WILSON CAPITAL
INVESTMENT ADVISORY

As an investment advisory firm, we feel 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 fourth quarter of 2013 rounded out one of the most impressive years for the U.S. equity markets in recent history. With a return of 32.4%, the S&P 500 index notched it's best year since 2003. The stock market was fueled by below average interest and inflation rates, both of which wreaked havoc on bond and commodity market returns. The U.S. bond market, as judged by the Barclays Aggregate Bond index, had it's first negative year in over a decade while the broad commodity market suffered a similar fate, posting its third consecutive negative annual return.

Below is a sample of how different asset classes performed in the past year:

Asset Class†	2013 Annual Return
U.S. Large Cap Stocks	32.4%
U.S. Small Cap Stocks	38.8%
International Stocks	15.3%
U.S. Bonds	-2.0%
Commodities	-9.5%

The best performing sectors in the U.S. were consumer discretionary and health care, while the normally defensive sectors* of telecommunications and utilities lagged the broader market.

Quarter in Review

It was déjà vu for U.S. company earnings in the 4th quarter. Approximately 75% of companies beat earnings estimates, with revenue growth lagging behind earnings growth and margins* continuing to expand. These results were nearly in lockstep with results from the 3rd quarter.

October saw fears of a government shutdown realized for the first time since 1996, as Congress was unable to find common ground on debates over the federal budget and debt ceiling. Fortunately the shutdown was short-lived, with minimal damage to the economy, but Congress was only able to enact temporary measures to keep the government open with another shutdown date looming in mid-January.

Improving unemployment numbers throughout 2013 culminated with the November unemployment rate hitting 7%. This triggered the Federal Reserve (Fed) to announce the much-anticipated taper or reduction of bond purchases that have been in place to keep interest rates low. While the taper of bond purchases is minimal, it does signal that the Fed believes the U.S. economy is strengthening and should continue to strengthen in 2014.

WILSON CAPITAL
INVESTMENT ADVISORY

Outlook

With the stock market on a roll and the economy showing increased strength, there are two things that we feel are worth watching in the coming months.

1. **Path to Stable Inflation**

   The Fed's dual mandate* is to achieve maximum employment and price stability. The current policy of low interest rates is supposed to act as a lubricant to the employment market, but typically results in higher inflation. With interest rates low, companies should be more willing to borrow to expand their businesses, creating jobs with wages that will be spent on the economy. With more money chasing goods, demand increases and higher prices will usually follow. The drawbacks to increasing inflation are fairly clear. Continually higher prices reduce the purchasing power of money, meaning the value of a dollar decreases over time.

   Strangely, despite low interest rates and lower unemployment rates, the economy has shown little in terms of higher inflation. Inflation in the U.S. in 2013 averaged 1.5%, which is below the Fed's target rate of 2% and marks the third straight year of declining inflation. On the surface this would appear to be a boon to the economy and the U.S. consumer, but a lack of inflation can be particularly troublesome for an economy. Lower inflation rates can mean that people and companies are hesitant to spend today believing that goods will be cheaper tomorrow, which could slow down a full economic recovery.

   If interest rates remain low, unemployment continues to decline, and the stock market pushes higher, inflation should return, but it's mysterious absence to date is cause for some attention.

2. **Performance of Momentum-Driven "Investments"**

   In 2013 there were a number of stocks that showed outsized gains well above that of the indexes. In most cases, such gains are attributed to higher profits, but what is perplexing about some of the best performing stocks of 2013 is that they have little or no profits at all. For example, Facebook focuses on the number of daily users and Amazon touts its progress in drone deliveries, each without regard to the impact of current profits.

   These so-called "momentum stocks" are bought on the premise that outsized yet-to-be-seen future profits justify the elevated prices. The future of the stocks that fall in this category are unclear, but if history is a guide, some may become household names a century from now, while others will be lessons on the danger of chasing future growth.

Glossary

Sectors – The stock market is commonly broken down into ten business sectors to which every company is assigned. Examples include Bank of America in the financial sector and Exxon Mobil in the Energy sector.

Defensive Sectors – Sectors that have stable earnings and are not as susceptible to changes in the overall economy.
Margin – Sometimes referred to as profit margin, is calculated by dividing the profit of a company by its revenues or sales. Higher profit margins can be driven by positive factors (more profitable products) or negative factors (cutting the workforce).

Debt Ceiling – the maximum amount of money that a government can borrow. This was first implemented in the U.S. in 1917 and currently stands at $16.7 Trillion.

Dual Mandate –The unemployment and inflation rates (the dual) are two measures monitored by the Federal Reserve to determine their interest rate policy. This interest rate policy is used to promote economic growth or slow an overheating economy as determined by unemployment and inflation.

IMPORTANT INFORMATION

† Indices used to represent asset classes:
U.S. Large Cap Stocks – S&P 500
U.S. Small Cap Stocks – Russell 2000
International Stocks – MSCI ACWI ex-U.S.
U.S. Bonds – Barclays Aggregate
Commodities – Dow Jones UBS Commodity