

Investment Letter
5/23/13

“The great menace to the life of an industry is industrial self-complacency.”
- Joyce Carol Oates (twice nominated for Nobel Prize in Literature)

I. Complacency

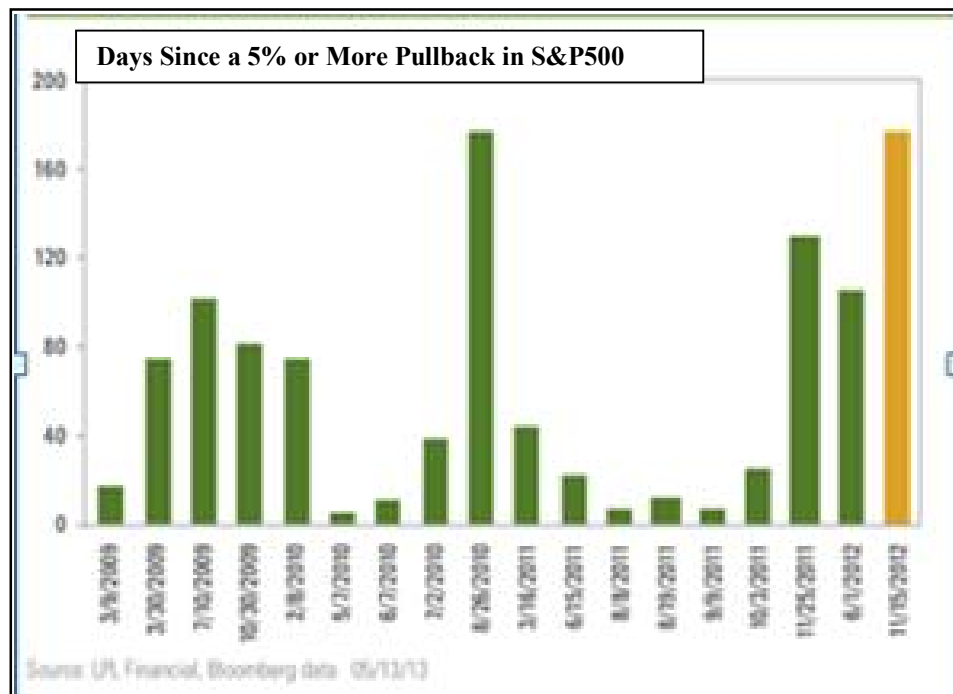
The investment industry has seemingly fallen into a state of industrial self-complacency.

Investor Complacency Defined

- A reckless belief that investment returns are easily achieved without concern for risk.
- A conscious effort to overlook apparent obstacles in an effort to maximize participation in the market.

Evidence of Complacency

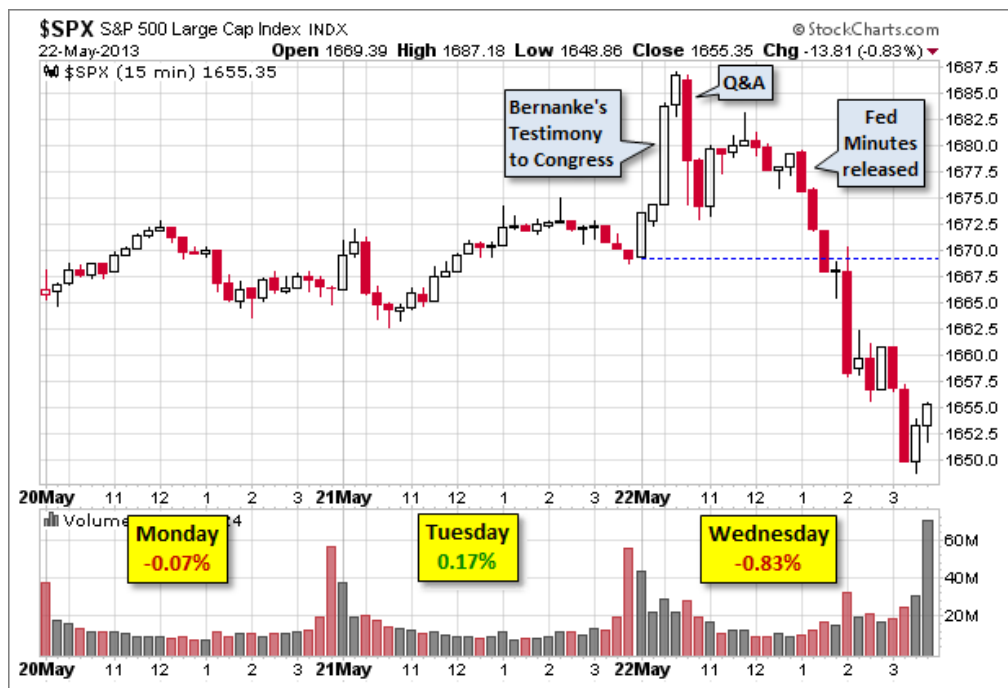
- 1) The relentless surge in the market, particularly since mid-November 2012.
 - There have only been two years since 1980 in which the S&P 500 didn't witness at least the beginning of a 5% correction by the first week of April (and now we are in May).
 - This is the 4th longest streak since 1962 without a 10% market correction.
 - “Sell in May and go away?” Will this axiom hold true?
 - It has been half a year without a 5% correction – a new record in this bull market.



