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THE SEIA REPORT

Successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

BULL MARKET TURNS 4!

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Director of Investment Strategy

BULL MARKET REVIEW: In early February, the venerable Dow Jones Industrial Average, with its long and storied past, traded above 14,000 for the first time since October 2007, moving to within 180 points (1.3%) of its all time high. The S&P 500, meanwhile, moved above 1500, to levels last seen in December 2007. With major U.S. equity indices approaching all time highs, it may be a good time to step back and reassess where capital markets could go from here. But before we look ahead, let's look at where we have been.

No investor can get every investment decision right—and we are no different. However, some of the more major calls we have made in past SEIA reports have been proven correct in this latest bull market. Examples include…

- **2009:** March (S&P at 787), "There are new pockets of strength throughout the investment landscape…and cash should come off the sidelines and move markets higher." And the December follow up (S&P at 1105), "Our current bull market is a relative baby…and is simply not getting long in the tooth."
- **2010:** March (Ten-year Treasury at 3.60%), "Our 2008 premise still holds…inflation is a possibility worth insuring against but not a probability that should dominate investment strategies." And the June follow up, "hopefully… we have illustrated alternatives to low-yielding short-term bonds." Longer duration assets proved profitable as the benchmark yield fell and now rests near 2.0%.
- **2011:** February (S&P at 1300), "With an accommodative Fed and still improving economic numbers, history suggests that further gains can still be achieved. (Even) with our current bull markets posting a nearly 100% gain…history suggests that this bull may still have room to run." And the September follow up (S&P at 1204), "There are serious hurdles that we need to overcome…but most of it is already priced in. The time will soon be upon us when stocks again regain their status as king of the investment choices, if only because the opportunity cost of not buying stocks is so enormous."
- **2012:** Our annual preview stated (S&P at 1257), "We don't need much to get double digit returns in the equity markets. Investors should start the year with defense…and defer offense until the second half." Global markets behaved inline as they gained 6% in the first six months of the year and then proceeded to add another 11% in the second half. Finally, before the fiscal cliff we added (S&P at 1380), "Compromise may be at hand and if true, this is big."

But all of that is in the past. How should investors prudently position themselves now for the next turn of the cycle?

2013 PREVIEW:

Lost in the Obama victory and ensuing Fiscal Cliff debate was one of the more

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BULL MARKET TURNS 4

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key determinations to any investment decision. With the Obama victory, Bernanke will remain Fed Chairman. Therefore, the policies of the Federal Reserve Central Bank that are dominating the global investment landscape will persist. Accordingly, many of the investment themes previously outlined here also should persist.

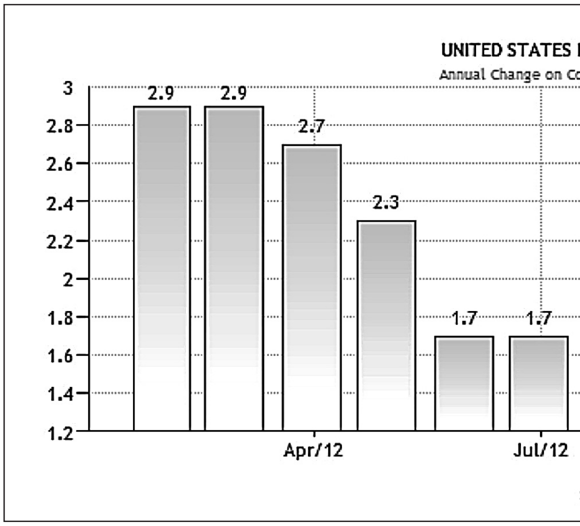
To review, Bernanke has pinned short-term rates to zero (ZIRP for Zero Interest Rate Policy) and has printed money to purchase longer-dated bonds to further suppress interest rates (QE for Quantitative Easing), stoke the business cycle, and reflate financial assets. Global central banks in most developed nations have followed his playbook. Now with yields near historical lows, the demand for higher yielding investments exceeds the supply of those assets. And when demand exceeds supply, prices are supported and should continue to head north. Therefore, we continue to expect that higher yielding securities will perform. Those types of assets include…

1. Dividend Equities as well as MLPs, REITs: A basket of dividend stocks not only can provide a higher income stream than government bonds (especially after-tax), but the dividend stream also has the potential to grow over time. Additionally, successful Equity Income strategies not only invest in equity securities with a favorable yield and income-paying history, but also into prospects that can increase dividend payments in the future. Although a move from bonds to stocks will increase a portfolio's market risk, the "un-fixed" nature of an increasing dividend stream (as opposed to the "fixed coupon" income of a bond) is an attractive hedge against future inflation (more on that below). We urge that any strategy should remain diversified and avoid concentration in the Consumer Staples or Utilities sectors. In our current markets, good dividends can be found in most any sector.

