Fagan Financial Report

Registered Investment Advisors

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PREPARING FOR THE FOURTH QUARTER

Despite the outlook of many at the close of the second quarter, the just-ended third quarter was a very profitable one for equity investors. For the quarter the Dow Jones Industrial Average rose 4.32% while the S&P 500 rose 5.76%, respectively. For the year, the Dow has risen 9.98% while the S&P 500 is up 14.56%. But that's behind investors. What lies ahead during the fourth quarter are many issues and events which will impact your portfolio. Here's a partial list of what we are watching for and what steps we may take in an effort to profit from or protect the client accounts.

We'll keep a close eye on the Presidential Election. Should President Obama be re-elected, he has vowed to let the Bush-era tax cuts expire while negotiating a new tax package with Republicans. If the past several years are any indication, this process of negotiation may take awhile. With this in mind, be aware that Long-Term Capital Gains Tax Rates, investments held more than one year, for those currently in the 15% tax bracket will move from 0% to 10% while all those in higher brackets will see their capital gains tax rate increase from 15% to 20%. Furthermore, regarding the rate of taxation rate on ordinary dividends, they will be taxed as ordinary income with rates ranging from 0% to 39.6%. Currently, the maximum rate on dividends is capped at 15%.

Another reason to keep an eye on the Presidential Election is in regard to health care. Recently, Darden Restaurants, the world's largest casual dining company (Olive Garden, Red Lobster, Smokey Bones) announced that it was experimenting with limiting the hours of some of its workers in an effort to avoid health care requirements under a provision of the Affordable Care Act which stipulates that large companies must offer health care to employees who work thirty or more hours per week. If they do not, they could be subject to a fine of up to $3,000 per employee. We are looking for intended as well as unintended consequences of an Obama victory this November as well as a Romney victory on the investments we have for our clients.

We'll keep an eye on interest rates. Pundits have been calling for the death of the bull market in bonds for several years. However, bond yields continue to decline to multi-decade low levels helping to push bond prices toward record highs. That said, at some point in time bond yields will reverse on a more sustainable basis causing some pain for bond investors. That said, keep in mind that "a bear market in bonds is like a day at the beach compared to a bear market in stocks" and quite often proper asset allocation requires purchases in the fixed income (bond) market. As a point of reference, through the end of September, our largest five fixed income mutual funds, the Payden GNMA Fund, Loomis Sayles Bond Fund, MetWest Total Return Fund, PIMCO Total Return Fund and the DoubleLine Total Return Fund have risen by 3.98%,11.45%, 9.77%, 8.86%, and by 8.12%, respectively. So, we've got a bit of a cushion.

Finally, and move obviously, **we'll keep both eyes keenly focused on the direction of the stock market.** Many investors are severely underweighted in stocks placing pressure on them to get in on pullbacks. This is potentially offset by those investors that are trying to lock in solid calendar year 2012 profits. Most likely this will end in a draw.

ROWING WITH ONE OAR

In an aggressive, unprecedented move by the Federal Reserve recently, the Federal Open Market Committee (FOMC), the body that determines Monetary Policy, has decided to begin to purchase mortgage-backed securities, at a pace of $40 billion per month, this in an attempt to lower what are already multi-decade low interest rates for homebuyers. Pertinent excerpts from the September 13 Federal Reserve Press Release, along with our interpretation *in italics*, where necessary, follows.

