FINANCIAL SERVICES ADVISORY

INCORPORATED

A Tale of Two Markets

Second Quarter Market Review From Your Portfolio Management Team—July 9, 2013

"It was the best of times, it was the worst of times." Well, that about sums up the mood of investors who were balanced between stock and bond investments in the second quarter. Most US stocks managed to add to their strong first quarter gains, with the Dow Jones Average and the S&P 500 index both up around 2%. For the bond markets, however, it was a different story. The typical bond fund finished the quarter down 2%. While not a large number on absolute terms, these results were the worst for these usually safe investments since Q3 2008.

Bond funds of every flavor dropped. High yield bond funds fell over 3%, while the typical tax-free municipal bond fund lost 4% - 5% for the quarter.

All FSA strategies hold a healthy allocation to bond funds of one variety or other. As you would expect, as these funds turned down, we began to trim back the positions and our money market allocations have risen. These money market holdings will be redeployed into more productive areas once upward trends become apparent.

Index	*Q2*
Dow Jones 30	2.3%
S&P 500 Index	2.9%
EAFE	1.2%
Barclays Bond	-2.3%
90-Day T-bills	0.0%

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 12/31/12 – 6/30/13.

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: 32%**

Most Conservative Growth accounts struggled in the second quarter as the bond funds turned in a negative result, with little help from the equity income funds also held in the portfolios. In light of the increased volatility (particularly in the bond market), we cut our bond allocation from 70% to roughly 35%. In addition, we also added an inverse Treasury fund (which goes up in value when interest rates are rising and thus helps protect the portfolio when our other bond funds are falling in value). For the past quarter, these accounts fell about 1%, on average.

Core Equity

*Current Money Market Allocation: 12%**

Overall, stocks managed to hold up relatively well in the second quarter, except for those areas that pay good dividends—Utilities, REITs. We had small positions in those two areas, and we sold them during the quarter. In addition, as stocks began to turn down in June, we added some inverse funds to help offset the losses from the stock funds in the portfolio. For the quarter, Core Equity accounts were up around 1%.

Tactical Growth

*Current Money Market Allocation: 11%**

Overall these accounts managed to weather the choppiness of the quarter pretty well. The high yield bond positions were down slightly, while most of the stock fund positions managed modest gains overall. During the quarter we sold the Telecommunications fund and cut back the Homebuilders position, while adding a fund that tends to rise in value when stocks are falling. We also increased our allocation to Japan late in June. For the quarter, these accounts were down slightly—less than 1%.

Income & Growth

*Current Money Market Allocation: 32%**

It was a relatively difficult quarter for these accounts which typically maintain a high allocation to bonds for their steady income and consistent returns. Unfortunately, during this past quarter, bonds provided the most turbulence. In response, we sold several of the funds that had stumbled the hardest during the correction. The remaining bond funds have so far held up well enough that they have not tripped the FSA Safety Net®. We also added an eclectic fund that moves with the stock market, but is quite conservative. For the quarter, these accounts were down about 1%.

Income

*Current Money Market Allocation: 37%**

As you might expect, the turmoil in the bond market forced us to take action in this strategy as various funds tripped the FSA Safety Net®. The money market position has increased to nearly 40%, with the remaining bond funds (so far) managing to hold up reasonably well. Short-term and floating rate funds have weathered the storm the best. For the quarter, these accounts fell just over 1%.

*These allocations represent the money market levels of our various strategies, including trades through June 30, 2013. Performance numbers for FSA portfolios represent composite results. A complete Performance History of all FSA strategies is available upon request.

What Next For the FSA Portfolios

Since late May, both stocks and bonds have been stalled out. We look at these periods as possible transition periods. It is too early to tell what might be the longer term direction for these assets (up or down), but we have found that it makes sense to be alert during these periods. Bonds, which have performed so consistently over the past 4-5 years, may be relinquishing their position as the most favored asset class for investors, as they pulled over $60 billion from bond mutual funds and ETFs in June.

Stocks seem to be getting renewed interest from investors, although fear of the Federal Reserve reducing its purchases of bonds has resulted in the return of market volatility. Investors have become comfortable with the Fed's actions to keep interest rates low and liquidity gushing through the financial system. Even though everyone knows it is not sustainable in the long run for the Fed to provide this liquidity, no one is quite ready for it to end, either.

In summary, the losses from the bond market have caused a number of funds to trigger the FSA Safety Nets®. Money market levels have risen in our more conservative strategies, and we have even taken some defensive measures in the more aggressive strategies (which carry smaller bond positions). The markets will direct FSA in where to deploy the cash holdings once upward price trends become evident. Time will tell.

Just know that the markets and the portfolios are in transition and we stand ready to adapt to the next market environment.