FINANCIAL SERVICES ADVISORY
INCORPORATED

Rockville, MD • Fort Myers, FL • 800.235.4567 • www.FSAinvest.com

All's Well That Ends Well

Fourth Quarter Market Review From Your Portfolio Management Team—January 9, 2013

Investors seemed to breathe a sigh of relief late in 2012, with stocks rising in spite of a supposedly teetering economy, a close Presidential election, and all the anxiety of the looming Fiscal Cliff. As usual, however, the stock market had things figured out pretty well. The economy has managed to trudge along just fine, with the most recent GDP growth number showing a respectable increase of 3.1%. In addition, the election went to the incumbent—as it usually does, and at the very last second, Congress managed to craft a compromise that allowed the U.S. to step into 2013 without saddling its taxpayers with high tax increases (although most taxpayers will see modestly higher taxes in 2013).

Sometimes, when the news seems the worst, the stock market has an uncanny ability to look beyond the headlines and grasp the true underlying theme. In 2012, the theme was that in spite of the uncertainty, the underlying economy and earnings picture for stocks were in decent shape.

For the fourth quarter, stocks and bonds were relatively flat, with gold finishing in negative territory, and foreign stocks finishing the quarter with a gain.

For the year as a whole, most stocks finished with decent gains, with the exception of energy stocks and utilities, which lagged. It was also a difficult year for commodities, which finished the year flat. Bonds continued their consistent ways, even though they could not keep pace with most stocks. High yield bonds were the exception, however, and did manage to keep pace with the broad market indices yet again.

Index	*Q4*	*YTD*
Dow Jones 30	-2.5%	7.3%
EAFE	7.5%	17.3%
Barclays Bond	0.2%	4.2%
90-Day T-bills	0.0%	0.1%

Source: Ned Davis Research
Note: EAFE represents the MSCI index of foreign stocks; Dow Jones 30 represents the Dow Jones Industrial Average; Barclays Bond represents the Barclays Capital Aggregate Bond Index. YTD covers the period from 9/30/12 – 12/31/12.

Portfolio Review

Below we review the five broad strategies that FSA manages. Keep in mind that your specific portfolio may differ to some degree from the averages, as our portfolios are individually managed.

Conservative Growth

*Current Money Market Allocation: 3%**

Another quarter of consistent growth for Conservative Growth accounts. We continue to maintain a relatively light allocation to stock funds (about 20%), to go with a 20% allocation to high yield bond funds. The balance (almost 60%) remains in a collection of high quality bond funds, both domestic and foreign. For the past quarter these accounts were up over 1%, on average, and were up over 7% for the year.

Core Equity

*Current Money Market Allocation: 9%**

We continue to pursue opportunities within the stock market in these accounts, as long as the overall trend for stocks remains positive. During the quarter, we cut back our allocation to utilities and REITs, as those areas have lagged, while increasing our allocation to leisure and transportation stocks. For the quarter, Core Equity accounts were up less than 1%, and were up just over 6% for the year.

Tactical Growth

*Current Money Market Allocation: 17%**

These accounts continue to hold a mix of sector funds, high yield bond funds and some foreign funds. During the quarter we sold the biotechnology position we had held since late 2011, as well as the emerging markets fund and the government bond fund. We added an inverse silver ETF, as well as a position in European stocks (more specifically—The Netherlands). For the quarter, these accounts rose almost 1%, and were up over 8% for the year.

Income & Growth

*Current Money Market Allocation: 4%**

We traded this group very infrequently in 2012, as we have been quite comfortable with the mix of bond funds within the portfolio. They have provided an attractive return for the risk they are taking, which is exactly what we like to find for this conservative growth and income strategy. When stocks are rallying, these portfolios do have 10% in equity income funds, as well as 10% - 20% in high yield bond funds, which allow these portfolios the opportunity to participate in the rally. For the quarter, these accounts were up over 1% and were up about 6% for the year.

Income

*Current Money Market Allocation: 3%**

The Income portfolios managed to post a solid year without the benefit of stock funds, thanks to a conservative mix of high quality bond funds, with a few higher yielding bond funds added to give the portfolios a boost. For the quarter, these accounts rose over 1% and were up almost 7% for the year.

*These allocations represent the money market levels of our various strategies, including trades through December 31, 2012. Performance numbers for FSA portfolios represent composite results and include the annual fee of roughly 1.2%. A complete Performance History of all FSA strategies is available upon request.

A Look Ahead

As has been the case over the past five years, it is difficult to have much confidence about where the stock and bond markets might go in 2013. While the immediate issue of the so-called Fiscal Cliff was averted, Congress still has not dealt with the necessary spending cuts or the looming debt ceiling, which must be resolved within the next few months. No doubt this will keep investors on edge as we move towards the end of the first quarter. In addition, most analysts feel that company earnings, which will get reported in January and into February, will be subdued. Given the nice rise in stock prices in 2012, it could make for a choppy start to the year.

For FSA clients, the big question is, "When will interest rates begin to reverse their 30-year downward trend?" The reason that question is so important for us is because we continue to have about 65% of our assets in that area. Our more aggressive strategies like Core Equity and Tactical Growth have shifted more to stocks, but overall, we are heavily weighted towards bonds. Amazingly, the major asset flows in 2012 continued into bond funds. This marks the fourth year in a row of a major realignment of assets from stocks into bonds. Investors want income and they remain skeptical of stocks, and are willing to sacrifice some return to get more consistency. We tend to agree. Nevertheless, with the yield on the 10-year government Treasury bond below 2%, the prospect of interest rates beginning to rise is a real possibility. The question is likely not if, but when.

To be clear, our portfolios hold very little in government Treasury bonds. The funds we own hold primarily corporate bonds, along with some mortgage backed bonds, and even some foreign bonds. That explains why the 10-year Treasury was down about 1% in the fourth quarter, while our bond funds were up, on average (a few funds were down slightly). So, while rising interest rates will also affect our holdings, it should not impact them as severely, and as a result, we should have plenty of time to exit them as they hit our FSA Safety Nets®.

Shifting to the stock market, the overall trend for stocks remains up (albeit choppy). For 2012, the S&P remained above its 200-day moving average for most of the year, with a 10% correction in the spring and an 8% correction late in the year. Both corrections reversed course shortly after breaking below the 200-day moving average. Those environments make for stressful times at FSA, as we are always quick to defend the portfolios when the corrections approach those 10% levels.

Of course, there was not much to stress about in the strategies that maintained a high bond allocation (Income, Income & Growth, and Conservative Growth). It was only in the strategies where we have added stock funds (Core Equity and Tactical Growth) that those stock market corrections had our attention.

One thing that we can be certain of is that it will be a challenging year. We don't expect a return to the consistent up-trending markets of the nineties anytime soon. We are diligently monitoring our positions to weed out the laggards, as well as, scan the horizon for new opportunities.

And we wish everyone a successful and healthy 2013.