"Consistent with its statutory mandate, the Committee seeks to foster maximum employment and price stability. The Committee is concerned that, without further policy accommodation, economic growth might not be strong enough to generate sustained improvement in labor market conditions. Furthermore, strains in global financial markets continue to pose significant downside risks to the economic outlook." *The Fed is very worried that our economy is at or close to stall speed and that global economic headwinds, emanating notably from Europe and China may push the U.S. into recession.*

"The Committee agreed today to increase policy accommodation by purchasing additional mortgage-backed securities at a pace of $40 billion per month. The Committee also will continue through the end of the year its program to extend the average maturity of its holdings of securities as announced in June (Operation Twist)….These actions, which together will increase the Committee's holdings of longer-term securities by about $85 billion each month through the end of the year, should put downward pressure on longer-term interest rates, support mortgage markets, and help to make broader financial conditions more accommodative." *These moves, the ultimate in trickle policy accommodation, will hopefully lower borrowing costs for homeowners, thereby placing more cash in the hands of the middle class."*

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"To support continued progress toward maximum employment and price stability, the Committee expects that a highly accommodative stance of monetary policy will remain appropriate for a considerable time after the economic recovery strengthens. In particular, the Committee also decided today to keep the target range for the federal funds rate at 0 to ¼ percent and currently anticipates that exceptionally low levels for the federal funds rate are likely to be warranted at least through mid-2015." *The FOMC has extended its stated term for "exceptionally low levels" from the end of calendar year 2013 through mid-2015. Bondholders beware. This is reflationary and then ultimately, inflationary.*

Now on to the reason for the title of this column – Since the early stages of the fiscal crisis during 2008, the Open Market Committee of the Federal Reserve has been proactive in dealing with the subsequent economic slowdown, namely lowering interest rates to near zero-percent as well as purchasing more than $2 trillion in U.S. Treasury securities and mortgage-backed securities in an effort to drive down interest rates for borrowers. This rower, in an effort to help the economy recover, has done yeoman's work in setting monetary policy. However, monetary policy is only one side of the equation. Fiscal policy, the other, the implementation and adjustment made by government in terms of spending and tax policy, has been severely lacking. As noted immediately above, this, the job of Congress and the Obama Administration, for whatever reason, has been non-existent. We agree with Kevin Warsh, Former Federal Reserve Governor, who "worries a lot about the Federal Reserve trying to compensate for the failure of other policies."

Until Americans get an effective effort on fiscal policy from Congress as well as the President's Administration, the economy will not recover on a sustainable basis for the middle class. However, stocks will most likely continue to do well as the Federal Reserve does its' part to inflate our way out of the recent economic malaise.

A MULTITUDE OF REASONS *NOT* TO INVEST

While reviewing some of the information we received illustrating the power of investing on a regular basis over a long period of time, we came across some data from GE Asset Management, entitled "86 Possible Reasons Why Investors May Have Avoided The Stock Market." This data is sourced from "The History Channel" and specifies one news topic that made headlines during each calendar year beginning in 1926 and ending in 2011 that may have made you to alter the way you invest or perhaps caused you to stop investing all together. We then coupled this data with the closing value of the Dow Jones Industrial Average for the prior year. Rather than provide you with data from each and every year, we picked the most recent one outlined on the report, 2011 and work back with all calendar years that end in the number one. The results follow.

Calendar Year 2011 – "Europe's Sovereign Debt Crisis." The Dow Jones Industrial Average began 2011 at 11,577.51 and, as of the market close this past Wednesday, closed at 13,175.64 for a total gain of 13.80% over this period.

Calendar Year 2001 – "World Trade Center / Pentagon Terrorist Attacks." The Dow Jones Industrial Average (DJIA) began 2001 at 10,786.85 and, due to the severity of the attacks on 9-11 as well as the ensuing damage to the psyche and economy of the United States, ended that year at 10,021.50 for a loss of 7.09%. Please note that today, stocks remain well above those levels.

Calendar Year 1991 – "Global Recession." We might add that this global recession was caused in great part, due to Gulf War I in response to the invasion of Kuwait by Iraq during 1990 that resulted in a spike in energy prices. The DJIA began 1991 at 2,633.66 and closed that year at 3,168.83 for a gain of 20.32%.

Calendar Year 1981 – "Interest Rates Remained Elevated." This was the year that steps taken by then Chairman of the Federal Reserve Paul Volcker, beginning in 1979 that limited growth in money supply, began to have an impact on high interest rates which, over the short term, ushered in a brief, but steep recession and which, over the long-term the bull market for stocks that ended during early 2000 and for bonds, which remains intact to this day. The DJIA opened this year at 824.57, but closed ten years later at 2,633.66 for a total gain of 219.40%.

