Inside Views From an Investment Management Leader

UPDATE

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About our Company

Company Profile:

Concord Investment Counsel is a private, boutique investment firm who has helped our clients grow and protect their wealth since 1991.

Key Offerings:

- *Personal wealth management*
- *Proactive investment strategies*
- *Proprietary research*
- *A professional team*
- *Fee-only services*

Distinguishing Values:

- *Passion for excellence*
- *Strategic focus*
- *A disciplined process*
- *Prudent risk management*
- *Comprehensive client care*
- *Superior long-term performance*
- *Sound judgment*
- *Objective Analysis*

CONCORD Investment Counsel

9811 Irvine Center Drive
Suite 200
Irvine, CA 92618
Phone: 949-852-4100 or 800-497-9400
Fax: 949-852-4106
www.cichome.com

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Economic Review & Outlook

Fed Posture Now Clear, But...

Mitch Pletcher
President
Chief Investment Officer

Fuzzy central bank policy is now clear, but a new set of problems in America has seized the attention of the world.

Improving clarity about the central bank's willingness to accommodate the needs of the US economy drove the markets to all time highs in September. Bernanke's comments about monetary policy had been a cause for concern throughout much of this year, and central bank posture, as well as the strength of the economy, were seemingly on a volatile ride. Finally in late September Bernanke put to rest the speculation and sent a clear message that the Fed's job was not done and bond purchases would continue for the foreseeable future. This news, along with a calming of war talk in Syria, brought optimism to most economists and investors. Markets made new highs despite a disappointing season for corporate earnings. The quarter ended with a theatrical presentation in Washington about America's growing debt and a showdown with Obama over healthcare reform. While most believe the current heated discussion about the government shutdown and possible default of US debt is nothing more than theatre, many worry that the irrational actions threatened could become reality given the stubbornness of both parties.

In the third quarter there were continued signs of economic progress. Although modest, the current trends have been consistent for many quarters, and the overall change is notable. Unemployment is now at 7.3%. Consumer confidence is at a two year high, retail sales are at all time highs, and industrial production has been making new highs for over a year now (pg. 4 figs. 1-3).

The steady trends were not all positive for the economy unfortunately. India and China continue to decelerate as their economies mature and their dysfunctional monetary situations become more problematic for growth. Heavy government spending in America on entitlements threatens to wind down as US government debt levels (pg. 4 fig. 4) become a front line item on newspapers around the globe. Household debt remains high and has capped consumption in Europe and America. The Federal Reserve's balance sheet is now over $3.8 trillion and seemingly has limits as to how far this can go.

The strength in the American economy lies in a handful of industries that are seeing strong top line growth from increasing consumption of their products and services. Most of this is evidenced in the earnings growth comparisons of small cap stock indices versus large cap indices, with superior results in small cap growth. Healthcare is at the top of the list of market and earnings performers with Obamacare opening up the door to government subsidies for healthcare and a population that is aging or in need of this benefit. The recovery in new home construction has benefited lots of small to mid cap lenders that have led the market over the last few quarters. Green energy and selective areas of technology are also seeing improving trends in top line.

The current stalemate in Washington will likely be put aside for the betterment of the country only to be brought out again when politicians see a better opportunity to solve our problems and gain politically.

We remain optimistic.

Financial Market Review & Outlook

Another Strong Quarter

Mitch Pletcher
President
Chief Investment Officer

Financial markets continue to perform well despite gridlock in Washington this year. The third quarter was great for equities of all types. The S&P 500 gained over 5% and the Russell Small Cap Growth Index recorded a 13.3% jump. Concord's Diversified Equity portfolio gained 7.5% followed by Concord's Dynamic growth portfolio which advanced 6.5%. Large Cap Value indices lagged the group with the IWD up 3.9%, after taking the lead earlier in the year. More problems with loans and the associated liabilities for the big banks dragged on the value indices. Distressed debt, and even commodities bounced a bit as well. The clear message by Bernanke to continue with aggressive monetary policy was the root of the rally this quarter as other economic data points that drive markets paused. The unexpected decision by Syria to peacefully end the crisis there was good news as well making the lean reports of corporate earnings seem palatable.

Treasuries and high quality debt continued on a downward trend that has taken rates on most long term instruments up almost 100 basis point over the last year. The ten year Treasury was flat in the quarter with a 2.6% yield.

REITs, after bouncing in the first part of the quarter, fell back by quarter-end and kept this group mostly negative for the quarter and inexplicably cheap.

The leadership in the markets was easy to spot with small cap growth indices way out in front driven by strong earnings reports and reasonable valuations. The slow but steady economy is gradually demanding more raw commodities and pricing is improving for most basic material providers and their stock prices reflect this. The rebound in consumer confidence is likewise showing up in earnings and stock prices for most cyclical areas of the consumer space.

