WILSON CAPITAL
INVESTMENT ADVISORY

This is Wilson Capital's first quarterly commentary. We hope it serves investors well by reviewing the past quarter and providing our outlook for the financial markets. We feel that investors should have an information outlet for the financial markets that is thorough, but does not require a prerequisite degree in economics. Thus we have included a glossary of terms at the end of this commentary. Each term with an asterisk has a corresponding definition in the glossary. We hope this makes our commentary informative and educational for all levels of investors.

The third quarter of 2013 saw the continued rise in the U.S. equity markets, but was most notable for the escalation of conflict in Syria and the anticipation of the Federal Reserve's (Fed)* next monetary policy* move. The S&P 500* closed the quarter with a 5.2% return, in spite of uncertainty that surrounded U.S. involvement in Syria's ongoing civil war and expectations that the Fed would begin to reverse course in their massive quantitative easing* program that has been in place since 2008. With neither event occurring in the third quarter, the equity markets seemed to focus on the slow, but steady path to economic recovery.

Quarter in Review

Second quarter earnings were solid with approximately 70% of the companies in the S&P 500 reporting earnings* above the analyst expectations. However, while company margins continue to expand, the trend of lagging revenue growth persists. July's earnings season was followed by fears of U.S. involvement in Syria over accusations that Syrian leader Bashar Al-Assad was using chemical weapons against its own citizens. Crude oil rose to its highest levels in 2013 over fears of a conflict in the Middle East, but without support of allies and members of congress the prospect of intervention receded, causing the rally in the stock market and lower oil prices.

September was largely shaped by the anticipation and reaction of the Fed policy meeting notes. In June, Fed chairman Ben Bernanke announced parameters in both the unemployment (below 7%) and inflation* (above 2.5%) rates where the Fed would consider economic improvement significant enough to begin "tapering"* their bond purchases that have worked to lower interest rates and spark economic growth. As economic data showed improvements throughout the quarter, longer-term interest rates climbed in anticipation of the taper. Despite almost unanimous expectations by Wall Street that they would announce tapering in their September meeting, The Fed announced no such thing citing conditions still too fragile to remove their support.

Outlook

The markets in the next 6 to 12 months will most likely focus on the slow, but steady improvement of the economy and the actions of the Fed. With the price-to-earnings ratio* of the S&P 500 hovering around 18x the broad stock market, it is still moderately valued by historical measures, but approaching the highest levels since the financial crisis in 2008. The opposite can be said for the bond market as the recent rise in interest rates for medium to long-term bonds* has made bond prices more attractive (bond prices move inversely to interest rates) than they have been in recent years. We are hopeful that the Fed will reduce the stimulus in a timely manner once economic conditions improve enough for the markets to handle a higher interest rate environment. However, despite the gradual economic improvement we believe there are two factors that could hinder Fed tightening.

1. **Inability for the Fed to control long-term interest rates**
   Despite the Fed purchasing $85 billion in long-term bonds per month, yields on longer dated bonds have increased. With individual investors reducing their positions in bond mutual funds, the Fed's purchases barely nullify the influx of selling taking place in the broader market. Since longer-term loans are more common for mortgages and corporate bonds used for capital expenditures, higher yields on those bonds reduce the incentive to take on new debt and thus reduce the efficacy of the stimulus.

2. **A reversal of the improving employment situation or sudden rise in inflation**
   Since the monetary stimulus was announced in 2009, the Fed has seen the employment picture improve in a gradual manner. While steady, the improvement to the employment picture has not been as robust as expected, leaving some doubt as to the sturdiness of the economy. Should jobs growth slow, the fed would be left with few arrows in their quiver to improve the economic picture.

We remain optimistic that the stock market still has room to increase at current levels. More specifically, we see stocks in some sectors such as energy and basic materials that we believe could offer significant upside in a more inflationary environment. The bond market is a little trickier. While the recent run-up in interest rates does make the case for longer dated bonds more attractive; we believe that rates will continue higher in the years to come.

Glossary

Federal Reserve – The United States' central bank, which is responsible for regulating the banking industry and controlling the money supply through monetary policy.

Monetary Policy – The act of controlling the money supply in order to attain certain objectives concerning the health and stability of the economy. The two main objectives of the U.S. Federal Reserve are maximum employment and stable prices. The primary method of controlling the money supply is by targeting short-term interest rates which is accomplished by buying (lowers rates) and selling (increases rates) bonds.

S&P 500 – Stock market index of 500 U.S. companies

Quantitative Easing – Monetary policy used in addition to policies to lower short-term interest rates. The intention of the policy is to reduce longer-term interest rates to further spur economic growth.

Earnings – In the U.S. all publicly traded companies release reports on a quarterly basis indicating their financial standing. "Earnings season" occurs 4 times a year with most companies reporting at the end of the month following each calendar quarter (January, April, July, October).

Tapering – In the context of quantitative easing this means the reduction, but not the end, of bond purchases.

Bond terms – Bonds are issued with a term, or length of time, when the bond will make interest payments. In order to compensate investors for setting their money aside for longer periods, interest rates tend to increase the longer the bond term.

Price-to-earnings ratio – a standardized measure of how much investors are paying for each dollar of earnings. An 18x p/e ratio means investors are paying 18 times each dollar of earnings.

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