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FINANCIAL STRATEGIES

First Quarter 2013

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FINANCIAL STRATEGIES

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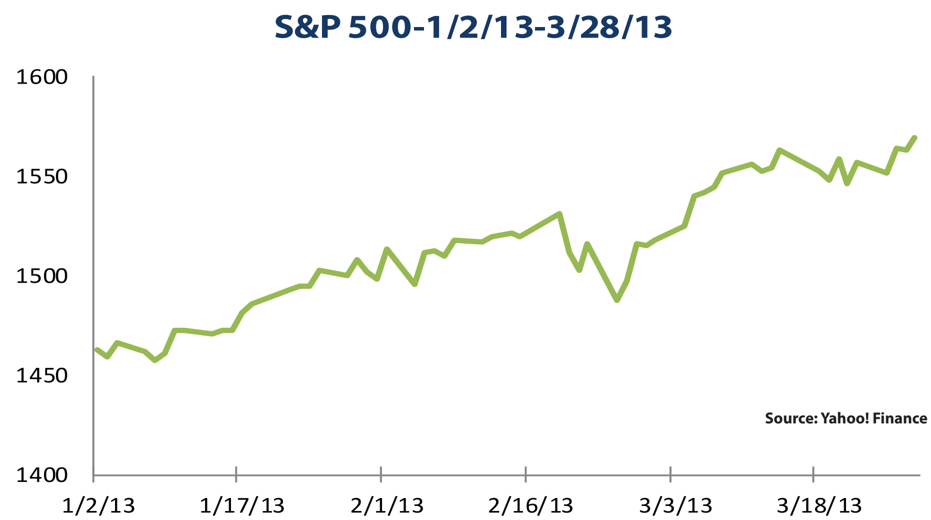
This Time It's Different?



The Dow Jones Industrial Average (DJIA)[1,2] and the S&P 500 Index[1,2] hit record levels the last day of the quarter, as the DJIA[1,2] had its strongest first quarter in 15 years, up 11.3%. The NASDAQ Composite[1,2], which contains more tech and growth oriented companies, was up 8.2%. Although these events were certainly cause for celebration, we have to remind ourselves the indices are only surpassing the highs reached previously in 2007.

However, when we compare other data to late 2007, we find companies currently have half the debt and significantly more cash on hand; pay bigger dividend yields; and have 13% higher profits. On the other hand, in late 2007 the global economy was doing well, unemployment was low, and investor sentiment was strong (*Barron's*, 4/1/13).

Let us look at a few other numbers which would suggest that economic conditions are indeed different than they were in 2007:

	2007	Now
S&P 500 Index Forward Price/Earnings Ratio	16.1	13.9
10-year Treasury bond yield	4.25%	1.86%
30-year fixed mortgage rate	6.6%	3.6%
Unemployment Rate	4.7%	7.6%

Source: Investment News March 11, 2013; Commonwealth Financial Network

Despite our concern about the stalemate in Congress, the economic data published so far this year suggests that the United States economy continues to improve. Despite Europe's seemingly endless problems, the payroll tax increase, and budget cuts in Washington, consumers kept spending, hiring picked up, and industrial production increased (*Wall Street Journal*, 4/1/13). The third and final revision to fourth quarter 2012 GDP showed an increase of 0.4%, weak but well above the -0.1% decline reported in January.

The U.S. Department of Commerce reported that consumer spending increased 0.7% in February, which was the largest increase since September. At the same time, they reported inflation was tame despite increased tax bills. The Thomson-Reuters/University of Michigan Consumer Sentiment Index posted a strong reading of 78.6 at the end of March (*WSJ,* 3/30/13). Apparently, consumers discounted the administration's warning of economic catastrophe following cuts in federal spending. Instead, consumers seem to be focusing on rising home values, rising stock market prices, increasing personal income, and somewhat easier access to credit.

