care of itself. For calendar year 2014 we believe that the direction of stocks is somewhat higher with interest rates following the same course. We also believe that 2014 will be a much choppier year than 2013 resulting in some periods of uneasiness. At the current time we believe that this uneasiness will ultimately be proven unwarranted.

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-percent. 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.

<u>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 call immediately should you have any questions, concerns or need clarification regarding the allocation of your investment with Fagan Associates, Inc.</u>

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WHOLESALE PORTFOLIO CHANGES USUALLY A MISTAKE

An interview with Gary Ran from Telemus Capital Parntners appeared some time ago in Barron's, a popular financial weekly, who noted that during market turmoil it was "hard for investors to stay focused in times like this, just when you need it the most, because there seems to be so much information But information isn't knowledge."

Do you mean that all the information that is thrown at us over the internet doesn't amount to the knowledge necessary to manage our own portfolios? In our opinion, if it is combined with the appropriate educational background, knowledge of how businesses operate, an ability to decipher financial data and the jargon that does along with it, a temperament that is conducive to dealing with turmoil and experience, it certainly does. Otherwise, it may not.   The problem arises when an investor discovers that they do not have one or more of these qualities only after it is too late.

For example, let's say that after coming home from work the day of the "Flash Crash" on August 23, 2011, you turned on your computer and logged on to the internet to check out how the stock market did that day. You would have discovered that the Standard & Poor's 500, the most widely followed stock index, had rebounded nearly 40 points, but over the past month it had declined from 1,345 to that closing day value of 1,162 for a decline of 13.60%, a drop that resulted in a loss of $34,000 on your portfolio of $250,000.

What do you do? Perhaps you look for some perspective from a trusted source, CNBC and log onto their website. You scroll down to an article entitled "It's 'Only Just Begun,' S&P Fair Value 800-900: Analyst." You read on and discover that Bob Janjuah, co-head of cross-asset allocation strategy at Nomura Securities, stated in a research note that the bear market "process has only just begun. It will not be a straight line down, but the secular (bearish) trend for risk assets is, to me, now clear and, with hindsight, this bear leg began in Q2 2011."

Furthermore, Mr. Janjuah notes that "in this world, and using the S&P 500 purely as a risk proxy, I see 'fair value' for the S&P down in the 800/900 area. I think we will see these levels trade in the next 12/15 months. And we may even undershoot to levels last seen at the lows of Q1 2009."

You quickly do a mental calculation and conclude that this implies another 22.00% decline at best and nearly 43.00% at worst. After picking yourself up off the floor, you immediately call your advisor and sell everything.

Was that the right action to take? Forget about whether or not it has been profitable (and as of this past Friday it has not), was it the correct move? In our opinion the answer is no. It is not the timing of the stock market but rather the time in the market that has historically resulted in investors reaching their goals.

In addition, generally speaking, many investors tend to focus too much on the day-to-day fluctuations in the stock market and not enough on their goals and objectives. Finally, some investors mistakenly make "all or nothing" moves. They are either "all in or all out" depending upon the latest news report, earnings hit or miss, political event or analyst comment. Our recommendation when it comes to investing is similar to life, everything in moderation. Work at the margins. If you are feeling a little skittish about the direction of stocks, raise a little cash. If you are feeling bullish about the direction of stocks, then put some of that cash to work.

EMAIL ADDRESS

In order to communicate more efficiently with all of our clients, we are updating our list of the email addresses.

Please email Mary at mary.schongar@faganassociates.com so that she is able to update your file.

WHY *NOT* TO CONVERT TO A ROTH IRA

It is more often that you hear or read of reasons to convert from a Traditional IRA to a Roth IRA than you hear or read of reasons not to convert. Given the fact that this column pertains to the latter, we will only briefly note the reasons to convert. These include the potential for rising personal income tax rates, tax free withdrawals after five years from a Roth and no mandatory distributions. That said, there are several reasons why one should not convert from a Traditional to a Roth IRA.

First and foremost, a bird in the hand is worth two in the bush. When you convert from a Traditional to a Roth IRA, you must pay the tax on the conversion immediately. This has two negative consequences, the first being that you are paying those taxes from retirement savings thereby reducing those savings and secondly that the tax money is now in the pocket of the Internal Revenue Service rather than continuing to work for you.

One must also keep in mind that the dollar amount that is converted is added to your current income and taxed as ordinary income, which for most of us is at a federal rate of 28%. This added income may push you into a higher tax bracket or cause your Social Security Benefits to become taxable, if you are currently collecting.

Another reason not to convert is that for many of us, our tax bracket during retirement may be lower than our tax bracket while working. If you convert during your higher income earning years, you will most likely lose 28% to the IRS. However, there is a fair chance that in retirement you may be in a lower tax bracket, perhaps 15%. Therefore, why pay 28% now when you can pay 15% later?