2. Real Assets: Assets such as real estate, master limited partnerships, and commodities should provide a hedge against higher inflation. Bernanke's policies are trying to successfully reflate the economy (as well as perhaps devalue the currency and provide a cushion for our enormous debt problems). The risk is that the Fed will not be able to stop at precisely the right moment before inflation heats up. History suggests that successful timing and removal of stimulus will prove difficult as Fed academia models often don't recognize real world problems (recall the inability to see the sub-prime crisis). In addition, Bernanke is on record that he will maintain current inflationary policies well beyond signs of true recovery. Bernanke and the mammoth resources of a Central Bank may succeed in reflating the economy, but we fear the end result will be higher inflation. Consider the facts: with nearly 8% unemployment and only 1% real GDP growth, we still run near 2% inflation. What will happen when we approach 6% unemployment and 2% GDP growth? Will inflation be higher or lower? And consider the following…

US Landscape: Improving Economy

i. More jobs and increased hiring in growth markets (see bullets v & vi below) > higher wages > more money



in system > inflation

ii. Banks will start to lend > more money in system > higher money multiplier > more money in system > inflation

Fed Policies

iii. Need to promote growth to combat deflationary forces > larger balance sheet via QE > more money in system > inflation

iv. Need to curtail U.S. Debt problem > inflation easiest cure among the other available options such as Default or Renege and cut promises to electorate via reduced Entitlement spending

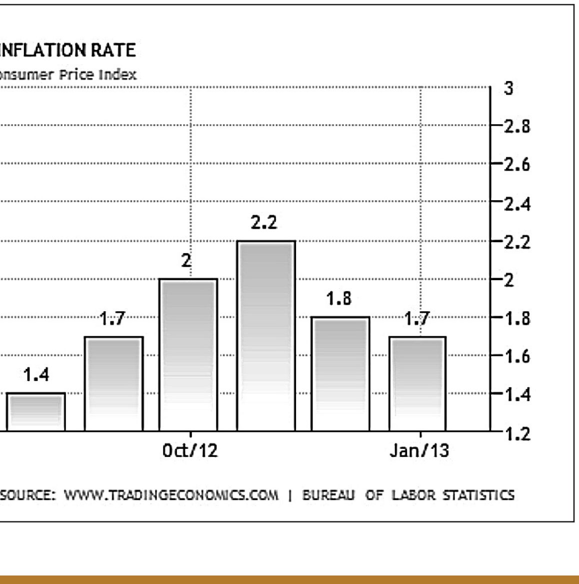
Global Landscape: Emerging Markets (EM) Growth

v. EM continues to get wealthier > better diets and lifestyles > consumption of more agriculture commodities, autos, wine, jewelry, etc. > inflation

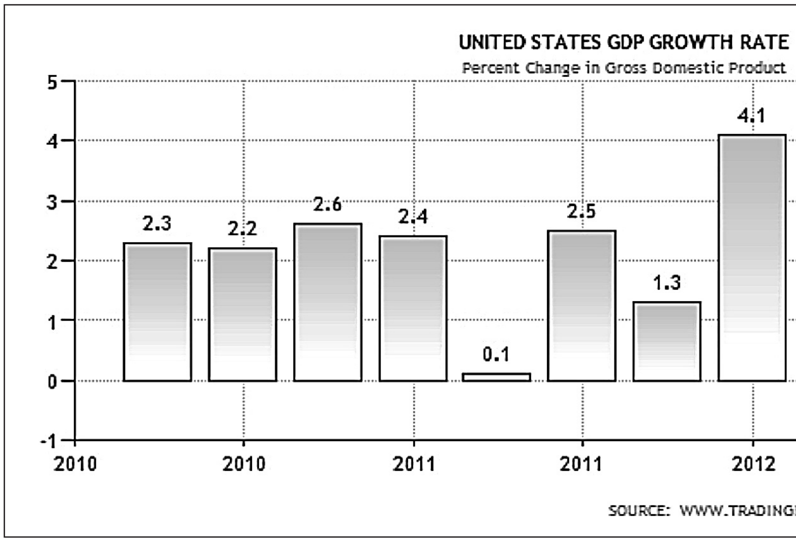
vi. EM continues to grow > industrialization & urbanization continues > consumption of more construction-related commodities like oil and copper > inflation