The S&P/Case-Shiller 20-City Home Price Index[1] last week reported the largest monthly year-over-year gain since 2006. Home prices rose 8.1% in January, although they are still lower than they were in 2009. Home sales continued to accelerate, with new home sales up 12.3% over the past twelve months, and existing home sales up 10.2%. This continued uptick in the pace of sales has driven the inventory of homes for sale down 19.2% over the last year. Anecdotal evidence in the Washington, D.C. area indicates that houses are being sold above the asking price, although our market is better than most.

Elsewhere, economic activity continued to show slow but steady improvement. The ISM Manufacturing Index, a gauge of activity in the manufacturing sector, dipped in March to 51.3, but any number above 50 indicates expansion. Meanwhile, the ISM Non-Manufacturing Index, a measure of activity in the service sector also dipped slightly, to 54.4, but again was above the key threshold of 50 indicating continued growth. On April 3rd, General Motors, Ford and Chrysler reported their strongest March sales in five years.

Employment data was somewhat disappointing as the Bureau of Labor Statistics reported just 88,000 new jobs in March. However, previous months' numbers were revised upward, and the unemployment rate dropped to 7.6%.

The stock market gains finally encouraged some investors to move out of bonds and into stocks. In addition, two other factors are causing this shift. First, many stocks are paying higher yields than bonds, attracting income oriented investors. Second, investors realize that when interest rates start moving up, which has to happen eventually, bond prices will decline. This was reflected in the Barclay's U.S. Aggregate Bond index[1,5,6] which broke even for the quarter (-0.1%).

Although the picture in the U.S. seems to have improved, the global economic environment remains unsettled. The bank scare in Cyprus, the saber rattling in North Korea, and the turmoil in Afghanistan all remind us that while improving in some areas, the situation is still fragile. This uncertainty was reflected in the MSCI EAFE (ex U.S.) index[1,3], a proxy for international stocks, which gained just 2.5% this quarter.

While we are pleased with the gains we have seen in the U.S. stock market year to date, we would not be surprised to see some kind of pullback over the near term. However, despite the seemingly endless reasons to be cautious about the future, slowly but surely our economy continues to improve. We do not expect any change in this trend (barring an unexpected negative event), and we hope this will be reflected in positive portfolio performance this year.

Finally, on a personal note, this month we celebrate thirty years in business. Over the years, we have built a nationally-recognized financial planning firm with sixteen employees (including seven Certified Financial Planner® certificants) managing over $800 million. We thank you for your continued support and look forward to working with you and future generations for many years to come.

-**Alexandra Armstrong, CFP ®**

[1]Investing in securities involves risk, including the potential loss of principal invested.

[2]The DJIA, S&P 500, NASDAQ, Nikkei, and STOXX indexes are unmanaged indexes comprised of widely held securities considered to be representative of the stock market in general. Performances of the indexes are not indicative of any particular investment. Individuals cannot invest directly in any index. Past performance is no guarantee of future results.