Calendar Year 1971 – "Wage-Price Freeze." In order to stem the rising tide of inflation, a battle that would take ten years to win, President Richard Nixon imposed a freeze on wages and prices during 1971. The DJIA began 1971 at 838.92 and ended that decade at 824.57, for a negligible loss of 1.71%, a lost decade. However, this lost decade was the predecessor to the great bull market of the 1980s and 1990s. What will the lost decade of the 2000s ultimately bring?

Calendar Year 1961 – "Berlin Wall Built." What could be a more frightful headline? Americans were in the throes of the Cold War. Remember "duck and cover." Remember bomb shelters. The DJIA closed 1960 at 615.80 and despite this was well as the Assassination of President John F. Kennedy, the race riots and the escalation of the Vietnam War, closed that tumultuous time at 839.92 on December 31, 1970 for a gain of 36.39%, not too shabby.

Calendar Year 1951 – "Excess Income and Profits Tax." How anti-growth (perhaps the current Administration should take heed) as Congress passed legislation adding a 5% tax to corporate tax rates as well an excise tax on alcohol, tobacco, gasoline and automobiles. The Dow opened this year at 239.92, closing ten years later 156.66% higher at 615.80.

Calendar Year 1941 – "Japanese Attack Pearl Harbor." How frightening. We tend to think of historical events in the context of how information is disseminated today. However, during the early 1940's, very few Americans had televisions and telephones. Obviously there was no internet. The threat to our mainland was perceived as real and perhaps imminent. That said, the DJIA opened up 1941 at 130.57 and closed ten years later at 239.92, for nearly a double. As an aside, the Dow closed December 6, 1941 at 116.60 and closed at or above that level every year since.

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Calendar Year 1931 – "Unemployment Rate Soars / U.S. Banks Collapse." In hindsight, probably the headline that is the most related to the economy and the returns of the Dow Jones Industrial Average reflects this, opening the year at 244.20 and subsequently falling by 83.13% to 41.22 on July 8, 1932. Moreover, the Dow only recovered to 130.57 by the end of 1940. In fact, it took nearly twenty years for the Dow to substantially exceed that 1930 high.

THE BOTTOM LINE – The point of this exercise is to illustrate the historical fact that there is always a seemingly valid reason why not to invest and why "it's different this time." Although perhaps it may be different this time, it is likely that it is not. Pessimists will draw a parallel between the current market environment and that of the Great Depression. However, if you wish to "build this Ark," do so with only a relatively small (less than 25%) of your portfolio. Any more would come with other risks.

NEW RETIREMENT GUIDELINES ISSUED BY FIDELITY INVESTMENTS

In an effort to keep or perhaps get their more than twelve million 401(k) accountholders on course for a financially secure retirement, Fidelity Investments, the nation's largest administrator of such plans, has issued new updated guidelines.

The guidelines suggest that to stay on pace, an individual must have saved at least their annual salary by the age of thirty-five, twice their annual salary by forty, four times their annual salary by age fifty, six times by sixty and eight times by their full retirement age as determined by Social Security, age sixty-seven. That means that an individual earning $75,000 per year would need to have $300,000 saved by age fifty to be on track, $450,000 by age sixty and $600,000 at age sixty-seven.

(It is ironic that these new guidelines were issued days prior to release of data from the U.S. Census Bureau that median household income in the State of New York fell by 1.4% between 2008 and 2011 while property taxes rose 18%. Trying to save when this divergence exists is nearly impossible. But we digress.)

Achieving a level of eight times your salary by age sixty-seven would allow one to retire with roughly 85% of their pre-retirement income during retirement. This also takes into consideration Social Security monthly benefits. In addition the new guidelines assume a lifetime average annual return of 5.5% and a 1.5% per year growth rate in the income of the individual over the rate of inflation.

