THE MAIN ADVISORY

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Piecing It All Together

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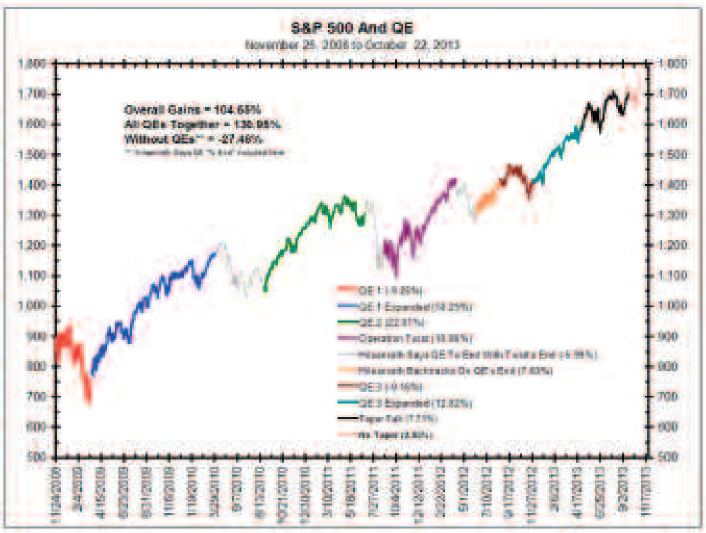
Before and Beyond…

It is my habit to spend the first few weeks of a new year reading commentaries from various renowned investment managers and economists. I intentionally do not focus on the writings and remarks from managers we commonly work with because I do not want to be jaded by their reports, but rather, want to remain open minded and objective.



Source: Forbes (via Barry Ritholtz)

The S&P 500 and the Dow Jones Industrial Average (DJIA) posted some of the best returns since the mid-1990s. The S&P 500 advanced 29.6%, its best return since 1997. The Dow had an impressive rise of 26.5%. You'd have to go back to 1995 to match this one!

The bond market and most fixed income investments did not fare as well. U.S. Treasuries fell 3.4% while high-yield debt and CCC-Rated bonds posted gains of 7% and 12.8% respectively (Source: Mauldin Economics). If you were bold enough to buy Greek bonds, you banked a 57% gain.

The uncertainties going into last year prompted many to predict little more than single digit returns for 2013. The U.S. faced the fiscal cliff, rising payroll taxes for workers, persistently high unemployment, sequestration, then the Cyprus banking crisis, then hints of a taper, then a government shutdown. So, what are the contributors to the returns of 2013?

"Risk On" was certainly the motto for 2013. The Federal Reserve Bank has created an environment through their Quantitative Easing (QE), i.e. "stimulus," that forces anyone with capital to seek out more risk than they'd ordinarily take because returns offered by safer guaranteed savings instruments generated little more than zero percent rates. Equities have been the benefactor of capital inflows. One analyst wrote, "In today's markets, which function at the whim of the Federal Reserve as opposed to market forces, the art of researching companies, analyzing their balance sheets, and the strengths and weaknesses of their business, and then trying to sort the wheat from the chaff has been lost."

I gasped when I discovered the chart depicting the rise of the S&P 500 in coordination with QE and felt I had to share it with our readers. Here is what I especially want to point out---notice how the S&P 500 (the market) reacts when the first round of QE ended in 2010. This prompted the Fed to implement QE 2, only to realize similar results when they stopped. So, they go for round three known as Operation Twist, then QE 3. Follow the graph to 2013 (color is black) when the Federal Reserve Chairman announced a $20 billion per month taper to begin soon. This caused both equity and fixed income markets to decline, so when September rolled around, the month the pullback was to take place, Ben Bernanke pulled the taper off the table. The last few months of 2013 resulted in more gains with the news. Total gain in the S&P 500 through the stimulus programs is 130.95%; without stimulus, the result is -27.46%.

Taper is back on for 2014--January, in fact. However, the taper will start at $10 billion per month, instead of $20 billion originally proposed, and increase, possibly, if economic growth can support more. Tapering by $10 billion per month is hardly enough to move the needle, and the stock market barely reacted. The goal is to end all stimulus. All eyes are fixated on the bond market as interest rates are expected to "slowly" rise to 4% on the 10-year Treasury. If rates suddenly spike, all bets are off for both the bond and equity markets!

