The Lam Group

Investment Management

Patience and the benefits of diversification enhanced our portfolio in the third quarter. While the asset classes that contributed to portfolio performance were narrowly concentrated in large and small US stocks in the first half of 2013, the second half of 2013 has begun with a broader array of asset classes contributing to aggregate portfolio performance. In 3Q 2013, the developed international equity markets led the way (large cap +11.56% and small cap +15.56%) with emerging markets showing possible signs of the early stages of a recovery (equity +5.77% and debt +1.19%).

Much of the fuel for this more broadly-based market rally came from market participants becoming less certain the Federal Reserve will taper its bond buying program, and that the inevitability of rising US interest rates (and the strengthening of the US dollar) may be less immediate. While medium-to-long-term US interest rates are in fact about 100bps (1%) higher than earlier this year, the majority of the world's equity markets have surged beyond expectations. Our small cap and value-oriented exposures have done particularly well 2013 YTD.

Table 1: Periodic Asset Class Returns as of 9/30/13

EQUITY ASSET CLASSES	3Q 2013	YTD	1 Year	3 Years*	5 Years*	10 Years*	10 Years
S&P 500 Index - Domestic Large Cap Stocks	+ 5.24%	+19.79%	+19.34%	+16.27%	+10.02%	+ 7.57%	+107.37%
Russell 2000 Index - Domestic Small Cap Stocks	+10.21%	+27.69%	+30.06%	+18.29%	+11.15%	+ 9.64%	+151.03%
MSCI EAFE Index - International Large Cap Stocks	+11.56%	+16.14%	+23.77%	+ 8.47%	+ 6.35%	+ 8.01%	+116.07%
MSCI EAFE SC Index - International Small Cap Stocks	+15.52%	+22.09%	+29.43%	+11.25%	+11.43%	+10.29%	+166.34%
MSCI EM Index - Emerging Markets Stocks	+ 5.77%	- 4.35%	+ 0.98%	- 0.33%	+ 7.22%	+12.80%	+233.48%
DJ US Select REIT Index - Domestic Real Estate	- 3.15%	+ 2.33%	+ 4.70%	+12.09%	+ 5.30%	+ 9.29%	+143.11%
S&P Global (ex-US) REIT Index – International Real Estate	+ 4.98%	+ 3.40%	+ 9.81%	+ 9.87%	+ 6.65%	+ 8.44 %	+124.89%
FIXED INCOME ASSET CLASSES	**3Q 2013**	**YTD**	**1 Year**	**3 Years***	**5 Years***	**10 Years***	**10 Years**
BarCap Aggregate Bond Index - US High-Grade Bonds	+ 0.57%	- 1.89%	- 1.68%	+ 2.86%	+ 5.41%	+ 4.59%	+ 56.71%
BarCap High-Yield Bond Index	+ 2.28%	+ 3.73%	+ 7.14%	+ 9.19%	+13.53%	+ 8.86%	+133.68%
BarCap TIPS Index - US TIPS	+ 0.70%	- 6.74%	- 6.10%	+ 4.02%	+ 5.31%	+ 5.23%	+ 66.61%
DJ UBS Commodities Index - Commodities	+ 2.13%	- 8.56%	- 14.35%	- 3.16%	- 5.29%	+ 2.14%	+ 26.62%
Citigroup Non-$ World Govt Bond Index - Non-$ Bonds	+ 4.06%	- 3.37%	- 5.65%	+ 0.55%	+ 4.27%	+ 4.91%	+ 61.54%
JPM EMBI Global Diversified Bond Index - Emerging Markets Debt	+ 1.19%	- 6.67%	- 4.06%	+ 4.95%	+ 9.75%	+ 8.46%	+125.44%

Sources: Morningstar, JP Morgan, and Dimensional. * Annualized

Obviously, more broadly-based contributions from a variety of asset classes is welcome, however market volatility is ultimately unavoidable over the long-term. Geopolitical unrest (currently Syria) and unnecessary domestic disturbances (Federal Government shutdown/debt ceiling gridlock) are consistent sources of uncertainty and potential triggers for unexpected systematic risk. While it may seem like a distant memory, it was only 5 years ago when the bankruptcy of Lehman Brothers, the Federal takeover of Fannie/Freddie and other catastrophic events in the capital markets caused our financial system to experience the darkest days of our lifetimes.

Especially when markets are sending mixed signals, patience and a global and balanced mindset are essential. The surge in US stocks in the first half of 2013 left many asking why global diversification was necessary, yet the 3Q 2013 rally in developed international equity markets have provided a strong answer. The difficulties in the fixed income markets in 2013 may have investors questioning the need for portfolio balance, however, the importance of diversifying elements in a portfolio, especially when many equity markets are at record (nominal) levels (and correlations across markets are increasing), cannot be overemphasized.

With this in mind, investors must remember that just because a particular asset class has done well (or poorly) one year does not mean it will continue to do so in the next. With the dramatic volatility investors have experienced over the past 5 years, it is essential not to fall in love (or entirely avoid) with any particular asset class or to place "all of one's eggs in one basket".

While large and small cap stocks in developed markets have made the greatest contributions to 2013 YTD portfolio performance, emerging markets equities have struggled. By some measures, the emerging markets equity asset class may be at valuation levels not seen since the most breathtaking moments of the 2008-09 financial crisis. Similarly, the emerging markets debt asset class and inflation-oriented investments (TIPS and commodities) have done sufficiently poorly this year to warrant our attention as the historical resilience of these asset classes should figure prominently into any rebalancing strategy.

As we have said many times, buying low and selling high is never easy or obvious. Over the course of the 3Q 2013, we have sold some domestic equities in favor of international (developed and emerging markets) equities and global short-term bonds. With risk management in mind, we are in the process of implementing rebalancing trades to bring the portfolio back to long-term asset allocation guidelines, and harvesting any losses in your taxable accounts to maximize the portfolio's overall tax-efficiency.