BEACON POINTE

ADVISORS

Beacon's Point: Subject to Change

Is Your Portfolio Ready for Tapering?

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Confidential – Proprietary

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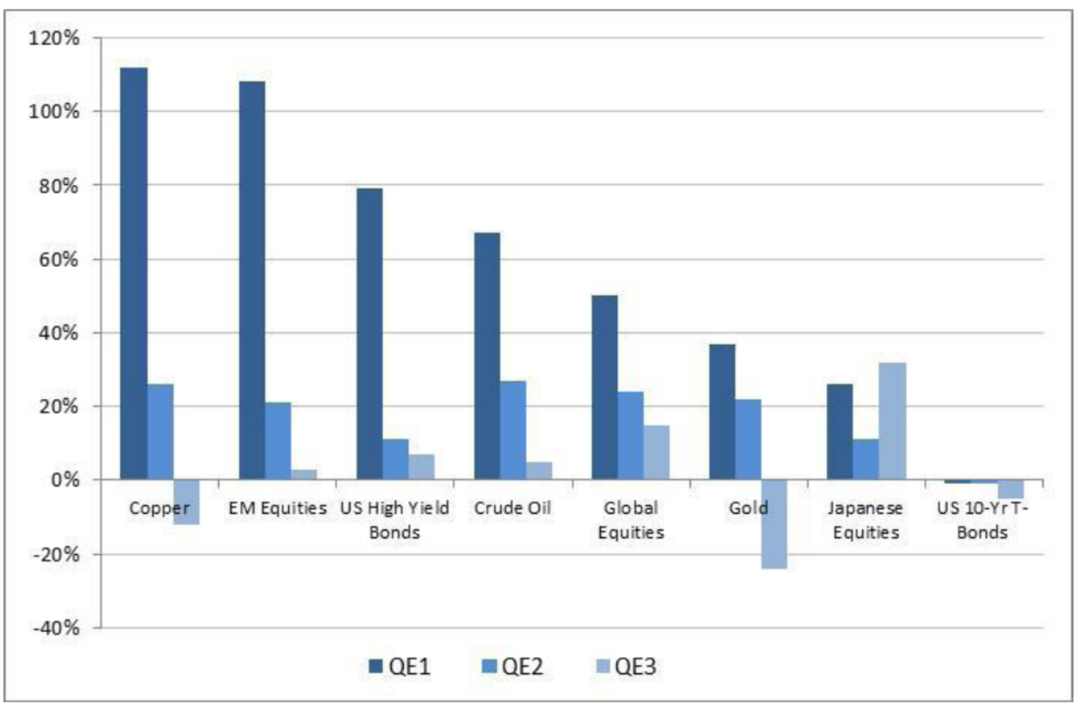
Subject to Change

Equity markets have undoubtedly benefited from loose monetary policy and the program of Quantitative Easing (QE). In a way, QE super-charged the stock market recovery off the March 2009 bottom. Specifically, the S&P 500 Index, which currently hovers around the 1,800 level, is up more than 160% in less than five years. But we are mindful that the status quo is subject to change.

Heading into the holidays, investors find themselves with hefty 2013 gains in their equity portfolios, but results in other asset classes tell a different story. This has been a market of the "haves" and "have-nots". Domestic large cap stocks, as measured by the S&P 500 Index, have advanced over 28% for the year-to-date period. Smaller cap companies, represented by the Russell 2000 Index, are up even more, +33% so far in 2013. In contrast, bond portfolios remain in negative territory for the year, emerging markets are a distant laggard among global equities, and a broad gauge of commodity prices -- the Dow Jones UBS Commodity Index -- has shed 11% since the start of the year.

Central bank policy has had much to do with the performance of the various asset classes over the past several years. As shown in the following Financial Times chart, courtesy of Absolute Return Partners, the latest round of quantitative easing (QE3) has propelled some categories to further gains, while turning others into money losers, at least over the short term.