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Assembling your financial puzzle one piece at a time.

Before and Beyond…
(continued from Front Page)

Darla D. Main, CFP®

President and CEO of Main Advisory, Inc.

Stock prices are supposed to appreciate on rising corporate profits, right? Nearly every commentary I have read, be it bullish or bearish, makes remarks about "multiple expansion." Multiple expansion results when the "P" (price) goes up but the "E" (earnings) stagnate. Investors are willing to pay up for future earnings; in other words, there is an expectation that earnings will eventually catch up. Revenue growth was actually on the decline heading into year-end 2013. But, there is more to the earnings story.

Headlines from the leading financial publications and talking heads on CNBC proclaim that corporate profits are at an all-time high. On the surface that looks true. Admittedly, there is some improvement in profitability due to profit margins being propped up by cheap capital courtesy of the Fed, lower numbers of employed workers, savings from increasing numbers of benefit-free, part-time workers, and a total lack of wage pressure by those fully employed. However, year-over-year earnings growth from operations has not kept pace as in the previous two to three years. Earnings have been inflated due to stock buybacks.

2013 was a banner year for corporate stock buybacks. This was a major contributing factor to the increase in reported earnings. If net profits are $100 and there are 100 shares outstanding, then earnings per share are $1. If 50% of the shares are taken off the market through a buyback, leaving 50 shares outstanding, then the $100 of earnings results in earnings per share of $2. Earnings go up despite a zero change in profitability.

I've often heard "the trend is your friend" and "don't fight the fed," but this advice can lead to extremes. David Cullen of Peak Prosperity wrote "Green Mountain Coffee (GMCR) was up 100% this year and 200% off its 2012 lows. Other stocks that popped up include Tesla (320%), BestBuy (250%), and Fannie Mae (1000%). Tesla's market cap ($20 billion) and number of cars sold (35,000 per year) corresponds to >$500K per car. Netflix is now sporting a p/e of 200, causing value investors to wince and momentum traders to just keep on clicking. Amazon.com shares were up 60% since 2011 whereas their revenues have fallen 50% over that same time period. Shares in Tweeter, a bankrupt electronics retailer, briefly soared 1,800% on October 4th because some investors mistook its ticker symbol TWTRQ for TWTR, the shorthand chosen by Twitter ahead of the IPO."

The stellar performer, however, was Bitcoin, everybody's favorite virtual currency, starting the year at $13 per Bitcoin. And then, it ran and ran and ran. A return of 100% **in 15 minutes** was upstaged by a *100-fold* jump in the first *10 months of 2013*.

It is so difficult to explain all the economic factors at work, i.e. housing, mortgage applications, employment, auto sales, retail sales, global growth and health, Japan's massive stimulus program, Middle Eastern conflicts, etc., in this short article. However, all these have a serious impact on markets. Here are a few outlooks from noted investment managers.

- "Even though equities may still advance, run-ups since 2009 and throughout 2013 have reduced our forward view for annual returns to mid-to-high single digits. We prefer companies with positive cash flow profiles, low valuations, economic sensitivity, and/or above average secular growth." *Bob Doll, Chief Equity Strategist and Senior Portfolio Manager at Nuveen Asset Management.*

- "QE is not anywhere near as effective as people think. We're not going to know the damaging effects from QE for some time. It's going to burn us, but in the short term, you don't see the effects of it." *Joe LaVorgna, Deutsche Asset Management's chief U.S. economist.*

- "…investors have been willing to pay more for a stream of earnings that has not accelerated much. I believe this sets the stage for increased volatility in stock prices." *Sam Stewart, founder and chief investment officer, Wasatch Advisors.*

The first few days of January are said to set the tone for the year. Thus far, the employment reports disappointed, the market indices have posted more down days than up, and companies continue to guide earnings lower. Several tax breaks expired on January 1, and the effects of the Affordable Health Care are still unknown. I'll continue to peel the onion to help you understand what's brewing below the headlines. ■

What *is* Bitcoin, Anyway?