vii. Rising wages and land prices in China > U.S. manufacturing no longer "off shoring" manufacturing > China no longer "exporting" deflation to the U.S. via cheap goods > not disinflationary > inflationary

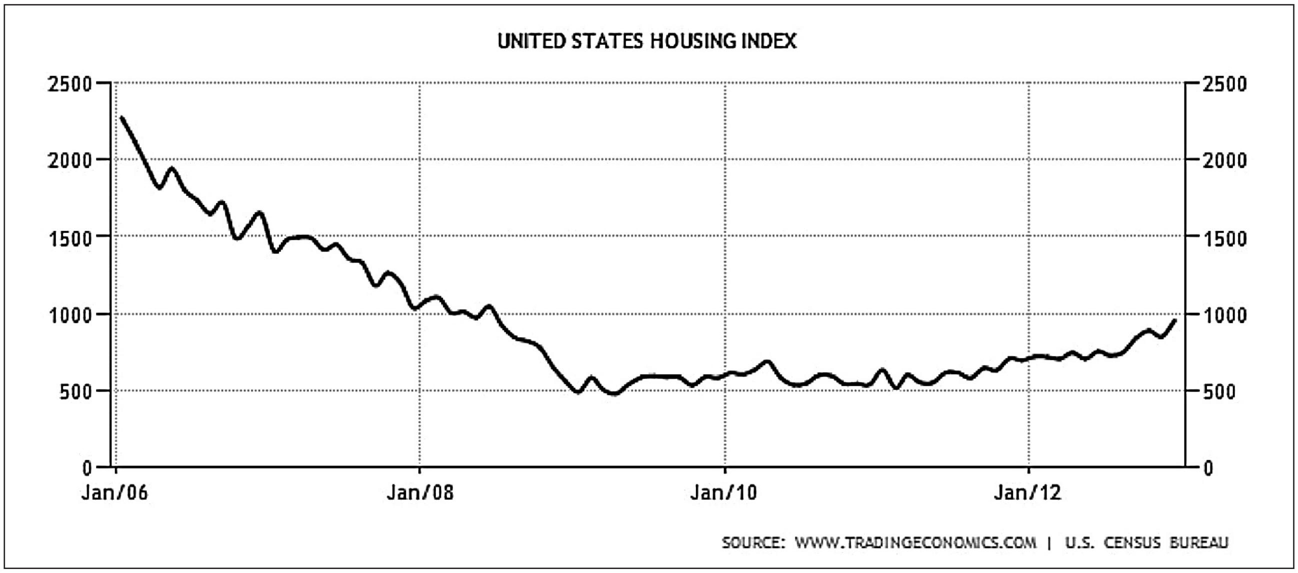
Investors would be wise to start adding inflation-related assets to guard against this outcome. Although higher inflation will probably surface in outer years. Unfortunately, it appears that most investors are not positioned for an inflation spike. Why? Perhaps because most investors were not actual investors the last time we experienced such a scenario.