2) *"Don't fight the Fed" mentality.*

Investors assume that the stock market will surely go up, given that the Federal Reserve keeps rates at the current historically low levels. The common refrain in the industry is "don't fight the Fed." This means that if the Federal Reserve Board, chaired by Ben Bernanke, is intent on keeping interest rates at rock bottom levels, then the environment is conducive to bullish market behavior. This sentiment is interpreted by many as the Fed trumps all other issues: politics, earnings, economics, European debt crises, commodity pricing, etc. That certainly seems to be the case, judging by the behavior of the market since mid-November. The concern, therefore, is the timing and approach to terminating the interest rate-suppressing, stock market-enhancing Treasury buying-program referred to as Quantitative Easing.

Yesterday was an excellent example of how the Fed leads the market. Chairman Bernanke participated in a hearing in Congress where he addressed a range of issues regarding the economy, Quantitative Easing, and even whether he would like to be reappointed Chairman in the Fall. During the course of his morning testimony, the stock market soared 1.1% to new all-time highs before violently reversing down 2.3% during the afternoon.



3) *Buying at the highs.*

After over \$500 billion exited equity mutual funds from 2008-2012, there is evidence of significant cash flowing into equities in 2013.



- 4) *Gambling behavior.* Massive call option buying by major hedge funds betting that record highs (1725 target) in the S&P 500 will be reached by year's end. This aggressive bet can be attributed to the common predicament of under performance by most investment professionals. According to *Barron's*, the funds reportedly missed the stock market's rally and are playing a vicious game of catch-up.
- 5) *Chasing the market with lower quality stocks.*
 - The 50 companies with the smallest market capitalization in the S&P 500 have outperformed the rest of the market since the start of April, with a rise of nearly 11 percent (Bespoke Investment Group).
 - Coal mining stocks, which were among the market's most loathed, have surged of late. For example, Arch Coal (ACI) peaked on Tuesday, having gained 30% in less than 5 weeks.
- 6) *Persistently low levels in the volatility index (VIX).*

The CBOE Market Volatility Index, referred to as the VIX, is trading in the vicinity of 2007 levels. The VIX tends to peak when the S&P500 troughs and resides in the sub-15 zone during periods of bullish complacency.



II. Ackerman Asset Management's (AAM) Portfolio Positioning

During the last six months, the AAM Core Portfolio has reached five year highs in equity exposure. AAM remains vigilant in monitoring client portfolios and utilizes our time-tested market signals to help guide decisions to increase or decrease equity exposure. These decisions are based on a risk/reward assessment and whether there is a suitable alternative to the current security. A couple of recent portfolio changes include the replacement of ETFs representing the emerging markets and semi-conductors with dividend and healthcare-focused securities. These changes were made in order to down shift risk as those prior securities were reaching what were assessed to be vulnerable levels.

Summary

As all of you know, I am eternally keeping an eye on downside risk. While some investment professionals are willing to swing with the volatility of the market, which can produce eye catching upside performance during bull markets, the inverse unfortunately follows with such strategies, as well. My preference, of course, is to temper some of that volatility and provide my clients a sense of calm with their investing. Portfolios managed by AAM have historically demonstrated as little as one-third to half of the volatility of the S&P500. That said, 2013 year-to-date performance in client portfolios has been particularly strong, coinciding with the strength of the markets.

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

05/23/13

** 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.*

*This investment evaluation is directed only to the client for whom the evaluation was performed. The underlying data has been obtained from sources considered to be reliable but its accuracy and completeness cannot be assured. This evaluation is for informational purposes only and is not intended to be an offer, solicitation, or recommendation with respect to the purchase or sale of any security or a recommendation of the services supplied by any money management organization. **Past performance is not a guarantee of future results.***