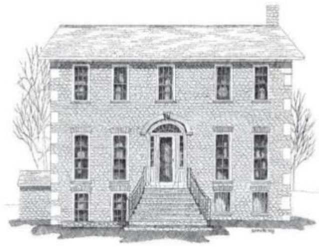

ON THE HORIZON...
NEWS, NOTES, AND COMMENTARY
FOR CLIENTS AND FRIENDS OF THE HORIZON GROUP

BY MARK CONGDON, SENIOR PARTNER

WASHINGTON AND INTEREST RATE NONSENSE

October 7, 2013

As I write this note this morning it looks as if the markets are finally reacting to the nonsense playing out in Washington. I know many of you are very worried about the brinksmanship and what it means for your money. It would be nearly impossible not to be a little concerned given the irresponsible comments from everyone involved. The lack of leadership is frightening.

That’s why a fair number of clients have called wondering what investments we’re moving in order to react to this. Worse yet, several called Friday wanting to go to cash until this is all over. Although this situation is serious and can cause a good deal of volatility this month, history suggests it’s just noise and will be over as quickly as it started. The United States will not default on its debt. It’s possible we’ll miss a deadline by a few hours, but then we’ll come to a resolution and move on.

Let’s compare our investment journey to hiking the Appalachian Trail with me serving as your guide. Jumping out of the market over this issue would be like getting scared and wanting off the trail because we came upon a snake and a rabid raccoon (a perfect metaphor for a donkey and elephant). I don’t think anyone should get off the trail. I know you could get lost and never come back. And even though I know fear of snakes is real, we could move off the trail and immediately find ourselves face to face with a mother bear and her cubs. Trust me, there is no better way to get mauled in the investment world than to get whipsawed in markets that could drop and recover within days or weeks. We advise holding to the path and waiting this out.

Staying with our hiking analogy, I'd like to tell you that, now that we're through it, we've come through a very treacherous stretch. Most people are unaware, but the quarter ended June 30th was the worst ever for long-term high quality bonds. **They lost a whopping 39%,** topping the record 33% loss in 2009. Experience taught me this storm was coming and I adjusted our course – the duration of our clients' bond portfolios had been reduced dramatically in 2012 – I'll admit a bit early. But the fact is our well-diversified bond bucket (bucket #1) held its ground while others took the brunt of a disastrous reset in the bond market head on. Our typical client was down less than 2% on that portion of their portfolio, and some even held funds that profited as we introduced negative duration funds. Add in excellent returns from the long-term growth bucket, and it's been a pretty good year. We made it through a dangerous stretch. Admittedly with a nervous night or two and a twisted ankle, but we're still healthy and on course.

One last thought about the upcoming debt ceiling debacle. Many clients want out of stocks and bonds because they are certain we're going over the cliff. One of my favorite shows years ago was "Early Edition", where a man named Gary Hobson got the Chicago Sun Times a day early and averted a disaster for some lucky soul. Let's suppose we could see the October 18th headline today and it said "U.S. CREDIT LIMIT REACHED – NO AGREEMENT YET!" My guess is the stock market would react negatively and spring back as soon as the limit was extended. But how would the bond market react? One school of thought is that interest rates would skyrocket overnight. That's because overseas investors could demand higher rates for the perceived extra risk of U.S. bonds. But markets are forward thinking. Another school of thought is that rates would plummet based on the drag that even a temporary or partial default would place on an already weak economy and labor market. That would forestall tapering by the Fed for quite a while. The point is that even if we knew for sure what was going to happen, it's totally unclear how the market would react.

The only strategy is to stay well-diversified and on the trail ahead. As your guide, I stay focused on the long-term threats that can cause permanent damage to your portfolio and financial health. Just like I have for the past 27 years, I'll make course corrections when warranted. However, I don't believe the temporary nature of the current manufactured crisis calls for action. The one thing you can take to the bank is that I'll be with you, step by step.

Mark