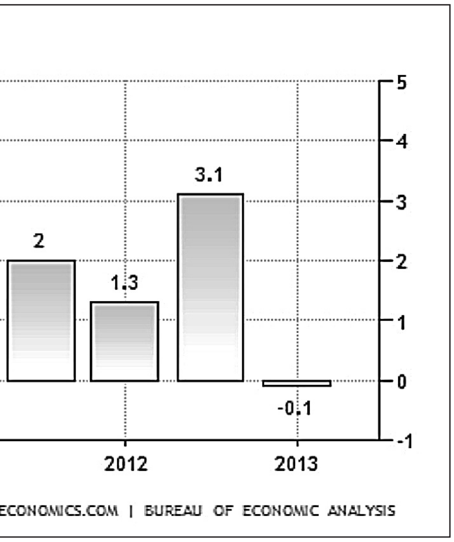


3. Credit Bonds: As we move further away from crisis mode, equities should continue to outperform bonds—even in this aging bull market. But that doesn't mean that investors should run away from bonds completely. Bonds should be viewed as a source of stable income and an appropriate hedge to stock market and economic cycle volatility. However, they should not be viewed as a way to accrue massive wealth. With that said, "Bonds" is the largest asset class in the world and a very broad topic covering US Treasuries, Japanese Government Bonds, Greek bank debt, Brazilian oil company loans, and everything in between. Where to invest? In an improving economy, bonds tied to riskier assets (Corporations, Emerging Markets, Sub-prime loans, etc.) may outperform Treasuries and other AAA Sovereign debt from developed countries that offer negative real yields (and some with negative nominal yields!). Investors not only receive higher yields for the perceived increase level of risk, they also could achieve price appreciation if credit spreads tighten and the securities are deemed less risky—even in a rising interest rate environment. Non-Agency Mortgages and Bank Loans are specific examples that may continue to shine.



4. Intermediate Maturities and Duration: Investors should avoid longer-dated bonds due to the inflation prospects in outer years. But bonds with maturities 10-years and under should continue to be in the sweet spot—as a steep yield-curve provides "roll down" opportunities, the shorter maturities can minimize losses from future inflation but are long enough to earn positive real rates of return. Interest rates should stay low this year for multiple reasons. First is monetary policy: Bernanke's two-pronged attack is specifically designed to keep rates low (ZIRP and QE). Second is the job market: the changes in Fed policy have morphed over time and are now tied explicitly to two indicators—the job market (unemployment rate) and the inflation rate. Short-term rates will be anchored near zero until the unemployment rate starts moving down towards 6.5% (keep in mind the February unemployment rate actually increased to 7.9%). The jobs picture may remain murky as long as GDP continues to disappoint, and it may





get worse. Recent 2% GDP numbers may be reduced in 2013 as the "Fiscal Cliff" negotiations produce a fiscal drag that may lower GDP by as much as 2% (1.30% from higher tax rates and 0.70% from lower spending and possible sequestration). And the third reason is inflation: Bernanke's now explicit inflation target is 2.5% and the current low number (CPI all items was up 1.7% for 2012) provides leeway for him to maintain the current policy.

Dividend and income strategies aside, investors should also pay attention to other areas of capital markets. As we move further away from the crisis, the ultra safe assets that were once hoarded should now be reduced or liquidated and the assets that were shunned should now be considered if not over-weighted.

5. The improvement in Housing has far reaching effects. Banks and other companies dealing with home building, mortgage issuance, furniture, paint, or appliances should all benefit from five years of pent-up demand. Also, the low inventory of new homes will assist the sales of older homes and thus help companies in remodel and renovation businesses. A second derivative off of housing is automotive as some companies are projecting huge increases in sales of pickups as the aging American fleet is replaced.

6. As the U.S. Shale Gas revolution continues, Chemical and Manufacturing companies should benefit from the glut of cheap natural gas. Midstream Master Limited Partnerships will continue to see demand, not only as a tax-advantaged yield asset but also due to the increased infrastructure required to move trapped oil from the American interior to the coasts (and perhaps for export).

7. And finally, Emerging Markets look poised for growth as China's property bubble and high inflation fears have abated for now.

Investment outlooks are not static and should be constantly monitored and revised. Risks still abound—the possible effect of higher taxes on consumer spending, possible sequestration, geopolitical shocks, and events we cannot foresee. Now more than ever before, events in Washington D.C. are affecting global capital markets and any investor needs to be cognizant of shifts in political circles. Although the second-term of a presidency historically has not been kind to equity markets, the fundamentals and relative valuations are lining up in favor of equities over fixed income in 2013.

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Is this an opportune time to reallocate to global bonds?

