BEACON'S POINT: CURB YOUR ENTHUSIASM

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CONFIDENTIAL – PROPRIETARY

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Curb Your Enthusiasm

Although September has historically been the worst month for U.S. equities, this year deviated from the norm. The S&P 500 Index gained 2.6% over the 30-day period, adding to its already healthy year-to-date advance. Through Friday, October 5th, the return of the broad stock benchmark (including dividends) exceeded 18%. Financial historian and economist Peter Bernstein has said that one cannot manage returns; all one can do is manage risk. In this spirit, we will discuss the major known risks presented by the current environment, acknowledge that there are unknown risks out there, and reiterate Beacon Pointe's approach to managing those risks.

But first, a note about the title choice for this edition of Beacon's Point. As most everyone knows, "Curb Your Enthusiasm" is an HBO comedy television series with eight seasons airing over the past 12 years. According to the show's creator Larry David, this title aimed to lower the audience's expectations after Seinfeld's phenomenal success. Far from discouraging viewership, his goal was to adjust expectations. Similarly, our focus on risk is in no way an alarm bell urging client to head for the exits, but it is a call for caution and realism. We believe that a more balanced perspective serves investors well along the way to achieving their investment goals.

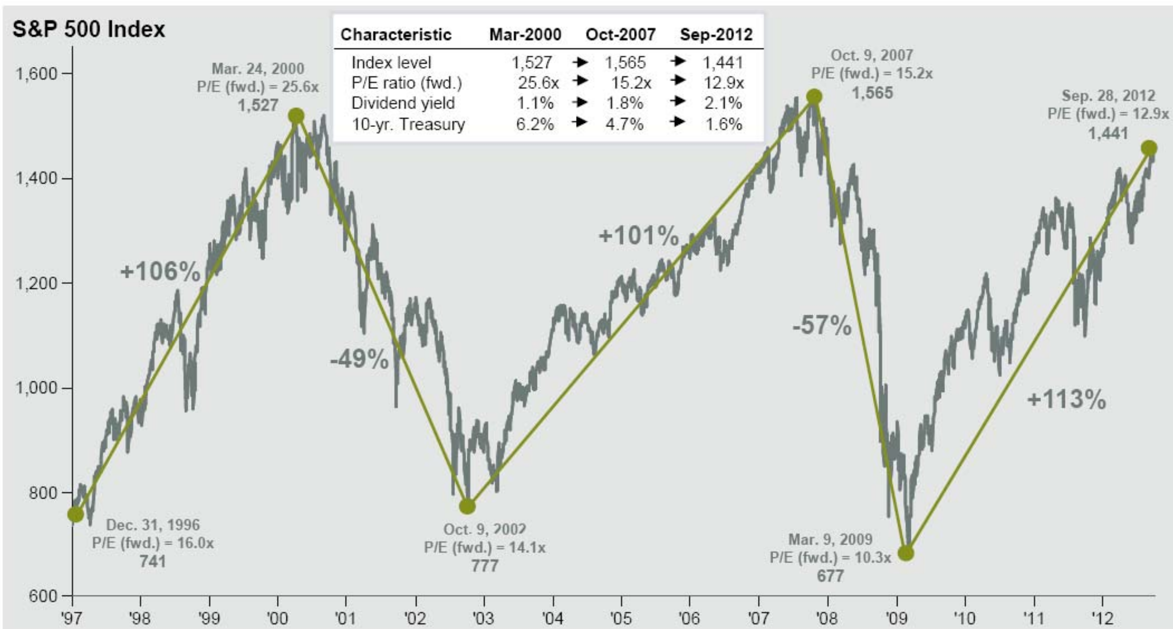
The announcement of the Federal Reserve's QE3/QE Infinity program provided the latest excuse for a rally in risk asset prices. U.S. equities have been especially strong. Although the S&P 500 Index is still below its October 2007 all-time high, several economic sectors -- consumer discretionary, health care, and consumer staples -- have overtaken their prior highs. On the other hand, the sectors that still have a long way to go are those that caused the last two market bubbles and busts: information technology and telecommunication services would have to double in order to reach their 2000 highs, while financial stocks would need a 150% gain to recover their 2007 levels. The analysis by Bespoke Investment Group in the following table provides the sector-level details.