Chart 1: The effect of QE on various asset classes



Source: The license to print money is running out, FT Money, 19-20 October 2013

Source: Absolute Return Partners

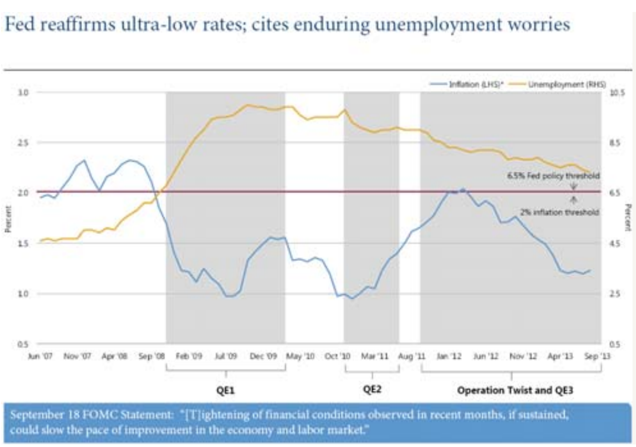
According to data from Ned Davis shown in the chart on the following page, courtesy of the Fat Pitch BlogSpot, this is now the second largest and third longest bull market of the last 80 years. Its gain is twice as big as the average and its duration is two and a half times longer than the average. How much of it is attributable to the QE tailwind is up for debate, but it is safe to say that this market advance was not driven solely by fundamentals. This is an important consideration -- once the pace of Quantitative Easing slows down, a scenario known as "tapering", equity markets will likely show symptoms of stimulus withdrawal. With reduced outside help, further U.S. stock gains will depend on corporate sales growth, profits, and valuations.

STANDARD & POOR'S 500 BULL AND BEAR MARKETS

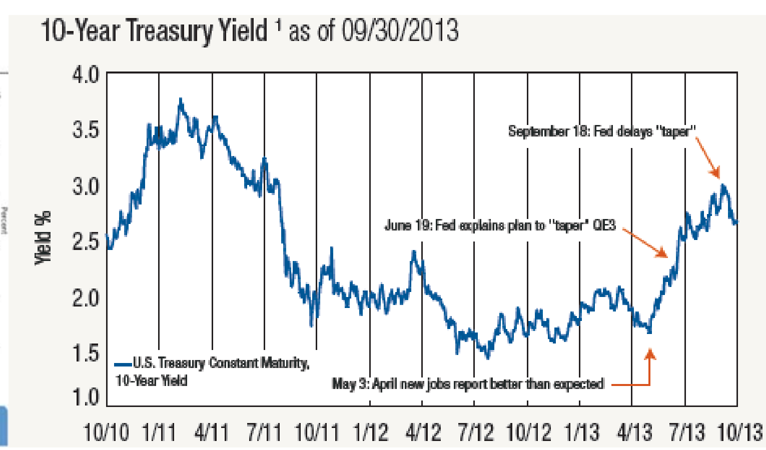
— Beginning —		— Ending —		Bull		Bear	
Date	S&P 500	Date	S&P 500	% Gain	Days	% Change	Days
10/11/90	295.46	7/17/98	1186.75	301.7 %	2836	– 19.3 %	45
4/28/42	7.47	5/29/46	19.25	157.7	1492	– 28.8	353
3/9/09	676.53	11/06/13	1770	162.0	1703	* Not in averages	
3/14/35	8.06	3/6/37	18.68	131.8	723	– 54.5	390
7/24/84	147.82	8/25/87	336.77	127.8	1127	– 33.5	101
9/14/53	22.71	8/2/56	49.74	119.0	1053	– 21.6	446
2/27/33	5.53	2/6/34	11.82	113.7	344	– 31.8	401
6/1/32	4.40	9/7/32	9.31	111.6	98	– 40.6	173
10/9/02	776.76	10/9/07	1565.15	101.5	1826	– 56.8	517
6/13/49	13.55	1/5/53	26.66	96.8	1302	– 14.8	252
6/26/62	52.32	2/9/66	94.06	79.8	1324	– 22.2	240
10/3/74	62.28	9/21/76	107.83	73.1	719	– 19.4	531
8/12/82	102.42	10/10/83	172.65	68.6	424	– 14.4	288
12/4/87	223.92	7/16/90	368.95	64.8	955	– 19.9	87
3/31/38	8.50	11/9/38	13.79	62.2	223	– 26.2	150
8/31/98	957.28	3/24/00	1527.46	59.6	571	– 36.8	546
10/22/57	38.98	8/3/59	60.71	55.7	650	– 13.9	449
5/26/70	69.29	4/28/71	104.77	51.2	337	– 13.9	209
10/7/66	73.20	11/29/68	108.37	48.0	784	– 36.1	543
11/13/29	17.66	4/10/30	25.92	46.8	148	– 83.0	783
3/27/80	98.22	11/28/80	140.52	43.1	246	– 27.1	622
10/25/60	52.30	12/12/61	72.64	38.9	413	– 28.0	196
11/23/71	90.16	1/11/73	120.24	33.4	415	– 48.2	630
4/8/39	10.18	10/25/39	13.21	29.8	200	– 43.5	916
5/17/47	13.71	6/15/48	17.06	24.4	395	– 20.6	363
3/6/78	86.90	9/12/78	106.99	23.1	190	– 8.2	562
9/21/01	965.80	1/4/02	1172.51	21.4	105	– 33.8	278
			Average	80.2 %	727	– 30.6 %	387