By Vince A. DiLeva, MS, CFP®, AIF®
Senior Partner

The media headlines over the last few years have warned investors to stay away from bonds, and these head-lines will only become louder over the next year or two. That is a broad-stroke statement on a diverse investment vehicle. There are so many types of bonds: government-issued, bank loans, high yield and emerging markets, to name a few. Should investors stay away from them all?

The answer is that because the developed nations have been keeping interest rates low to try to heal their mismanaged balance sheets, there may be opportunity in emerging market debt. Some emerging market economies have kept tighter spending controls in their economies and therefore may be considered safer than some of their developed nation counterparts.

Many developed nations, such as the U.S. and countries in Europe, continue to struggle with a large debt load compared to GDP. The average debt-to-GDP ratio is 34 percent in the emerging market economies, which is much lower than that of developed nations, where the debt-to-GDP ratio is closer to 100 percent. Considering that some emerging markets have a smaller debt load in comparison to GDP, some would argue that these bonds have less credit risk than their counterparts. There is a misconception by investors that emerging market debt is too risky for their portfolios. Yet the credit ratings on many of these bonds have steadily been improving since 2000. Currently about 60 percent of emerging market debt is investment grade compared to less than 40 percent 12 years ago.

Today emerging markets account for 35 percent of global GDP. But the amount of their outstanding debt is only 10 percent of the fixed income market. Therefore you have economies with a small amount of available bonds to invest in that make up a significant part of the world's output. I believe the demand for these bonds will increase, and since there is not a lot of supply in the market, that fact should drive up these bond prices. This is where the opportunity lies in the bond market.

In my opinion, the best way to own emerging market debt is in an individual nation's local currency. This allows the investor to diversify away from owning everything in U.S. dollars. Over the last four years, the U.S. government has flooded the market with U.S. dollars in an attempt to re-inflate the economy. That strategy has helped start a slow recovery out of the Great Recession. Over the next few years, with the risk of inflation rising and the increasing possibility of the U.S. dollar weakening, owning bonds in other currencies will offer a hedge to those risks. Another concern we will be dealing with is the increase in interest rates in the developed nations. This is not the case in emerging market economies. They are on a different interest rate cycle than the U.S. Interest rates are already higher, and that difference will allow investors to realize more income, with less probability for interest rate increases.

There are different risks as you invest in the emerging or international debt markets: You deal with political uncertainty, currency risk and general economic risk in those countries. Yet, that being said, this category of investment allows your portfolio to own an asset class that will not correlate to your U.S. equity and bond investments. With the strength of the U.S. dollar behind us, we need to own asset classes in a portfolio that will hedge against a weakening dollar; I believe emerging market debt is that asset class.

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SIGNATURE FUND *for* GIVING

By Marshall Smith

It was a very successful 2012 for SFFG. We raised close to $20k for the three local non-profits that we have partnered with; A Place Called Home, Toberman Neighborhood Center and Miracles for kids. This was almost double the amount we raised in 2011. In addition, we raised close to $50k for nonprofits across the country in which our Partners, Advisors and staff work with on a more individual basis. All totaled, our Signature Fund for Giving has raised $100k since its launch in October 2011.

A major factor in our success was due to the holiday generosity of our Advisors, donating $100 to charities across the country on behalf of each of our Private Client Group members. A goal for this year is getting all of our staff and clients involved; not only by donating money but also their time.

Thank you all for your continued support. We couldn't have experience such growth in giving without you.

If you have any questions regarding our Signature Fund for Giving or about how you can get more involved, please feel free to contact Marshall Smith or Allison Crandall at 310-712-2323 or at msmith@seia.com.

Upcoming Events

A Place Called Home Presents

Stars and Strikes 2013

Celebrity Bowling and Poker Tournament

When: Wednesday, March 6th, 2013 7pm-11pm
Where: Pinz Bowling & Entertainment Center
12655 Ventura Blvd., Studio City, CA 91604

For more info about this event please visit us at:
www.starsandstrikesforapch.org

Toberman Neighborhood Center Presents

A Worthy Evening

An evening honoring Hall of Famer James Worthy

When: Saturday, April 6th, 2013 6pm
Where: Manhattan Beach Marriott
1400 Parkview Avenue, Manhattan Beach, CA 90266

For more info about this event please visit us at:
www.toberman.org