SECOND QUARTER
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DEIGHAN WEALTH ADVISORS

MARKET COMMENTARY

Investing is full of truisms: sell high and buy low; a good company doesn't necessarily make a good stock; never put all your eggs into one basket; there's no such thing as a free lunch; be fearful when others are greedy; etc. Truisms are remarkably useful, because they take complex concepts and distill them down into simple, colorful statements of fact.

For example, there's a lot of math behind portfolio theory. Harry Markowitz won a Nobel Prize in Economics for his work on the subject, and countless other academics and professionals have dedicated their lives to understanding the How's and Why's behind portfolio diversification. But even a schoolchild can recognize that putting all of one's eggs into one basket is a risky proposition. The Why doesn't have to be understood in order for the truth of the statement to be recognized and appreciated.

And so we're happy to abide by such truisms. They're blunt instruments, to be sure, and they require proper context. But they can be useful tools, and they often serve as apt reminders. We believe that each of the aforementioned truisms applies in today's investing environment.

Sell High and Buy Low

It's easy for an investor to get caught up in the excitement and momentum that accompanies a winning investment. We've all encountered investments that only ever seem to go up, up, up. When something is such a clear winner, why wouldn't an investor want to pile on and buy more?

The problem is that this "clear winner" is often a logical fallacy. It's almost never correct to assume that the price of an investment will go up solely because it's gone up in the past. If fundamentals dictate that further price appreciation is warranted, then that's one thing. But if prices get ahead of fundamentals, then that's when investments become susceptible to price corrections.

To protect against price corrections, and to bank gains as investments rise, we consistently implement a practice known as rebalancing. Rebalancing is actually a form of selling high and buying low, because it involves trimming a portfolio's winners and putting the proceeds into the portfolio's losers. This can seem strange, selling winners to buy losers, and it can even lead to short-term underperformance. Over the long term, however, rebalancing ensures a greater likelihood of retaining gains and capitalizing on discounts. That's why we've dutifully trimmed U.S. stocks over the past several months and used the proceeds to buy positions in other investments, like emerging market stocks.

"REBALANCING IS ACTUALLY A FORM OF SELLING HIGH AND BUYING LOW."

A Good Company Doesn't Necessarily Make a Good Stock

It's often all too easy to mistake a good company for being a good investment. Sometimes a company's stock simply outruns its operating potential. This doesn't mean the company is bad, but it can mean its stock is a bad, or less good, investment at current prices. Remember, investing is all about the price an investor pays. All else being equal, paying a lower price means a higher potential return and a greater margin of safety.

When we look at the U.S. economy, we see many positive signs. Employment and consumer spending have been resilient, if not robust, in the face of decreased government spending and a stagnant global economy. Housing has started to meaningfully rebound. We're becoming more

energy independent, and so forth. If the U.S. economy were a company, then we might not call it great, but we'd surely call it good or improving.

Despite this, U.S. stock prices give us pause. Much of the run-up since 2009 has been warranted, but prices seem to have decoupled from reality recently. Since the end of 2012, around the time the Federal Reserve announced the extension of QE-Infinity from $40 billion to $85 billion per month, U.S. stocks have risen almost linearly. However, most other major asset classes have not:

Index	YTD Return
S&P 500 Index (U.S. Stocks)	14.31
MSCI EAFE Index (Foreign Stocks)	5.38
MSCI Emerging Market Index (Foreign Stocks)	(10.34)
Cohen & Steers Global Realty Majors Index	2.66
Dow Jones UBS Commodity Index	(9.38)
London Gold PM	(24.43)
Barclays U.S. Aggregate Bond Index	(2.31)
Barclays U.S. High Yield Bond Index	0.73

We'd like to say robust economic fundamentals have driven this outperformance, but it's hard to make that case. The Wall Street Journal recently compared the current economic recovery to each of the past recoveries since 1970. What it found was that, even though the S&P 500, since 2009, has had the greatest rebound of any prior recovery period, other metrics have been less strong. Home construction, government spending, and consumer spending have rebounded at the slowest rates of any recovery period. In fact, consumer spending, the lynchpin of the economy, has improved only 8.3% versus an average of 15.8% in prior recoveries. Private industry job growth has been just 5.4% compared to an average of 10.2%.