S&P 500 Sectors Amount Needed to Reach All-Time High

Sector	All-Time High	Year Reached	Price	% Gain Needed to Reach All-Time High
Cons Discret.	369.29	2012	368.25	0.28
Health Care	457.77	2012	454.97	0.62
Cons Staples	371.34	2012	366.56	1.30
S&P 500	1576.09	2007	1433.8	9.92
Industrials	381.26	2007	320.06	19.12
Utilities	225.01	2007	183.69	22.49
Energy	678.93	2008	550.45	23.34
Materials	289.04	2008	233.28	23.90
Technology	988.49	2000	493.3	100.38
Telecom Svcs	339.28	1999	155.52	118.16
Financials	510.9	2007	210.19	143.07

Source: Bespoke Investment Group

As the S&P 500 approaches the 1,565 mark set exactly five years ago, the current environment is somewhat reminiscent of 2007. GDP growth is slowing on a year-over-year basis, much as it did then, but instead of home prices coming off their peak, today's concerns surround corporations' top and bottom lines Profit margins are well above their long-term historical average and vulnerable to the risk of contraction. Going forward, revenue growth for the average company will be challenged at best, given a highly uncertain global macroeconomic and political background. And yet, U.S. equities have maintained their upward bias, taking them 113% higher than the March 2009 trough. It would be unrealistic to expect gains to continue at their current pace. Beacon Pointe believes that the risk of a correction has increased in recent months. Looking at the S&P's chart for the past 15 years (shown below), it seems that the rally may be getting over-extended in terms of both duration and magnitude.



Source: Standard & Poor's, First Call, Compustat, FactSet, J.P. Morgan Asset Management.

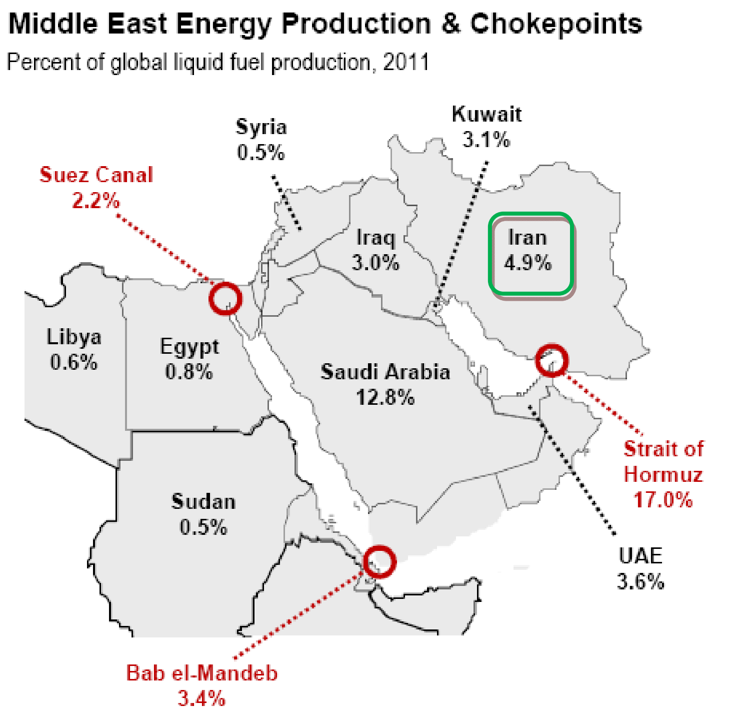
Dividend yield is calculated as the annualized dividend rate divided by price, as provided by Compustat. Forward Price to Earnings Ratio is a bottom-up calculation based on the most recent S&P 500 Index price, divided by consensus estimates for earnings in the next 12 months (NTM), and is provided by FactSet Market Aggregates. Returns are cumulative and based on S&P 500 Index price movement only, and do not include the reinvestment of dividends. Past performance is not indicative of future results.

Source: J.P. Morgan "Guide to the Markets"

More importantly than this technical perspective, there remain several significant fundamental risks that investors should not underestimate. While not exhaustive, the following list highlights some of these overhangs and the potential repercussions for financial market participants:

- The future of Europe -- progress made over the summer months has reduced the likelihood of a sovereign default. At the same time, Eurozone manufacturing remains in contraction territory, consumer sentiment last month fell to the lowest point since early 2009, and the unemployment rate hit an all-time high of 11.4%. Despite the pledge of the European Central Bank to do whatever it takes to save the euro, bond yields in Spain and other peripheral countries still linger around unsustainably high levels. Europe may have bought itself some time, yet the eventual end of the crisis is likely years away. For U.S. investors, this signals "proceed with caution" when investing directly in European securities, reassessing their exposure to non-European securities with revenue or debt exposure to Europe, and setting the overall risk profile of their portfolios (i.e. choosing either a defensive or aggressive positioning).

