March 3, 2014
As always, we encourage you to share this newsletter with friends, family members and colleagues.

Themes for 2014

By John M. Silvis, CFA
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It turned out 2013 was an eventful year filled with government shutdowns, healthcare websites and the much anticipated start of tapering. We saw the S&P 500 Index rise over 32%, capping the best year since 1995, solidifying our belief that we are in the early stages of a secular bull market. As we look towards 2014, we thought it would be good to outline a few themes (and maybe a prediction or two) that we will be focusing on throughout the year. As John M. Keynes once said, "It is better to be roughly right than precisely wrong."

- **Great years are followed by good years.** According to research by ISI Group, since 1950 the S&P 500 index has returned 27% or more 6 times. The following year, the average return (all positive) has been approximately 19%, with the first quarter averaging 7%.

- **Expect corrections along the way.** We are in the second year of the four year presidential cycle which is also called the mid-term year due to the congressional elections. Historically, the mid-term year has the most 5% corrections of any in the four year cycle.

- **Less fiscal drag in 2014.** With congressional leaders agreeing to a two year budget framework, looming shutdowns should be avoided. Rising tax revenues and constrained spending should also help lower fiscal drag going forward. Areas of concern: the upcoming debt ceiling, implementation of Obamacare and the midterm elections in November.

- **We continue to favor Developed Markets over Emerging Markets.** Developed Markets (led by the U.S.) should continue to experience expanding economic growth and low inflation in 2014. On the flip side, Emerging Markets (led by China) will see slower growth and rising inflation.

- **Returning to normal monetary policy?** With the announcement back in December that the Fed would start tapering its bond purchases, we may be beginning the "return to normalcy." We do not see the Fed raising rates in 2014.

- **GDP growth improves throughout the year**. The domestic economy will continue to improve and GDP growth should top 3% by year end. The unemployment rate will trend lower as the economy picks up momentum throughout the year. On the other side of the globe, China will struggle to meet their 7% growth target in 2014 as they continue the transition to a consumer-based economy. Overall, global growth should accelerate.

- **Europe still in question but markets should improve.** The economy in Europe is slowly improving but not totally out of the woods yet. Overall valuations are attractive in most of Europe, but questions still remain as they move towards more fiscal unification. ECB President Draghi is committed to keeping rates low "for an extended period of time."

- **Yield on the 10-year Treasury likely to rise.** With the Fed embarking on "tapering," the yields will likely rise throughout the year with 3% possibly becoming the new normal.

- **Corporations will continue to return cash.** As earnings per share for the S&P 500 rise towards our target of $120 over the next 2 years, corporations will continue to return large cash hordes to shareholders through dividend increases and share buybacks. Multiples will expand further in 2014 towards 17x forward earnings as inflation remains low.

- **Rotation out of bond funds continues.** Bond Mutual funds saw a total redemption of over $79 billion in 2013 according to the Investment Company Institute (ICI). The trend could pick up steam in 2014 as yields rise and bond fund returns are constrained. The question is whether or not the retail investor will return to equities after sitting most of the rally out over the last few years.

It is safe to say that 2014 has not gotten off to a good start. The month of January saw a negative return of -3.46% on the S&P 500 Index and -3.97% on the global MSCI ACWI Index. Since bottoming in early February with the S&P down -5.66% and the ACWI down -5.51%, both indices have come within striking distance of the previous highs. As we stated early in the year, we expect more volatility in 2014, but still see positive returns in the equity markets over the next 12 months. Weather continues to wreak havoc on the most recently released economic numbers (it has been the coldest start of a year since 1994), but overall, signs still point to an improving economic environment.

Overseas we continue to see a decoupling of the international markets, as Europe looks to have exited their most recent recession and has seen signs of economic improvement. The U.K. continues to pledge low rates for the foreseeable future (taking a page from ***former*** Fed Chairman Bernanke's playbook) while they benefit from higher growth. Meanwhile, Brazil and India are both flirting with negative growth on the horizon and rising inflation. Unrest in the Ukraine and Venezuela has been playing out on the front page and is a reminder that democracy should never be taken for granted.