Source: The Fat Pitch BlogSpot, data from Ned Davis

The question many market participants are pondering right now is around the timing -- the "when" rather than the "if" -- of tapering. In May and June, Fed Chairman Bernanke led investors to believe that may happen in the fall of 2013. Bond markets reacted to the news, resulting in spiking yields and falling bond prices. Then came the surprise "no-taper" decision by the Fed in September, easing the pressure on fixed income instruments and fueling the S&P 500 to new record highs.



Source: Managers Investment Group



Source: PIMCO

Insights from the Fed's press conferences and meeting minutes point toward continued uncertainty. Although bond volatility has returned to more normal levels, Treasury yields have not retraced the summer move higher. This signals a bond market that still believes a taper is coming, even though the timing is unclear. Much will depend on the flow of economic data and the transition to a new Fed Chair at the beginning of 2014. At this point, it appears almost certain that Janet Yellen will take over as central bank leader. Ms. Yellen is unlikely to drastically shift Fed policy. This means that a gradual reduction in the pace of asset purchases by the Fed is the most likely scenario for the next few months. It would be reasonable to expect bond yields and equity prices to adjust at that point.

The May-September 2013 period may give us an idea of what this adjustment period could look like. As shown in the table below, the prices of Treasuries and municipal bonds experienced the largest drawdowns, but equities retreated as well, at least initially. Earlier periods of rising interest rates show a similar pattern -- drawdowns during the earlier periods followed by partial, or in the case of equities full, recovery by the end of the period. To state the obvious, no one knows exactly how interest rates and asset prices will react to the next source of uncertainty. However, past episodes provide some context to the timely discussion about investor preparedness and portfolio positioning.

Comparisons to Recent Rising Rate Scenarios	Jan 1994 to Nov 1994		Oct 1998 to Jan 2000		Jun 2003 to Jun 2006		May 2013 to Sep 2013	
Start	Oct-93		10/5/98		Jun-03		5/3/13	
Start Rate	5.2%		4.2%		3.1%		1.9%	
End	Nov-94		1/21/00		Jun-06		Sep-13	
End Rate	8.0%		6.8%		5.3%		2.6%	
Change	2.8%		2.6%		2.1%		0.9%	
	Drawdown	Total Cumulative Return	Drawdown	Total Cumulative Return	Drawdown	Total Cumulative Return	Drawdown	Total Cumulative Return***
Barclays US Aggregate	-6.6	-4.7	-3.7	-1.7	-4.6	6.3	-4.9	-2.9
Barclays US Aggregate Government - Treasury (7-10 Y)*	-8.0	-7.3	-8.9	-8.1	-7.2	2.1	-8.9	-5.8
Barclays Municipal Bond**	-8.3	-5.9	-3.6	-1.9	-5.3	10.5	-6.8	-4.4
BofA Merrill Lynch U.S. High Yield*	-5.3	1.0	-3.8	5.0	-5.3	28.2	-5.2	-1.4
Barclays Global Aggregate**	-3.2	-0.1	-6.8	-4.7	-6.2	13.6	-5.1	-1.3
Barclays US Aggregate Credit – Corporate – Investment Grade – Intermediate*	-5.0	-2.9	-2.0	0.1	-4.6	6.0	-4.2	-2.5
S&P 500 – Total Return	-8.5	3.3	-11.8	46.2	-7.4	38.8	-5.6	6.2

Source: Managers Investment Group "On Top of the Market"

For U.S. equity investors, 2013 will likely be remembered as a year of strong absolute returns as the S&P 500 Index is on pace to record its best performance since 2003. But we are mindful that the **status quo is subject to change**. Monetary stimulus is unlikely to remain at current levels for much longer. Tailwinds eventually turn into headwinds. Looking ahead, markets will ultimately face the reality of tapering and have proven to be sensitive to any news or hints on that issue. Now is the right time to consider how your portfolio is positioned for this outcome. Beacon Pointe's team is paying close attention to the market environment with a strong focus on meeting client needs while taking the least amount of risk possible.

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