January 2014

Dear Clients and Friends:

I hope you all had a great holiday season. Except for Alabama's unfortunate stumbles in the Iron Bowl and the Sugar Bowl, we had a great one. Christmas is hectic and crazy for everyone, but it is exponentially fun with a wild 4 year old. Finn is very much into Star Wars. He gets it very honestly, as I was pretty obsessed with it from age 3 (the year Empire Strikes Back came out) until, well, now. Earlier this year I gave Finn my old Star Wars toys and while it was hard for me to remove them from my desk in my office, I thought he might enjoy them, but he has really taken my enjoyment to a whole new level. Finn's birthday in late October was centered around Star Wars, he was Luke Skywalker for Halloween and we are pretty sure "The Force" gives Santa his powers to travel the world at Christmas.

FATHER AND SON

The last year has seen the market almost behave like it is from a galaxy far, far away. Most investors as well as professional money managers would not have dreamed that the S&P 500 would have ended up 32.39% in 2013. As we have discussed in previous letters, the market has continued to defy odds. Most people are in diversified portfolios and probably did not see returns like the S&P provided. In fact, there are very few managers that I use that beat the S&P 500 last year, but many did very well. Strangely, this can be a trying time for investors. Most regular investors would like those high returns, but surely do not want to experience the significant double digit losses that can come along with a full allocation to stocks in a portfolio. Still, people will feel the urge to adjust their portfolios at the beginning of this year in an attempt to get in while the getting is good.

There are primary fears in investing, but they have the same name—"fear of loss". It is either fear that you lose money or fear that you lose opportunity by not keeping up with the market. Reacting to those fears usually results in bad decisions.

The fear of loss is a path to the Dark Side—Yoda

Today, as you read this, there are investors out there who are analyzing their accounts and looking at the market and thinking that they need to make a change and maybe get more aggressive. They may think they don't need bonds anymore in their portfolio, since bonds lost money last year. They may think that there is no need for non correlated strategies or alternatives, because they sure didn't do much last year either. Maybe it is just time to add to last year's winners, right? That is the fear of loss creeping in. Let's let others make the bad decisions based on fear instead of rational investing. Remember what your goals were when you started.

Who is more foolish, the fool? Or the Fool who follows him?—Obi- Wan Kenobi

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There is an opinion on every streetcorner. Virtually every manager that we use in client accounts has a different view on today's market. That is why we build diversified portfolios. Good money managers know that they can only have educated guesses as to what lies ahead and invest accordingly. Our job is to find those that have shown the ability to put the blinders on and forge ahead, not wavering in the face of an ever changing market.

Impossible to see, the future is—Yoda

I saw this in action in November when I attended a Due Diligence meeting for PIMCO at their headquarters in Newport Beach, CA. There are few settings as scenic and fancy as Newport Beach. I heard in depth presentations from some of their top people, who are absolutely among the brightest minds in all of finance. Our first speaker on day 2 was Mihir Worah, who is head of the real return team (inflation strategies). Mihir has been with PIMCO for 13 years. He has a PhD in theoretical physics and did postdoctoral research at Stanford where he built models to explain the difference between matter and anti-matter. Additionally, he literally wrote the book on commodity investing called "Intelligent Commodity Investing".

This was pretty much the norm of each speaker and portfolio manager we were able to hear. More than one of the speakers was a past winner of Morningstar's Mutual Fund Manager of the Year. It was truly an impressive group and deepened my confidence in PIMCO as a manager to use in client accounts.

What might have been even more impressive was the down to earth quality that PIMCO showed. Globally, PIMCO manages nearly $2 Trillion. They are an absolute behemoth and the success they have had in the years post the financial crisis have been second to none. With all of that success, they still don't have their name on their building and while the headquarters was very nice, it was not to the level you would expect from a firm managing that amount of money. In fact, their trading floor is probably about the same size as Sterne Agee's in Birmingham, but I will note PIMCO's has a view of the Pacific. You can see it in photo on the right of me with PIMCO founder and billionaire Bill Gross. It was good to see the largest manager I use with clients operates in a similar fashion as

PATRICK AND PIMCO FOUNDER BILL GROSS

the smaller managers such as Roumell, Reaves, Princeton etc.

I would love to talk more about some of the insights I gathered in Newport Beach or the upcoming new Star Wars movies if you have an interest. Proper management of client accounts takes a bit more than just buying a few mutual funds and saying "may the force be with you", and unfortunately we are not blessed with small green 900 year old teachers. Now, let's see what happens in 2014.