We continue to be cautiously optimistic on the equity markets as we head into 2014, keeping in mind that there will be corrections along the way and they should be viewed as opportunities. We believe we are at the beginning of a secular bull market in equities and valuations remain reasonable. Overall, current economic news remains positive, earnings continue to grow and inflation is well contained, forming a solid foundation for the upcoming year.

Fixed Income Commentary

After failing to decisively break through the 3.0% resistance level in early January, the 10-year Treasury is once again hovering towards the middle of our near-term trading range at 2.73%. The move back down in rates has been supportive for the Barclays U.S. Aggregate, which has returned 1.41% YTD through February 20, 2014. A key support and source of demand when rates have brushed up against 3.0% has been the $16 trillion dollar U.S. pension fund industry which, according to Federal Reserve data, shifted out of equities and into bonds in the third quarter at the fastest rate since 2008. After a strong rally in domestic equities last year, corporations are now closer to closing pension shortfalls than they have been in several years. As such, corporate pension plans are more apt to reduce equity risk going forward. The shift out of equities and into bonds allows corporations to better match liabilities and reduce the risk of future deficits. A prime example of this is Ford Motor Company, which according to Bloomberg, is looking to increase its fixed income allocation to 80%, up significantly from the 55% allocation held in 2012. Despite this strong source of demand, our view is that rates will eventually gravitate higher as the Fed seeks to complete its asset purchase program by the 4th quarter of this year. As such, we remain short duration and tactically underweight "taper" sensitive sectors such as U.S. Treasuries, TIPS and Agency MBS in client portfolios.

Estate Planning Changes its Stripes

By Thomas A. Seifert, CPA/PFS
Partner & Senior Advisor

To state the obvious, estate planners had always focused on reducing or eliminating estate tax. Now the focus may need to shift to reducing capital gain and income tax, as well as unwarranted complexity. Under the new law, the unified estate tax exemption is now $5.25 million, indexed for inflation. This means every U.S. person can own up to $5.25 million at the time they die and pay no estate tax. The estate tax rate, which is now 40%, only applies if your taxable estate exceeds that amount. And if you are married, you get two exemptions for a total of $10,500,000.

For most people (99% of us), the federal estate tax will no longer be an issue. Most estates are below $5.25 million and certainly way below $10.5 million for married couples. Contrast this to a little over ten years ago when the estate tax exclusion amount was $675,000. Additionally, Ohio has eliminated its estate tax effective January 1, 2013 that had previously taxed estates over $338,000 which in itself warranted some estate planning. If you are domiciled in a state that still has an estate tax you need to consider its ramifications on your estate plan.

What to do now…If you have a will or a living trust, you should check to see if it includes a bypass trust (also referred as A-B trust, credit shelter trust or exemption trust). In the past, these trusts were recommended for married couples. This strategy comprises of setting aside the deceased spouse's share of the estate into a bypass trust so that when the surviving spouse dies, only his/her half of the estate would remain subject to the estate tax.

This was necessary to utilize the first spouse's exemption amount or else it would go unutilized and be wasted. In addition to the increased exemption, the new law made permanent the concept of "portability." The surviving spouse can treat the unused deceased spouse's estate tax exemption as their own, rendering the establishment of a bypass trust for estate tax purposes unnecessary. (Caveat: There may be some non-tax reasons to have such a bypass trust funded depending on your personal situation, for example, a blended family).

Potential negative impacts to having an irrevocable bypass trust funded:

- Inadvertently locking up too much money in the bypass trust due to the increased exemption.
- Higher overall income tax on undistributed trust income as the highest tax rates (39.5%) kick in at around $12,000 of trust taxable income.
- 3.8% Medicare investment income surtax likewise comes into play at the lower $12,000 level.
- No tax "step-up" at the surviving spouse's death since assets in the bypass trust would not be includable in his/her estate. This may result in your heirs incurring significant capital gains unnecessarily.
- Expenses and complexity resulting from having assets in an irrevocable trust.

A simple amendment to your current estate plan might be all that is required to alter the amount of assets automatically going into the bypass trust on the first spouse's death. It is recommended that you should thoroughly review the pros and cons of having a bypass trust with your family's estate tax attorney based on your own set of circumstances. There may be non-tax benefits that outweigh some of the negatives noted above.