In terms of valuation, the earnings yield on the S&P 500 is lower than its long-term average (5.36% versus 7.47%), and the index's current Price to Earnings (PE) Ratio is 18.67, compared to a long-term average of 15.49. Its Shiller PE Ratio, which is a PE metric based on inflation-adjusted earnings over a 10-year period, is 23.62 compared to a long-term average of 16.47.

At best, these numbers imply that U.S. stocks are fairly valued at current prices; at worst, U.S. stocks are somewhat overvalued. In other words, there's a risk that stock prices have outrun the operating potential of the U.S. economy in the near term, either because of quantitative easing or simply because the U.S. has been the cleanest dirty shirt for investors to wear. Unless growth starts to pick up significantly, then the U.S. could start to resemble a good company that's a less-good investment.

Never Put All Your Eggs Into One Basket

This brings us to the timeless concept of diversification. Looking at the above table, the average diversified investor has done worse year-to-date than the one who's been invested purely in U.S. stocks. So, why diversify? Because it's been demonstrated, both in theory and in practice, to reduce risk and improve portfolio returns over time.

We're humble enough to realize that we can't predict the future, and that's why we espouse, and in times like these defend, diversification. The S&P 500 might have recently surpassed its 2007 high, but our clients, who were well-diversified going into the financial crisis, reached that milestone a couple years ago.

So far, 2013 has not been a banner year for diversification. At the same time, however, six months is a very narrow timeframe. For example, the S&P 500 declined 28.4% in the final six months of 2008. Diversification looked more attractive back then. We don't know if U.S. stocks can sustain current prices or if they will correct. By diversifying, we're recognizing that we don't know, and we're preparing for both possible outcomes.

There's No Such Thing As a Free Lunch

In finance, there's a theoretical concept known as the "risk-free rate of return." It is the return an investor would expect to earn from an absolutely risk-free investment over time. Unfortunately, no such investment exists in the real world. Even the three-month U.S. Treasury Bill, the closest proxy for a risk-free rate, does carry some risk. What this means is that an investor can never expect to earn a return without taking on some amount of risk. There is no free lunch. The greater the return expectation, the greater the risk that must be taken. This rule always applies, even for Treasury investors.

Because the U.S. government is stable, well-respected, and pays its bills on time, U.S. Treasuries are often considered low-risk investments. The market for U.S. Treasuries is broad and liquid, and prices are generally well-known.

However, even if U.S. Treasuries have very little default risk, they are yield instruments. This means they are susceptible to interest rate risk, which is the risk that an investment's value will change due to changes in interest rates. When rates are low, like they have been, and interest rates rise, then yield-based investments decrease in price. In other words, seemingly "low risk" U.S. Treasuries can fall in value significantly when interest rates rise.

When interest rates rise gradually over time, the shock is manageable and investors can rotate into higher yielding investments in a planned manner.

But when interest rates rise suddenly, like they did in June, then the shock is more difficult to absorb. In June, the yield on the 10 year U.S. Treasury Note spiked from 1.6% to 2.2%. This caused an immediate price correction across all yield investments. As a result, the Barclays U.S. Treasury 7-10 Year Index lost 2.42% in one month.

We mention this to drive home the understanding that all investments are susceptible to risk. If traditionally low-risk U.S. Treasuries can decline in value so suddenly, then surely more volatile U.S. stocks can. We feel investors need this reminder when U.S. stocks are hitting all-time highs.

Be Fearful When Others Are Greedy

This truism, of course, is only one-half of Warren Buffet's well-known quote. The other half reads, "and be greedy when others are fearful." It is our responsibility as portfolio managers to wear both hats at the same time.

We're of the opinion that the unprecedented actions taken by the Federal Reserve to stave off deflation post-2008 have resulted in price distortions across a number of capital markets, including U.S. stocks and bonds. This leads us to be cautious, if not fearful, despite the excitement surrounding the U.S. stock market.

At the same time, we want to be a bit greedy and purchase those investments that have not fared as well, because they represent, in our view, better relative opportunities. We want to sell high and buy low. In all instances, you can expect us to carefully weigh the potential risks versus the potential returns of any investment action we take.

Have a Wonderful Summer!

