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Investment Letter
Victory in Recovering Bear-Market Losses

1/20/13

Performance Highlights (as of 1/18/13)

Benefiting from market strength during the last six weeks of 2012 and now early 2013, the AAM Core Portfolio, upon which clientôs equity-targeted investments are largely based, has reclaimed the losses from the 2008/2009 bear market. This was achieved more quickly and by exposing clients to substantially less risk than the benchmark S&P500.

- Return relative to 12/31/07 (year-end high leading into bear market).
  The S&P500 finally cleared above the 12/31/07 closing price of 1468.29. As of Fridayôs close, the S&P500 is now 1.2% above that key level. In comparison, the AAM Core Portfolio is up +12.9% on a gross and +5.7% on a net of fees basis.

- Return relative to 10/31/07 (month-end high leading into bear market).
  The S&P500 is still 4.1% below the 10/31/07 pre-bear market monthly closing high of 1549.35. In comparison, the AAM Core Portfolio is up +5.6% on a gross and -1.08% on a net of fees basis.

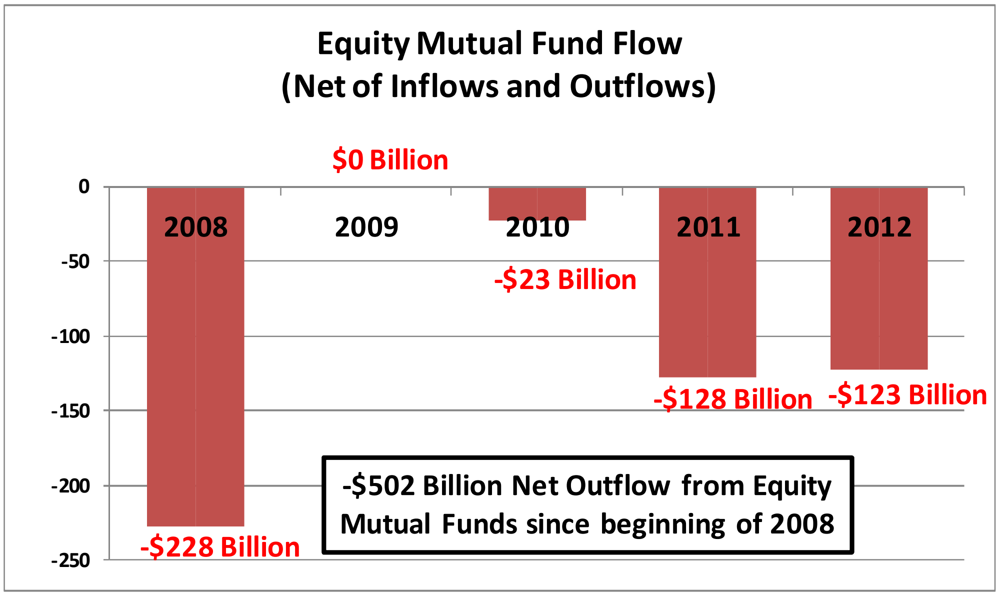
- Volatility and risk management.
  Portfolio volatility and risk, as measured by the statistical metrics of standard deviation and downside risk capture, point strongly in clientsô favor. These metrics show that the AAM Core Portfolio has operated, since inception, at a substantially reduced level of volatility relative to the S&P500.

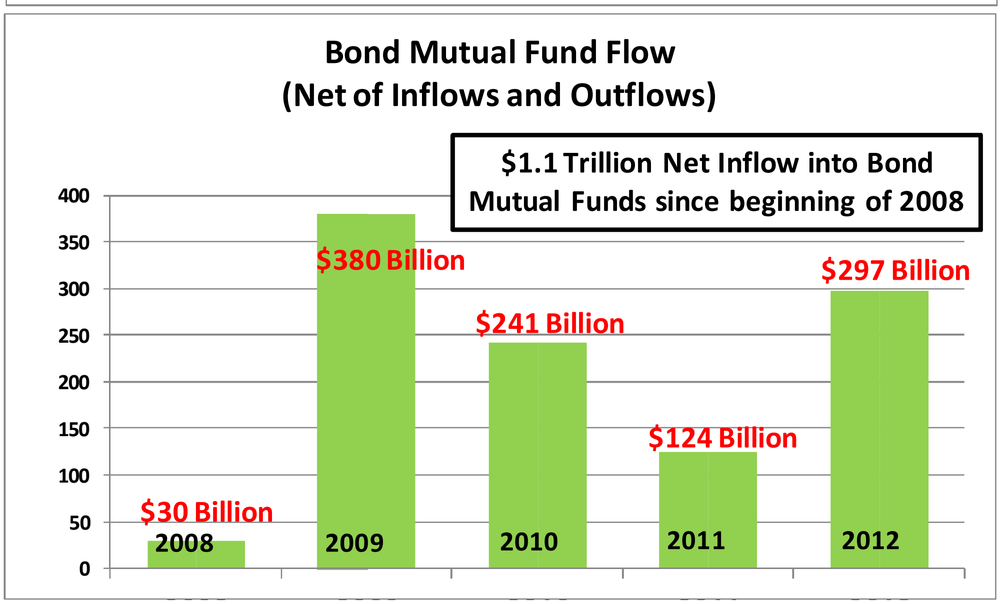
  - AAM Core Portfolioôs standard deviation of 7.4 was nearly half that of the S&P500ôs 14.6 (higher values indicate greater volatility).