What to do periodically... It is a good idea to review your estate plan every few years or when there are significant estate tax law changes. You should consider updating them if you've experienced any major life changes, including marital status, children, death of anyone named in the document, moving to a new state or large increases (or decreases) in the value of your estate.

Please contact a member of your Fairport team if you have any questions or you would like to discuss any estate planning matters in more detail.

Community Beacon – Cleveland Foundation

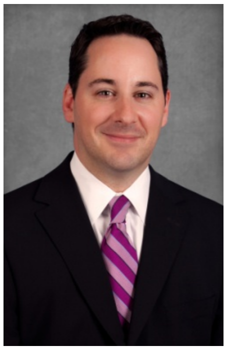
In early February, we announced the Cleveland Foundation as our 2014 Community Beacon recipient. Desiring to unify our efforts as a firm to provide meaningful support to the Northeast Ohio community, Fairport selects one charitable organization per year that reflects our firm's values. We are proud to join many of our clients and friends who are active foundation donors, board members, employees and supporters.

Fairport is celebrating the Cleveland Foundation's centennial year in a few special ways. Combining our professional expertise, we are partnering with the foundation to present four exciting educational programs. We are tailoring the presentations to address the unique financial and philanthropic questions of individuals in like-stages of their careers and lives. In addition to our series of educational events, Fairport will also be joining the Cleveland Foundation to delve into the past, present and future of our neighborhoods. In the fall, we will enjoy a guided trolley tour from Midtown's Health Corridor to Greater University Circle, learning about exciting civic plans and projects along the way. We will end our tour with a group volunteer activity with a cause critical to the area.

We will continue to share opportunities for you to participate in the Cleveland Foundation's community-wide, year-long celebration. Happy birthday, Cleveland Foundation!

Fairport News
Read about our most recent accolades, community involvement and continuing education.

Ken Coleman has formed an industry study group with five other registered investment advisory firms from across the country with combined assets under management of over $10 billion.



Andrew Connors has been elected to President of the Board of Directors of Esperanza, Inc. Esperanza (meaning “hope”), began in the early 1980s as a community project to improve the educational opportunities for Hispanics by motivating and recognizing academic achievement through scholarships. The mission of Esperanza is to improve the academic achievement of Hispanics in Greater Cleveland by supporting students to graduate high school and promoting post-secondary educational attainment. Esperanza works to motivate academic achievement, enhance the quality of economic and community life, promote continuity of community through leadership, offer enriched educational services and opportunities, and provide scholarship assistance.

We are proud to announce that **Heather Ettinger** has been asked to serve on the Schwab (Institutional) Advisor Services Advisory Board. She is one of only 21 such members who are leaders in their respective firms representing top registered investment advisors from across the United States. Heather will serve a two-year term and as advisory board member will participate in meetings and discussions with Schwab top management about Schwab’s role in providing services for independent investment advisory firms and their clients. This is a very noteworthy acknowledgement of the impact Heather has made in the industry and within our firm. Please join us in congratulating Heather on this special appointment.

Heather Ettinger met with the members of the Family Wealth Advisors Council (FWAC) in San Diego in January. Notably, FWAC has just released its second Women of Wealth white paper entitled “Caught in the Middle: How Does the Sandwich Generation Woman Not Get Squeezed.”

Tom Seifert has been nominated to serve on a sub-committee of the Gesu Church Endowment fund to rewrite the investment policy statement using socially responsible stewardship in how the endowment funds are to be managed and invested.

FINAL IMAGE
A client relaxing in Miami, FL shared this photo with us…
Spring is Almost Here, Clevelanders!

Newsletter Disclosures

This newsletter represents an assessment of the economic and market environment at a specific moment in time and is not intended to be a forecast of future events or any guarantee of future results. It is for informational purposes only and should not be relied upon as research or investment/financial planning/tax advice. It should not be considered as a solicitation or recommendation by Fairport to buy, sell or continue to hold securities or other investments. Past performance is not a guarantee of future results, and is not indicative of any specific investment. It should not be assumed that the investment process and strategy discussed herein has been or will prove to be profitable. Diversification and strategic asset allocation do not assure profit or protect against loss in declining markets.