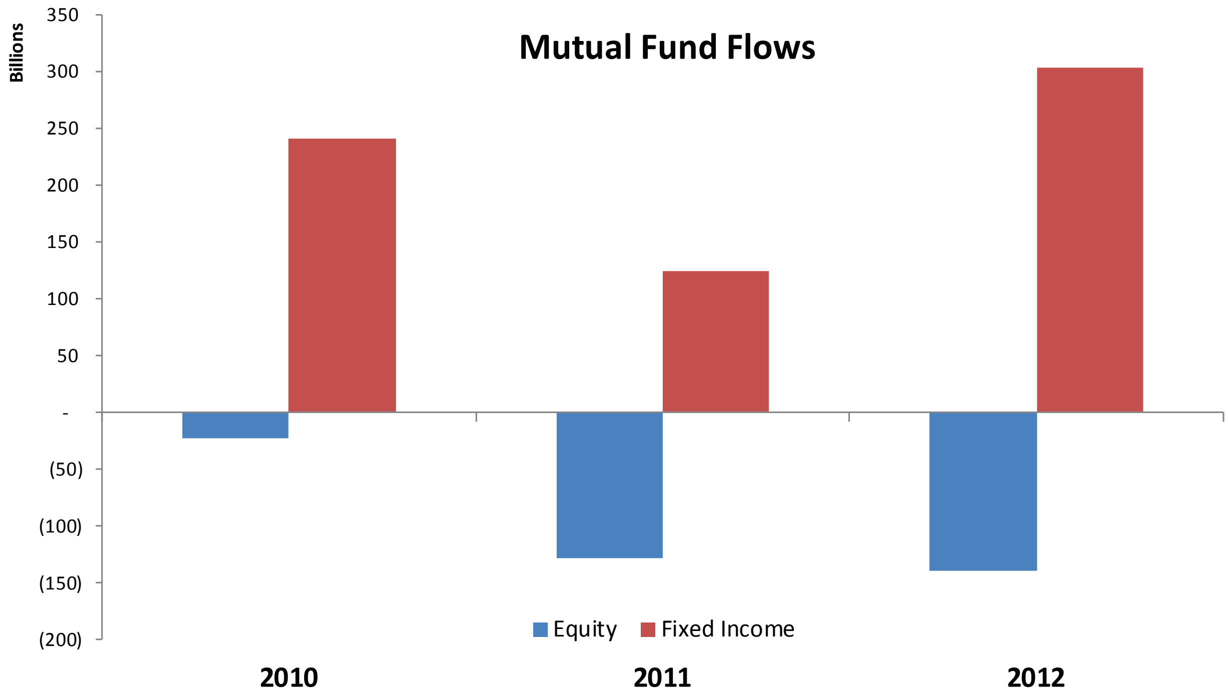
[3]The MSCI EAFE Index (Morgan Stanley Capital International Europe, Australia and Far East Index) is a widely recognized benchmark of non-U.S. stock markets. It is an unmanaged index composed of a sample of companies representative of the market structure of 20 European and Pacific Basin countries and includes reinvestment of all dividends.

[4]Foreign investments involve special risks including greater economic, political and currency fluctuation risks, which may be even greater in emerging markets.

[5]The Barclays Government/Credit Bond Index is a benchmark index made up of the Barclays® Government and Credit Bond indexes, including U.S. government Treasury and agency securities as well as corporate and Yankee bonds.

[6]In general, the bond market is volatile, bond prices rise when interest rates fall and vice versa. This effect is usually pronounced for longer-term securities. Any fixed income security sold or redeemed prior to maturity may be subject to a substantial gain or loss.

Statistical Spotlight: Fund Flows



Source: ICI, Morningstar

The chart above illustrates the amount investors have added or withdrawn from stock and bond mutual funds each of the last three years. This chart is notable in that it shows both investors' inability to conquer their fear of recent losses, as well as the folly of trying to time the market. Investors pulled $139 billion out of stock funds in 2012, and poured $302 billion into bond funds. This despite a year in which stocks rose 16.0% and bonds gained 4.2%. So while stocks posted considerable gains in 2012, few investors reaped the rewards.

This is by no means a new phenomenon. Studies and articles abound on the gap between the overall market return and the return that actual investors realize. In July of last year, Dalbar released a study showing that while the S&P 500 gained 7.8% and the Barclays Aggregate Bond Index gained 6.5% over the past 20 years, the average investor's return over that same time period was just 2.1%. This occurs precisely because investors cannot resist the temptation to buy high, when all seems well; and sell low, when things seem hopeless.

Sure enough, investors began to clamor for stocks in 2013, after the markets performed well in 2012. A record $77.4 billion poured into equity funds in January 2013.

Lastly, the chart illustrates the vast amount of cash that has poured into bond markets over the past three years, with over $667 billion in new investment into bond mutual funds since January 2010. That amount of buying, combined with $290 billion in withdrawals from stock funds, leads us to wonder how much room bonds have left to gain, and how many investors will suffer when interest rates begin to rise.