The quarter ended poorly with political theater on most investor's minds. With Yellen set to begin a new chapter for the Fed, our optimism for equities and concern for debt continues.

Concord's Dynamic Growth portfolio beat the S&P 500 in the 3rd quarter with strong performance from AAPL, healthcare, small cap growth ETFs and consumer discrectionary equity ETFs, offsetting weak performance from REITs and Fixed Income.

Table 1: Stock & Bond Market Returns — 9/30/13

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
Large Cap Growth (IWF)	8.3%	19.2%	Small Cap Value (IWN)	7.6%	26.8%
Large Cap Value (IWD)	3.9%	22.1%	Small Cap Growth (IWO)	13.3%	33.5%
Europe Asia Far East (EFA)	11.3%	24.1%	Emerging Markets (EEM)	5.6%	0.5%
Invest Grade Bonds (LQD)	0.8%	-3.2%	High Yield Bonds (HYG)	2.3%	5.6%
Interm Treasurys (IEF)	0.04%	-4.3%	Mortgage Bonds (MBB)	0.9%	-1.7%

Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

Table 2: Real Estate & Commodity Returns — 9/30/13

	Quarterly Change	Trailing 12 Mos		Quarterly Change	Trailing 12 Mos
DJ US Real Estate (IYR)	-3.1%	3.0%	DJ Commodity Index (DJP)	2.1%	-15.7%
NAREIT Industrial/Ofc (FNIO)	-1.3%	6.6%	Goldman Commodity (GSG)	5.1%	-4.2%
NAREIT Residential (REZ)	-5.4%	5.3%	Gold (GLD)	7.6%	-25.4%

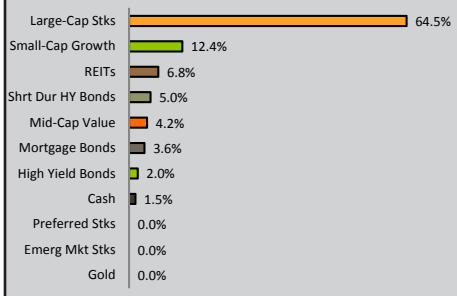
Source: Bloomberg, Barclay's Global Investors ETFs. Actual performance including dividends.

CIC Managed Accounts

Growth Portfolios

Dynamic Growth

A dynamic blend of stocks, bonds, commodities, REITs, and cash for growth investors with a bias toward timely asset classes.

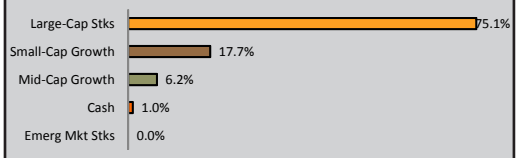


Growth

A portfolio of large- and mid-cap US stocks that are industry leaders with strong brands and timely products.

Diversified Equity

A global, all-cap equity portfolio following economic trends across capitalization and geographic ranges.



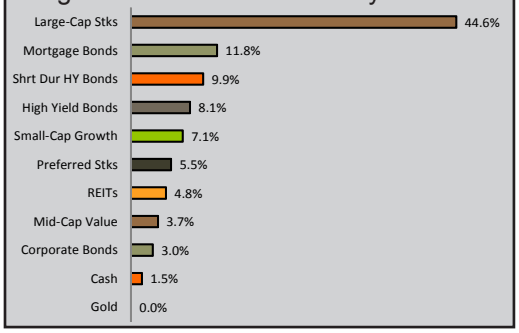
Focused REIT

A portfolio of companies whose primary business is owning and leasing real properties.

Balanced Portfolios

Asset Allocation for Income

A portfolio of stocks, bonds, and cash for moderately-conservative investors seeking income and growth with relative stability.



Equity Markets: Consumption Drives Growth

Earnings growth drives leadership in the stock market, while consumption generally drives earnings. Every market cycle has consumption themes which are either secular or cyclical in nature. Here's what is active in this market cycle.

Secular Consumption Themes:

- **Theme:** Global demand for wireless devices, digital media and cloud computing power. Demand growth is a product of industry's ability to innovate. Sector: Technology
- **Theme:** Global demand from wealthier and growing emerging market populations for meat and poultry to support more "western-like" eating habits, as well as growing demand for technologies that provide greater agricultural yields.
  Sector: Materials
- **Theme:** Global demand for energy as population grows as well as increasing demand for the technologies that make it viable to extract natural resources from the farthest reaches of the earth. Sector: Energy
- **Theme:** Increasing demand for healthcare as population ages, as well as growing demand for new and better products provided by innovation in the development of life-saving drugs, devices, and services. Sector: Healthcare

Cyclical Consumption Themes:

- **Theme:** The return of mild consumer discretionary spending balanced against purchasing decisions based on need instead of want. Sector: Consumer Discretionary/Staples
- **Theme:** Pent-up demand within the enterprise upgrade cycle. Sector: Technology
- **Theme:** The re-surfacing of emerging market infrastructure spending. Sector: Industrials
- **Theme:** Credit market stabilization and a return of demand for investment banking products and services. Sector: Financials
- **Theme:** The return of demand for manufactured products.
  Sector: Industrials, Energy

Commentary: Cyclical Leadership in Equities

Strengthening economic data in retail, manufacturing, and employment segments helped fuel cyclical sector leadership for equity markets in the third quarter of 2013. Healthcare also had repeatedly strong results as the date of new regulations taking effect draws nearer, which most consider a net positive for providers and other healthcare companies. Look for continued outperformance in consumer related sectors as a sizeable rise in year-over-year home prices has many households feeling richer and has pulled many homeowners out from underwater.

Sector Performance Review *9/30/13*

	Quarterly Change	Trailing 12-Months
Materials	9.9%	16.5%
Industrials	9.4%	31.4%
Consumer Discretionary	8.7%	34.1%
Technology	8.6%	9.3%
Healthcare	7.4%	29.4%
Energy	6.1%	13.3%
Financials	2.6%	27.6%
Consumer Staples	1.1%	14.9%
Utilities	0.4%	8.8%
Telecom	-3.3%	0.2%

Data based upon Russell 1000 Index and GICS sectors. Source: Bloomberg Financial

Fixed Income Review

By Kyle Aron

Headfake by the Fed

Kyle Aron
Senior Analyst

Markets were shocked in the third quarter as the Fed declined to begin tapering. The S&P 500 rallied 1.2% on September 18th in reaction to the broadly unexpected announcement. However, exuberance quickly wore off as markets digested the Fed's rationale for its course of action: economic data that continues to lack meaningful positive acceleration. Further, another political circus in Washington brought a negative tone to markets. Politicians' failure to compromise has now left the government in the midst of its 18th shutdown since the late 1970's. In light of these circumstances, the S&P 500 fell 2.6% from its high following the Fed's announcement as of quarter-end.

Nonetheless, the third quarter saw positive performance overall for equity markets, with the S&P 500 up over 5.0%. Gold, bolstered by the Fed's policy stance, outperformed as an asset class for the quarter, up nearly 8.0% (GLD). REITs ended the quarter down over 3.0% (IYR) as the tug of war continues to play out between an improving property market and increasing pressure of rising interest rates in the real estate lending space. REITs can essentially be seen as fixed income instruments with reliable yields, many of which become relatively less attractive in a rising rate environment. However, assuming REITs continue to see occupancy rates increase and property values accelerating to the upside, they currently appear to be undervalued.

The fixed income space generally continued to adjust for a rising rate environment in the third quarter, albeit less dramatically this quarter than the last. Yields in Treasurys rose slightly, with longer-term Treasurys again seeing a pronounced yield increase as prices declined in excess of 3.0% (TLT). Investment-grade corporate bonds were mostly flat (LQD +0.8%) in total performance. Mortgage-backed securities performed similarly (MBB +0.9%). Leveraged mortgage securities, like PCM, continue to struggle. Down over 3.0%, PCM is trading closest to its net asset value now than it has since early 2010. We continue to believe PCM will outperform as investors come to understand its value and ability to perform well in a rising rate environment, as it did throughout the mid 2000s.

Shorter-duration fixed income outperformed in the third quarter as anticipated and was a source of alpha generation. Speculative-grade short durations bonds (HYS) ended the quarter up over 3.0%. General speculative-grade bonds (HYG) gained over 2.0%. This space continues to be the most attractive within the scope of fixed income assets. Broadly, however, fixed income persists as a relatively less appealing asset class. We continue to advocate steadily reducing portfolio duration and overall exposure to fixed income.

We are entering a seasonally strong part of the year for equities. The S&P 500 has averaged a gain of 4.3% in the fourth quarter dating back to 1980, netting a positive return over 78.0% of the time. As investors formulate their expectations going forward, particular attention must be paid to the upcoming change in leadership at the Fed. As the Wall Street Journal points out, Fed Chair nominee Janet Yellen is a relatively good economic forecaster, producing "the most accurate economic forecasts of all the current Fed officials from 2009-2013." Further, she "has consistently called for the Fed to respond forcefully to high joblessness…[and] argues that inflation isn't likely to emerge with the economy in such a debilitated state, a point on which she has so far been right." It doesn't appear that Yellen will be a large departure from Bernanke, a fact in which many investors will likely find comfort.

A Word from Our Advisory Team

Jill Pletcher
Vice President
Senior Financial Advisor

Redefining Your Investment Posture as You Age

As we grow older, we all at some point face our mortality and plan for it.