Summertime can often lead to increased market volatility, because lower trading volumes can exacerbate the impact of news and events. Volatility has picked up recently, and, if it continues, we encourage you to call us. We're here to help ensure you get to enjoy summer! From all of us here at Deighan Wealth Advisors, we wish you lots of sun.

Matthew T. Skaves, CFA
Chief Investment Officer

TAKING A WIDER VIEW

Since 1994, thoughtful portfolio management has been our primary business, and it remains so today. However, we are now offering a broader range of services collectively described as "Financial Planning" to those portfolio management clients who may want them.

Financial Planning involves a potentially broad range of financial actions including: education savings planning; retirement planning and budgeting; social security maximization; insurance review; and estate planning.

I first entered the world of portfolio management thirty-five years ago. Since then, the notion of financial planning has significantly evolved. What was once a fractured and vague discipline is now a structured profession covering specific areas of practice and study. The Certified Financial Planner Board of Standards (CFP Board) has set a high bar for Certified Financial Planner (CFP®) practitioners. The organization oversees examination, certification, and continuing education requirements. It also enforces the Standards of Professional Conduct, which hold CFP® professionals to high ethical and fiduciary standards of care. Before becoming CFP Board certified, CFP® practitioners

SOUNDBYTES

Jean Deighan traveled to Pittsburgh, PA to assist in the maintenance of the national Investment Adviser exam. A highlight of the trip was the Boston Bruins' victory over the Pittsburgh Penguins!

Congratulations to Jenifer Wilson, who was elected President of the Rotary Club of Bangor!

You didn't miss it! Our annual Seasons of Maine art event is scheduled to take place on September 20th. Join us for food, friends, and fun while enjoying some of the best art Maine has to offer.

Visit us online
www.deighan.com

must demonstrate mastery of each topic area, develop advanced problem-solving skills, and integrate topic areas into complex fact patterns.

Although Deighan Wealth Advisors has never performed portfolio management in a vacuum, we never truly delved into the many and varied areas of financial planning, instead leaving those areas to lawyers, CPA's, and attorneys. We will continue to work closely with our clients' other advisors, and we have no intention of practicing law or accounting. In many cases, the services provided by a CPA or attorney fulfill a client's planning needs, and therefore that client has no further need for financial planning. In other cases, a client might need complimentary planning services that bring all aspects of their financial situation into perspective under one roof, and we are happy to provide such services. We believe many clients can benefit by taking a wider look at their financial situations.

Financial Planning is not a "one size fits all" proposition. Some clients will be comfortable with a shorter, highly focused engagement that results in an overview of their financial roadmap. These "Quick Planning" engagements are often concluded in one meeting using data previously assembled by the client. The Quick Planning meeting generally takes three hours, during which time the advisor and client discuss goals, financial resources, and other relevant financial issues. The benefit of the Quick Planning session is that the client generally sees, by the end of the session, some alternative courses of action that may be used to accomplish financial objectives. It also includes a task list takeaway for the client and is less expensive than a more detailed plan.

Other clients may require a more in-depth look at one or more particular areas, such as budgeting, education planning, estate planning, or alternative retirement projections. In these cases, the advisor may need to interface with the client's other professionals, and the entire planning process will likely take longer and be more expensive.

Twenty or more years ago, I enjoyed lunch with a colleague who had recently left the practice of trust and estate law and joined an independent investment advisory company. "Certainly portfolio management is important," he mused, "but there are other financial decisions people have to make that can have an equal, if not more profound, effect on their family's financial well being." He was referring to the value of thoughtful estate planning, which was a hot topic at the time. Today our concern has shifted to a much wider range of topics. The hot ones may change over time, but there will forever remain the need to factor in all sorts of financial considerations when developing a personal financial roadmap. For this reason, we have made a point of adding Financial Planning to our service offerings.

Jean M. Deighan, JD, CFP®
Chief Executive Officer

MEET JACK

You may have already met Jack, our new official people greeter. If you haven't, then please stop by! Jack would like to meet you.

Jack is a four year old Pug and Pomeranian mix. Jean and Glen adopted him from the Bangor Humane Society, because they missed the patter of little feet. Some might say they rescued Jack, but Jack would argue he rescued them.

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