By Lauren C. Peck, CFP®

If you're like me, you've probably heard or read about Bitcoin and thought, "What is Bitcoin, anyway?" While the concept may be somewhat complex and unfamiliar, the following is my attempt to break it down for you in a way that is easy to understand.

Bitcoin is a purely digital currency – kind of like cash for the Internet. It was developed and introduced by a shadowy Japanese programmer named Satoshi Nakamato in 2008. Little is known about Nakamoto, and he/she remains relatively anonymous to this day.

Bitcoin is the first decentralized peer-to-peer payment network that is powered by its users with no central authority or middlemen. Unlike traditional currency, which is issued in digital and physical form by governments, Bitcoin exists only online and is maintained by a decentralized network of computers called "miners."

Bitcoins enter circulation through a process called "mining" whereby miners attempt to solve increasingly complex math problems (designed to get more difficult over time) for which they are awarded bitcoins (which come in the form of a long string of numbers and letters known as an "address"). Anyone can become a miner using his or her home computer – though the need for more specialized and costly computer systems is becoming a deterrent for the average bitcoin enthusiast.

As more miners enter the network, competition to find solutions also increases, and as more bitcoins are created, the potential payoff falls. The system is designed so that the total number of bitcoins won't exceed 21 million.

One of the many things that makes Bitcoin unique is the fact that all bitcoin transactions are recorded (using cryptography) on a public ledger which is shared across the Internet. This innovation helps prevent fraud and eliminate counterfeiting – which is important given there is no government oversight or central database to track transactions.

Bitcoin miners are, in a sense, both maintainers of the public ledger and expanders of the virtual money supply.

Miners store bitcoins in password protected virtual "wallets" which save the addresses. Once created, bitcoins can be traded on currency exchanges or used as money to purchase goods and services from merchants that accept it. Say a bitcoin owner wants to use his/her coins to make a purchase, the retailer gives the owner his bitcoin address, to which the owner sends the bitcoin or fraction of a bitcoin as payment.

One of the major risks associated with Bitcoin, and one of the key determinants to its success, is whether or not it will ever become widely accepted as a means of exchange. Investors who worry about inflation like the fact that the supply of bitcoins (capped at 21 million) can't be manipulated by a central authority. Some have even compared the digital currency to gold – a commodity that is widely used to hedge against inflation.

Because of its limited quantity, Bitcoin is traded like a commodity – with its worth determined by supply and demand. In other words, the price of Bitcoin is determined entirely by what someone else is willing to pay for it.

As I write this, the price of one bitcoin in US dollars is $840.60. There is a likelihood that Bitcoin will end up being worthless; but, there is also a chance that it will end up taking over at least part of gold's traditional role as a "store of value." A small amount of bitcoin may be similar to a lottery ticket. It will probably be worth nothing, but if it's worth something, it could be a lot.

As an asset class, Bitcoin is incredibly volatile. Its all-or-nothing nature means that investors shouldn't treat it as they would a normal asset class at all and instead think of it as long-term speculation rather than a short-term trade or long-term investment.

Speculators have liked it because Bitcoin's price in U.S. dollars has grown exponentially since 2008. Over the past six months, the price of a bitcoin has shot up, dived, shot up again – and kept on rising, making bitcoin mining one of the most frenzied corners in technology.

As bitcoin mania unfolds, the currency might turn out to be merely a speculative bubble that bursts as investors lose interest. But, by risking very little, at the very least, an investor might be richly rewarded.

Right now, about 12 million bitcoins have been found, with about 9 million yet to be discovered. Happy mining! ■

Important Information about Email …

With the increasing need to protect your financial information in every way, we are using a **secure email system** should we need to email you financial data.

The email you will see in your Inbox with be from one of us, and once you open it, you will see in the body of the message "New Secure Email from Suzanne@MainAdvisory.com." You need to click "OPEN MESSAGE" to be linked to the Total Control Secure Email system.