Many of our clients are now finding themselves in a desirable financial position as they turn 80 and beyond. Their wealth has grown significantly more than they have expected and they no longer fear outliving their assets. As a result, the goals for their wealth can be reviewed and redefined if needed.

The long-held thought of becoming more conservative as you age is no longer embraced by everyone. The previously envisioned linear relationship between risk and age seems to look more like a bell curve today.

We have had many of our clients take the position that they will never deplete the full amount of their wealth. As such, the investment posture for their wealth should really be set up for the posture of their children, who will ultimately inherit their assets. This new type of thinking has resulted in clients, who were previously heavy in fixed income at age 70, now heavy in equities at age 80-90.

In a similar vein charitable strategies to donate wealth to good causes are now a solution as possible paths for your wealth when you pass on. Further, current laws for donating IRA assets still allow direct donations from IRAs to charities without taxes. This is good through the end of 2013.

If the above seems particularly applicable to your current situation, please don't hesitate to contact us to further discuss how Concord can help strategically position your wealth as you age.

Economic Charts

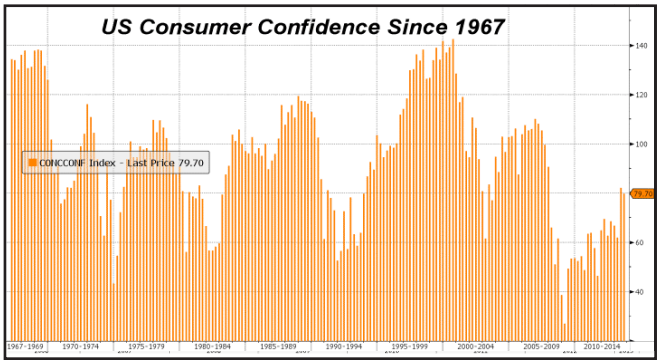


Figure 1 - Source: Bloomberg Financial
Graph of US Consumer Confidence showing post-recession highs in 2013

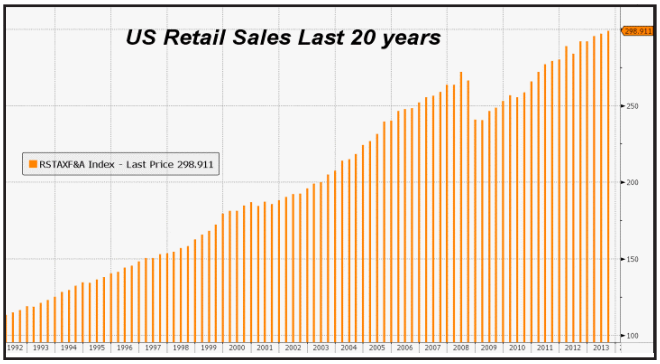


Figure 2 - Source: Bloomberg Financial
Graph of US Retail Sales exhibiting a continued steady trend upward

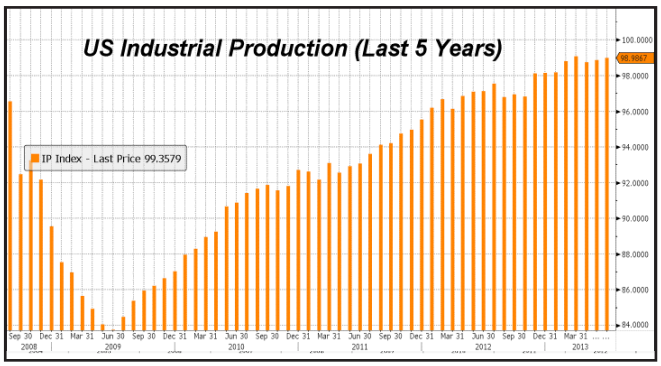


Figure 3 - Source: Bloomberg Financial
Graph of US Industrial Production showing sustained strength in 2013

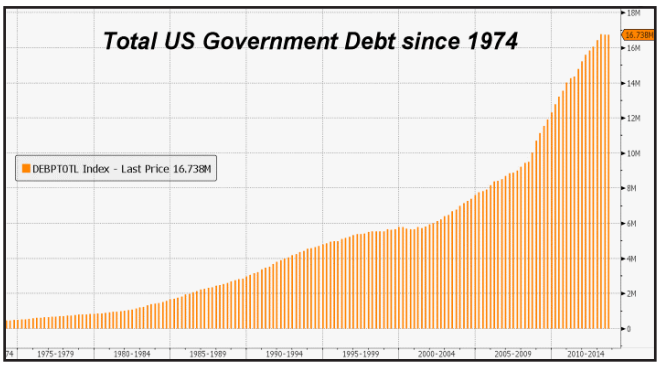


Figure 4 - Source: Bloomberg Financial
Graph of US Debt exhibiting record-high levels