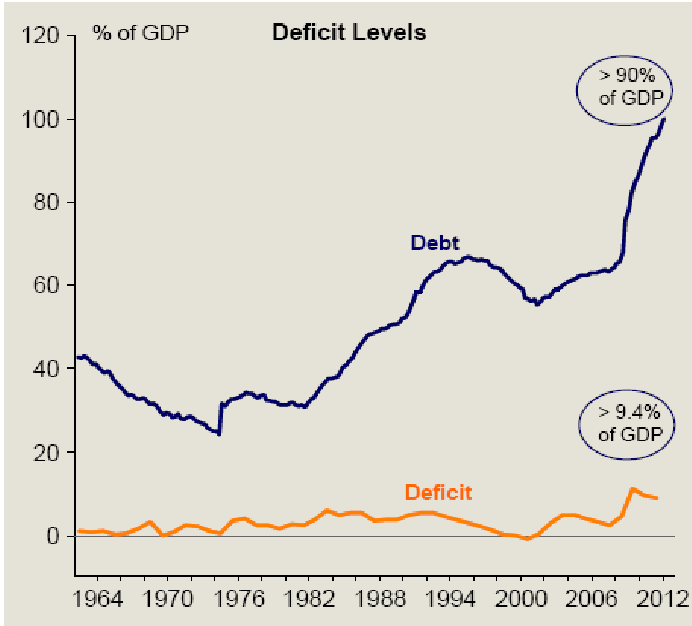
- Iran/Middle East geo-political tensions -- the conflict in Syria is escalating; Israel is stepping up diplomatic pressures; and news out of Iran is troubling. Iran's economy seems stuck in a downward spiral, its currency collapsing almost 75% so far this year, and inflation accelerating. Iran matters as one of the world's top oil producers (supporting data shown in the following map), as a nuclear threat, and as an additional source of social unrest in the unsteady Middle East region.



Major Producers				Major Consumers			
Percent of global total, 2011				Percent of global total, 2011			
Saudi Arabia	13%	China	5%	United States	22%	India	4%
Russia	12%	Iran	5%	China	10%	Saudi Arabia	3%
United States	12%	Canada	4%	Japan	5%	Brazil	3%

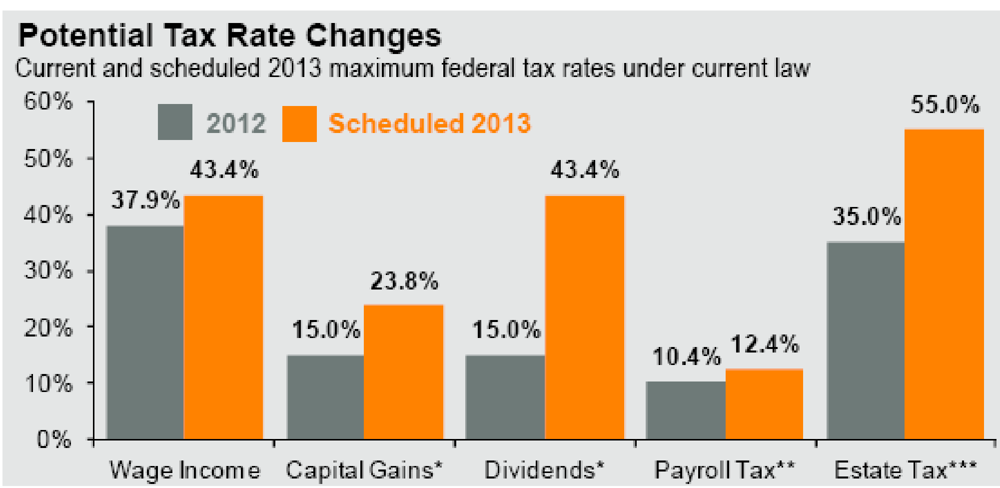
Source: EIA, J.P. Morgan "Guide to the Markets"

- U.S. government debt dilemma -- the budget deficit was $1.4 trillion in 2009, $1.3 trillion in 2010, and $1.3 trillion in 2011. This year's pace suggests a budget deficit of $1.2 trillion. Much of the debt issued by the government is in short maturities (in order to take advantage of low rates), which implies refinancing risk. If and when interest rates move higher, the burden of interest payments is going to be significantly more onerous. At present, total federal debt exceeds 90% of GDP, and the deficit is about 9%, without Social Security or Medicare (chart shown on the following page). In early 2013, policy-makers will be faced with another decision on the debt ceiling -- the limit on the Treasury's bond issuance that will need to be raised if the government is to continue to finance its deficit. Furthermore, it is hard to envision the two parties agreeing on a long-term plan for debt reduction and deficit cuts when the political divide in the U.S. is unusually high and ideological compromise is elusive. Investors should expect heightened volatility for what could be an extended period of time.