If you are new to Total Control Secure Email, you will need to create a password. Here is what the screen will look like:

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Click on "Register" to set up your password and enter your email address. In a moment, an email will be sent to you to confirm your email address, then you simply re-enter the password you created and open the email we have sent. You can also reply to us using this system. Remember to keep this password in a safe place as you will be asked for it again whenever we use Total Control Secure Email to communicate. Thanks! ■

Our Team!

The Main Advisory Team. Suzanne Campanella, Lauren Peck, and Darla Main.

Darla Main - President, Main Advisory, Inc.

We peel away a bit from the cold gray of Pittsburgh the first part of January to our timeshare outside of San Juan, Puerto Rico. This year, we were awakened at midnight when our bed began vibrating and sounds of cracking and creaking grew louder. An earthquake measuring 6.5 was occurring approximately 40 miles from shore. The palm trees outside our window were not moving, so we immediately concluded there wasn't a tornado. There was no damage to anything but our nerves, and we joked later about how quickly we were running for cover!

Lauren Peck - Assistant Director of Investments

The 2014 Sochi Olympics are still weeks away, but I am more excited than ever to watch. I can't really pinpoint the reason for my newfound excitement, but I'm counting the days till the opening ceremonies nonetheless (Friday, February 7!). I love watching the competitions unfold. I love the behind-the-scenes stories about the athletes and the sacrifices they made to get to the Olympics. I love learning about the sports I've never had the opportunity to try (pretty much all 15 winter Olympic sports with the exception of downhill skiing). I love acquiring new information about the country that hosts the Olympics. And, I love the rivalries between countries and the pride I feel in the United States when I see our athletes bring home medals. For two weeks in February it is a good bet that I'll be glued to my TV or computer, cheering on our athletes, when I'm not at work or busy. I hope you'll join me, too! Go USA!

Suzanne Campanella - Client Services

Being a lover of classical music and facing these long winter months, I thought what better time than to dive into the world of opera! My newest companion now is "Opera for Dummies," and along with my local PBS radio station, I can listen to the Metropolitan Opera on Saturday afternoons. My family was a bit taken aback when I wanted privacy for so long on Saturday, but I nestled away with my trusty radio and listened to "Die Fledermaus," live from the Met. The announcers help so much with the story and the characters, and blessedly, this version was updated to the early 1900s and *sung in English*. "Die Fledermaus" is a lovely, light, waltz-filled opera, written by Strauss, very familiar and easy to listen to. Next week is "Eugene Onegin," the most successful of Tchaikovsky's ten opera efforts. Will I make it through all three acts?!

Journeys & Travels

… to the Dolomites of Italy

Darla writes, "Many of you know we frequently visit Italy. While Tuscany is a favorite hideaway for us, we recently fell in love with the northern mountain region of Italy known as the Dolomites.

Our Italian friends who run a fabulous boutique inn in Montepulciano mapped out our trip to the Dolomite region by recommending fabulous hotel spots, restaurants, and activities. We began the journey from Tuscany northward with a lunch stop at Lake LaGarda--oh, what a gem that few travel guides ever mention. Then, on to Ortesi, a quaint little ski village that sits at the foot of the Alpe di Suisi. A postcard would not do justice to the beauty of this town. Balconies overflow with gorgeous flowers boasting a broad palate of color; every bend in the street invokes another breathtaking ah.

Then, we hopped a cable car for the first leg to the top of the Alpe di Suisi, then boarded a ski lift for the remainder of the climb. Once on top, we were awestruck with the beauty of Europe's largest high-alpine meadow — eight miles wide, 20 miles long, and soaring up to 6,500 feet. I felt like I had stepped right onto the set of *The Sound of Music* minus the beautiful voice. The meadow was open with foot and bike trails, and cows adorned with bells grazed in the open pastures. As we strolled along the meadow pathways, we were surrounded by the mountains high above that provided a great place for avid hang-gliders to sharpen their skills.

I do believe when we return, we will spend most of our time near Ortesi where English is not frequently spoken but the hospitality is incredible. The food is also not Italian, but reflects more of the Austrian/German influence of its neighbors less than 100 kilometers away. If you want to go where few Americans travel, I'd highly recommend the Dolomite region of northern Italy. I suggest you get there before Rick Steve's or Fomer's "puts it on the map." ■