-Chris Rivers, CFP ®

AFM Mission Statement

"Our mission is to provide prudent financial solutions that achieve your goals through personalized financial planning and independent investment advice, and to do this with integrity, objectivity and excellence."

AFM turns 30!

Alex on the cover of *Changing Times* (now *Kiplinger's Personal Finance*), 1983

This year marks a special year for AFM, as we celebrate our 30th anniversary. On April 4, 1983, Alex Armstrong opened the doors of Alexandra Armstrong Advisors with 5 employees, after many years as a stock broker and planner at Julia Walsh & Sons. From that modest start, the company grew quickly, and today we have four principals, seven CFP® certificants, over 550 clients, and we oversee more than $830 million.

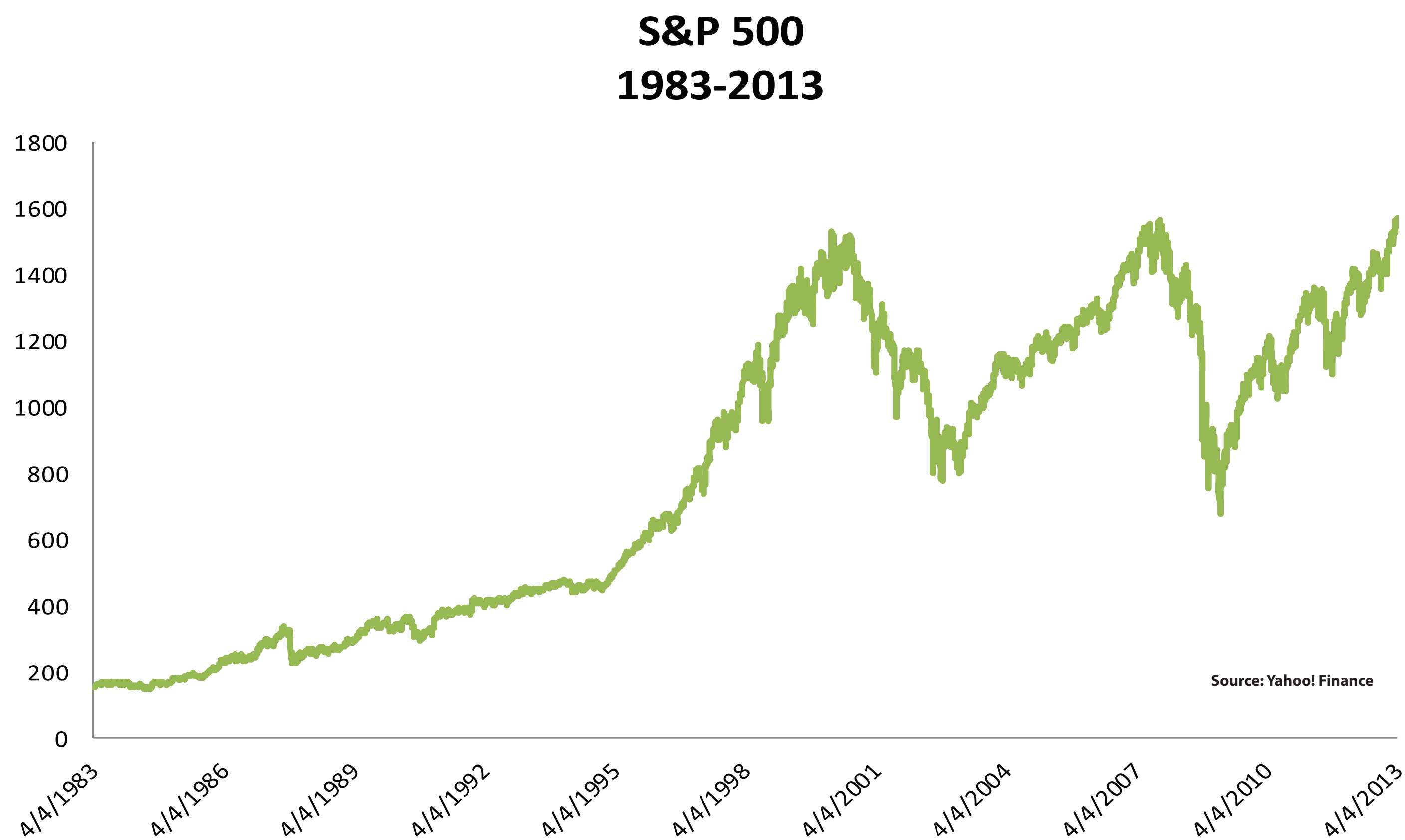
Some of you may have in fact made the transition with her, as we have a handful of clients who have been with us more than 30 years. During that time, we have seen five Presidents, three Redskins Super Bowl victories, two market crashes, the rise of the internet, the fall of Communism, and the longest bull market in history. We have seen planners, employees and interns come and go, though most come back to visit from time to time. Many left for jobs completely outside the realm of finance, while others left to start their own financial planning firms, and we are happy to continue to count them as colleagues. A few retired and rode off into the sunset, while our good friend Norma Severns left before her time. It has been a pleasure to help our clients meet their goals over the past 30 years, and we look forward to thirty more!