Current law states that an individual may begin to withdraw from your Traditional IRA without penalty after you turn age 59½, but that you must begin to make withdrawals on or before April 15 following the year the individual turns 70½. For some of our clients, we are able to make calculated withdrawals between these dates in such an amount that will keep the client in a low tax bracket. This is another reason not to convert while you are in a high income tax bracket.

We like to turn the tables on those that recommend conversion due to the fact that with Federal and State budget deficits at alarmingly high levels, higher personal income tax rates are a fait accompli. Although we do believe that marginal rates will rise, we do not consider it a done deal nor do we believe that they will rise substantially for the middle class.

With the tidal wave of baby boomers set to retire and thus set to begin to live on their savings, pensions and Social Security, we believe the Federal Government through the IRS will begin to explore different methods of taxation as a supplement to the personal income tax. These alternatives include a flat tax, a value added tax (VAT), consumption tax or a national sales tax. This may result in personal income tax rates remaining at or near where they are now with the added revenue coming one or more of these four sources noted immediately above.

Finally, although somewhat remote and given the wave of baby boomers nearing retirement, we would not be surprised should the government eventually tax distributions from Roth IRAs should the income or assets of the taxpayer exceed a certain level, a la Social Security. “Somewhat” remote, but not that unlikely. Think about it.

THE BOTTOM LINE – Think twice prior to converting from a Traditional to a Roth IRA. As noted above, a bird in the hand is worth two in the bush. Why pay taxes now when you can pay them later.

Largest Holdings Regardless of Asset Class
Ranked by Market Value as of December 31st, 2013.

Percent of Total Assets Managed	Company Name	Symbol	As of Dec 31, 2013	As of Nov 30, 2013	As of Oct 31, 2013
11.42%	Cash & Equivalents		1	1	1
2.86%	SPDR Dividend ETF	SDY	2	2	2
2.74%	Loomis Sayles Bond Fund	LSBRX	3	3	3
2.44%	Celgene Corporation	CELG	4	6	8
2.44%	General Electric	GE	5	7	7
2.33%	MetWest Tot Ret Bond Fund	MWTRX	6	8	6
2.30%	DoubleLineTotal Return	DLTNX	7	4	4
2.09%	MasterCard, Inc.	MA	8	12	11
2.07%	Gilead Sciences, Inc.	GILD	9	10	10
2.06%	Apple Computer	AAPL	10	12	12
2.10%	Conoco Phillips	COP	11	9	9
1.87%	Nike, Inc.	NKE	12	13	13
2.46%	PIMCO Diversified Income	PDVDX	13	5	5
1.67%	Visa, Inc.	V	14	14	14
1.56%	Google, Inc.	GOOG	15	16	16
1.64%	RidgeWorth Flt Rate	SAMBX	16	17	17
1.56%	Ridgeworth High Income	STHTX	17	15	15
1.45%	JP Morgan Chase	JPM	18	19	20
1.29%	Altria Group, Inc.	MO	19	20	19
1.22%	Hartford Financial Services	HIG	20	21	21
1.11%	Harley Davidson	HOG	21	24	29
1.03%	Bank of America	BAC	22	23	25
1.01%	Ford Motor Company	F	23	22	22
0.96%	Exxon Mobil	XOM	24	27	26
0.94%	Hertz Global Hldgs	HTZ	25	31	33
0.93%	Parnassus Eq-Inc Fund	PRBLX	26	25	24
0.86%	PIMCO Unconstrained Bd Fd	PUBDX	29	26	23
0.11%	PIMCO Total Return	PTTDX	120	18	18

Portfolio Concentration: Top 25 holdings represent 54.15% of the Assets Managed at Fagan Associates as of December 31st, 2013.

Largest Mutual Fund Holdings as of December 31st, 2013

Domestic Equity Funds	International Equity Funds	Balance/Fixed Income/ Muni Fund/ETF
Parnassus Equity Income Fund	Oakmark Global Select	Loomis Sayles Bond Fund
Schwab 1000 Fund	Harbor International Fund	MetWest Total Return Fund
Dow Jones U.S. Broad Mkt Index	Oakmark International	Double Line Total Return Fund
Oakmark Fund	Tweedy Browne Global Value	PIMCO Diversified Income Fund
Scout MidCap Fund	Templeton Foreign	Ridgeworth Floating Rate Fund

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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Additional information including management fees and expenses is provided on our Form ADV Part 2. The actual return and value of an account fluctuate and, at any time, the account may be worth more or less than the amount invested. Bond Investments are affected by interest rate changes and the credit-worthiness of the issues held in the portfolio. A rise in interest rates will cause a decrease in the value of fixed income positions. **Past performance results are not indicative of future results.**

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.

The RECORD Read the Fagan Financial Report every week in The Sunday Record