  - The average downside experienced since inception in the AAM Core Portfolio, as measured from beginning of each year to the monthly low point is a mere -3.3% compared with -10.9% for the S&P500. AAM views this statistic as incredibly important, as the limited downside experienced by AAMôs clients during the bear market and the ensuing fear-inducing market corrections have helped in maintaining fortitude and sticking with their long-term investment strategies. This favorably compares to the extraordinary outflow of over $500 billion that has exited equity mutual funds over the last five years.

Analyzing Investor Fortitude

- **Five years of outflows from equity funds.** As presented below, since the beginning of 2008, $502 billion of assets have been withdrawn from equity mutual funds, while over a trillion dollars has been added to bond funds. That includes 2012 when there was nearly $300 billion of new money flowing into bond funds, while $123 billion left equity funds. Our take away from this fund flow data is that while the S&P500 has managed to regain the 12/31/07 high, many investors have not participated in this multi-year surge, leaving their portfolios stuck in the red.





Source: JP Morgan Asset Management

- **Flight to safety.** Why have investors fled the equity markets? I surmise the primary reasons are fear and distrust. It is hard to blame investors for feeling this way, given what has transpired:
    - Two bear markets in a 10 yr period
    - Flash Crash
    - U.S. Government facing crisis after crisis
    - European debt crises involving Greece, Spain, Italy and others
    - Gyrating price of oil due in part to political turmoil in the Arab world and the risk of war with Iran
    - Financial scandals, including Madoff and others defrauding clients
    - Poor economy with high unemployment
    - Exaggerated swings in the market

- **The risk of bonds.** While investors may find comfort by buying the traditionally conservative asset class of bonds, risk does exist here. As the Fed Funds rate is currently 0-0.25%, the only direction for rates to go is up. The precise timing of such a move is unclear, but Chairman Bernanke has linked it directly to improvement in the unemployment rate. Therefore, as the economy improves, investors should anticipate that rates will move up. Interest rates are inversely correlated with bond prices. Thus, when rates move up, the value of bonds will decline.

Source: JP Morgan Asset Management

Another aspect of fixed income investing that is worth noting is the historic tendency of high-yield bonds to move more in line with the equity market than the bond market. The statistical term for this is correlation[1]. High-yield corporate bonds are the bonds issued by corporations that have less than a ôBBBô credit rating and to compensate for the lower rating pay a higher yield to investors. Over the last three years, the high-yield bond index is 84% correlated with the S&P500, 43% to the corporate bond index, and -60% to the US Treasury (moves inversely to Treasuries). At Ackerman Asset Management, portfolios with fixed income needs are typically positioned in funds that we judge to have the flexibility and expertise to better navigate a challenging rate environment. High-yield bonds, mixed in with other areas of fixed income are typically an important part of these strategies.

Summary

Generating performance in the market is a necessity. Saving for retirement, college and other life milestones is critical. Some people believe the only way to invest is to buy the market and hold on for dear life, hoping everything will work out in the end. Based on the substantial outflow from equity funds during the last five years, it would seem that many do not have the fortitude required to withstand 50% plus portfolio declines. Further, it would seem that investors view their choices as rather black and white. Either buy and hold or just take your money and hide out in cash or bonds. At Ackerman Asset Management, we have successfully offered an alternative. We provide clients an opportunity to invest in the markets while managing their risk in such a way that the volatility in their portfolios has historically been as little as one-third to half that of the S&P500. This has been accomplished while generating long term returns that to date have been superior to the S&P500.

As always, my primary priorities are to: 1) protect client assets, 2) achieve favorable/market competitive returns over the course of a typical 5-7 year market cycle, and 3) manage portfolio volatility.

Thank you for your continued confidence in Ackerman Asset Management. Please feel to call me with any questions or to request a meeting in person.

Kind regards,

Jim Ackerman
01/20/13

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1 Correlation is a statistical measure of how two securities move in relation to each other. Perfect positive correlation (100%) imlies that as one security moves, either up or down, the other security will move in lockstep, in the same direction. Alternatively, perfect negative correlation means that if one security moves in either direction the security that is perfectly negatively correlated will move in the opposite direction. If the correlation is 0%, the movements of the securities are said to have no correlation; they are completely random. (Source: Investopedia)

* *The AAM Core Portfolio is the equity-focused center piece to client portfolios. An individual client's total portfolio may differ from the AAM Core Portfolio due to customization related to legacy positions, fixed income requirements, risk tolerance, size of portfolio, and other client specific reasons.*