Source: ING Global Perspectives

- The looming fiscal cliff -- based on estimates from the Tax Policy Center and the Joint Committee on Taxation, if all tax increases scheduled for January 2013 take effect, tax liability will increase 21% next year relative to the taxes people would owe if pending tax increases were postponed. Higher taxes could be applied to wage income and payroll (including Medicare and Social Security taxes), capital gains and dividends (including the 3.8% healthcare cost tax), and estate tax, as shown in the following chart:



Tax rates based on maximum U.S. individual income tax. Wage income tax rates include employer and employee contributions to the Medicare tax. *Includes recently enacted healthcare tax of 3.8%. **In 2011 and 2012, the payroll tax cut reduced the employee's share of Social Security taxes by 2%. Rates shown include both employer and employee contributions to the payroll tax. ***In 2013, the estate tax exemption amount was expected to fall to $1 million from $5.12 million in 2012.

Source: J.P. Morgan "Guide to the Markets"

If these go into effect, domestic GDP will almost certainly turn negative next year. Many believe that the necessary steps will be taken to avoid this fiscal cliff, albeit at the last minute.

At this time, financial markets are pricing a positive outcome and economists' projections for 2013 growth in the U.S. exclude any potential impact from tax increases and spending cuts. The danger of such benign assumptions lies in the possibility of a negative surprise. Markets may completely reverse course at year-end if no compromise is reached.

- Presidential and Congressional election outcome -- as November 6th nears, neither party can claim a clear advantage yet. One potential scenario involves a split, paralyzed government at a time when effective leadership is badly needed. The seven-week period between the elections and the beginning of 2013 will be a crucial time for Washington; our leaders have a short window to address the fiscal cliff challenges discussed above and to prevent the U.S. economy from entering another recession. As mentioned earlier, the government will also need to make a decision on the debt ceiling in early 2013 before tackling the pressing issues of ballooning debts and persistent deficits. Strong opinions and eloquent rhetoric will not be sufficient; at some point the markets will want to see results in order to move higher.

- Persistent unemployment and health care cost uncertainty in the U.S. -- although the headline unemployment rate dropped to 7.8% in September, news from the jobs market is still a mixed bag. Private payrolls were weaker than expected and the manufacturing sector lost jobs for the second consecutive month. The U-6 labor impairment rate -- which includes discouraged and underemployed workers -- remained at 14.7%. One of the reasons small business owners are hesitant to add to their payroll is health care cost uncertainty. How could an employer make hiring decision and commit to growing the business without a reasonable view on how future health care costs will affect margins and the bottom line? The two issues, we believe, go hand-in-hand: a meaningful improvement in unemployment will occur when business owners gain some clarity on health care regulation and taxes.

There are certainly other sources of known risk not included in the above discussion. And then there are the unknown risks -- in the famous words of Oscar Wilde, "I am no longer young enough to know everything." Many years of real-world investment experience have shown us that the unexpected can and does happen.

This is why Beacon Pointe follows the principles of diversification, long-term investment horizon, and prudent manager selection. When guiding our clients in devising an investment plan, we recommend diversification among asset classes (i.e. equities, fixed income, and – where appropriate – alternatives) as well as investment styles (value/growth, large cap/small cap, domestic/international) to create the most attractive risk/return profile for the aggregate portfolio. Our long-term discipline allow us to stay the course regardless of the market environment. Finally, the investment managers we utilize emphasize risk management and are committed to capital preservation; they remain closely tuned into geopolitical, economic, and market dynamics as well as company fundamentals at all times. At the time of this writing, U.S. equities are up 18% year-to-date and 30% over the trailing 12 months. Our clients' portfolios have posted healthy, if smaller, gains. **We are comfortable trailing the indices in this type of market and believe that the only benchmarks that truly matter to our clients are whether they are on plan to meet their goals.** Beacon Pointe's consultants and advisors can work with each client to determine if this is the case.

Please feel free to call Beacon Pointe at 949-718-1600 should you need additional information or have any questions.