AFM by the Numbers:

- **75:** AFM planners have been quoted or profiled in over 75 publications in all 50 states and D.C. including *The Wall Street Journal, Barron's, The Washington Post, The New York Times, Chicago Tribune, Los Angeles Times, Atlanta Journal Constitution,* and *USA Today.*
- **1st:** Alex Armstrong was the first woman to serve as President of the International Association for Financial Planning.
- **7:** Current or former AFM planners have served as president of the Financial Planning Association's National Capital Area chapter, or the International Association for Financial Planning.
- **10**: Number of years Alex Armstrong was a panelist on the TV program *Wall Street Week with Louis Rukeyser.*
- **3:** Number of different office locations AFM has called home in 30 years.
- **3:** Number of blocks separating those three locations.
- **2006:** The year that Alex Armstrong was elected to the Washington Business Hall of Fame.
- **42:** Number of employees of AFM at its largest, in the early 1990s.
- **31:** Number of years Alex Armstrong has written a column for *Better Investing Magazine.*
- **4:** Number of current AFM employees who were yet to be born when AFM opened its doors on April 4, 1983.
- **98:** Combined years of industry experience of the four current principals of AFM.

"On Your Own"

The fifth edition of *On Your Own: A Widow's Passage to Emotional and Financial Well-Being* is available. Although this book was written primarily for widows, women of all ages and circumstances have found the information helpful to them as it provides basic financial planning and investment advice. You might want it for your own use or to give to a family member or friend. It is a thoughtful bereavement present. You can order it direct from our offices by calling your financial planner or through www.amazon.com. In either case, Alex would be glad to autograph it if you desire.



A look back at 1983

	1983	2013	Increase
Cost of a New Home	$89,800	$313,700	249%
Median Household Income	$20,885	$45,018	116%
First Class Stamp	$0.20	$0.46	130%
Gallon of Regular Gas	$1.24	$3.69	198%
Gallon of Milk	$2.24	$3.48	55%
Dow Jones Industrial Avg	1,287	14,585	1033%
S&P 500	173	1,567	808%

Source: www.census.gov, www.eia.gov, www.bls.gov, finance.yahoo.com

Financial Times Top 400 Advisers

Alex was recently named one of the top 400 advisers in the country by *Financial Times*.

Financial Times assessed those with 10 or more years of experience and $250 million or more under management. The formula used was based on six factors: assets under management, asset growth, years of experience, industry certification, FINRA compliance record, and online accessibility.

Save the Date

June 11, 2013

We hope you will join us in celebrating 30 years for Armstrong, Fleming & Moore, Inc.

Tuesday, June 11th, 6-8 pm

1850 M Street NW Suite 250
Washington, DC 20036

Invitations to follow!