According to Beth McHugh, Vice-President at Fidelity, "we constantly are asked by participants, 'How do I know if I'm on track and what do I set as a target to ensure that I will have sufficient income in retirement?'"
The eight times guideline assumes that a worker contribute into a 401(k), 403(b) or other retirement plan at a rate of 6% of salary during the first year of employment and then raising that amount by 1% each year until reaching an annual rate of 12%, from ages 25 to 67 and then living until age 92. In addition, the guidelines assume a matching 3% employer contribution.

Due to circumstances in and beyond their control, not the least of which are noted in the parentheses bracketed paragraph above, unfortunately the vast majority of Americans have not been saving an adequate amount to prepare for retirement. Many have fallen prey to pay myself later and save what is left rather than to commit to saving and spending what is left. Also, many have failed to plan for retirement or are not aware that defined benefit plans are a thing of the past. Despite the above the best advice we can provide is to start now.

James M. MacDonald, President of Workplace Investing for Fidelity Investments, noted that "the two factors that have the greatest impact on retirement savings over time are **starting early and saving consistently."** We couldn't agree more.

Largest Holdings Regardless of Asset Class Ranked by Market Value as of September 30th, 2012.					
Percent of Total Assets Managed	***Company Name***	***Symbol***	***As of Sept 30th, 2012***	***As of Aug 31st, 2012***	***As of July 31st,2012***
10.33%	Cash & Equivalents		1	1	1
5.22%	Payden GNMA Fund	PYGNX	2	2	2
4.22%	Apple Computer	AAPL	3	3	3
3.59%	SPDR Dividend ETF	SDY	4	4	4
2.79%	Loomis Sayles Bond Fund	LSBRX	5	5	5
2.44%	MetWest Tot Ret Bond Fund	MWTRX	6	7	7
2.24%	PIMCO Total Return	PTTDX	7	6	6
2.16%	DoubleLineTotal Return	DLTNX	8	8	8
2.05%	General Electric	GE	9	10	11
1.76%	MasterCard, Inc.	MA	10	11	10
1.75%	Conoco Phillips	COP	11	12	13
1.71%	Nike, Inc.	NKE	12	9	9
1.59%	Ridgeworth High Income	STHTX	13	16	17
1.57%	iShares Barclays TIP Bond	TIP	14	13	12
1.53%	Altria Group, Inc.	MO	15	14	14
1.48%	Visa, Inc.	V	16	15	15
1.34%	Celgene Corporation	CELG	17	17	18
1.31%	PIMCO Diversified Income	PDVDX	18	21	36
1.22%	Google, Inc.	GOOG	19	19	20
1.09%	JP Morgan Chase	JPM	20	22	21
1.08%	Exxon Mobil	XOM	21	20	19
1.06%	EMC Corporation	EMC	22	24	22
0.98%	Verizon Communications	VZ	23	25	26
0.93%	Permanent Portfolio	PRPFX	24	27	25
0.92%	McDonald's Corp.	MCD	25	26	24
0.92%	Schwab 1000 Fund	SNXFX	26	23	23
0.36%	Intel Corporation	INTC	53	18	16

Portfolio Concentration: Top 25 holdings represent 56.36% of the Assets Managed at Fagan Associates as of September 30th, 2012.

Largest Mutual Fund Holdings as of September 30th, 2012.		
Domestic Equity Funds	***International Equity Funds***	***Hybrid/Fixed Income/ Muni Fund/ETF***
Schwab 1000 Fund	Oakmark Global Select	Payden GNMA Fund
Parnassus Equity Income Fund	Harbor International Fund	Loomis Sayles Bond Fund
Baron Asset Fund	Tweedy Browne Global Value	MetWest Total Return Fund
Dow Jones Broad Market Index	Vanguard International Growth	PIMCO Total Return Fund
Oakmark Fund	Harding Loevner Emerging Markets	Double Line Total Return Fund

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• "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.

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