FAIRPORT ASSET MANAGEMENT
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The Compass

Wealth management tips, trends and articles that provide confident navigation for high net worth clients.

February/March 2013

Thank you for your continued confidence and feedback. As always, we encourage you to share this newsletter with friends, family members and colleagues.

Mid-Quarter Outlook

By John M. Silvis, CFA
Director of Investments

After weathering all the drama surrounding the fiscal cliff, the equity markets dusted themselves off and continued their march towards all-time highs. The S&P 500 Index registered positive gains in each of the first seven weeks of the year, hitting multi-year highs along the way. As of February 27th, the S&P 500 Index had a total return of 6.69%, while the broader MSCI ACWI Index returned 4.11% so far this year. Unfortunately, we may finally be embarking on what is probably an overdue correction in the equity markets, having gone 65 days without a correction of 5% or more (past the average of 49 days).

Investors have finally started to return to equities over the last few weeks with $49 billion flowing into equity mutual funds as measured by the ICI since the beginning of the year. The data shows that most of the funds have come out of cash or money market holdings and not bond funds (they have had positive flows of $42 billion so far this year). Many in the industry see this as a start of a "Great Rotation" out of bonds and into stocks over the coming quarters or years. With the ten year yield flirting with 2% for much of the past month, this may be the beginning of a slow march higher for bond yields. However with the Fed committed to "easy" money for the foreseeable future, rates may drift sideways for quite some time. Unemployment remains too high at 7.9%, well above the 6.5% threshold drawn by the Fed, and with fourth quarter GDP growth registering 0.1%, monetary policy most likely will not change anytime in 2013.

Bloomberg's survey of economists is still forecasting below trend growth for the domestic economy in 2013. The most recent survey has the economy growing at 1.8% and unemployment staying above 7.0% for the year. We are again staring in the face of fiscal despair as the President and Congress cannot agree on any deficit reduction plan to offset the beginning of sequestration, which is scheduled to take place on March 1st (this was written on February 27th). This could be the catalyst for the equity markets to take a breather after the fast start. All is not lost when it comes to the economy. Housing prices, as measured by the S&P/Case-Shiller Index, jumped 6.8% over the last twelve months – the best yearly gain since July of 2006. Inventories continue to decline and existing home prices have steadily increased over the last few months.

Fairport Global Asset Allocation

Election chaos has crept into Italy with no clear winner of the parliamentary elections over the weekend. This could cause more uncertainty in Europe as the continent has seen its economy shrink in the fourth quarter of 2012. The equity markets in Europe, which were among the best performers in the previous quarter, have begun to price in further disruptions in the coming months. We remain cautious on European equities in the near term. Growth in China is reaccelerating with productivity increasing, consumer confidence rising and the Shanghai Index rising over 18% from its low in December.

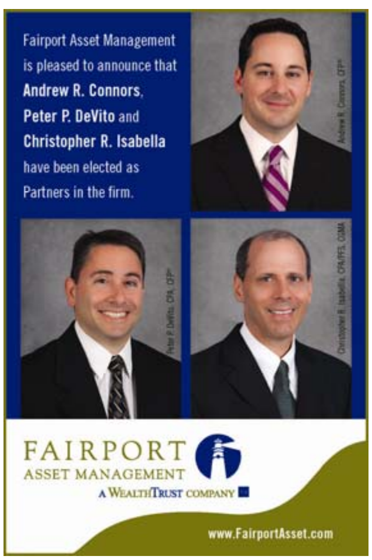
Fairport Large Cap

Earnings for the companies in the S&P 500 Index increased approximately 7% in the fourth quarter versus last year. All the ten sectors of the stock market are up year-to-date with Staples, Health Care and Energy leading the way. We still expect Cyclicals to reassert themselves as we move into the year and grind towards a new high in the S&P 500 Index (the Small and Mid-Caps have already hit new highs). Mergers and acquisitions should pick up in the coming months (the purchase of Heinz is a good example) while cash piles up in corporate coffers.

Fixed Income Commentary

While we are biased towards higher interest rate levels over the long run, rates could remain relatively constrained in the near-term due to supply and demand. Ned Davis Research (NDR) Group recently laid out a scenario in which bond demand could outstrip supply in 2013. For instance, NDR is forecasting a net increase in bonds outstanding of $1.08 trillion in 2013. If the Federal Reserve continues easing at its current pace, the Fed’s bond purchases will total almost $1.02 trillion, eating up a substantial portion of available supply. When you factor in demand from other sources, such as reinvested interest and bond purchases by mutual funds, banks and foreigners, demand has the potential to overwhelm supply in 2013, keeping yields low.

Given the current level of interest rates and spread tightening that occurred throughout 2012, we have muted return expectations for the fixed income asset class going forward. Investment grade yields began the year 103 basis points lower than in 2012, while high yield and emerging market yields were 223 basis points and 173 basis points lower, respectively. Credit spreads also began 2012 at substantially higher levels, which allowed for significant price appreciation in investment grade, high yield and emerging market debt last year. With the exception of floating rate loans, all fixed income sectors now appear rich, trading inside their respective 10-year spread averages. As such, we do not expect a repeat of the double-digit returns we saw from some fixed income sectors in 2012 (e.g., high yield, emerging markets debt) and are looking for more coupon-like returns in 2013.



Fairport’s New Partners

Andrew R. Connors, Peter P. DeVito and Christopher R. Isabella have been elected as partners and equity shareholders in the firm.

This recognition is based on demonstrated leadership skills, ability to foster trusted client relationships, entrepreneurial attitude and strong personal character.

They join the existing Partner group of Paul R. Abbey, Kenneth J. Coleman, Emily A. Drake, Heather R. Ettinger, Thomas A. Seifert and Emily N. Shacklett.

This achievement is another demonstration of Andrew, Pete and Chris’ unwavering dedication to exceeding the expectations of our clients.

Please join us in congratulating our colleagues on this much-deserved recognition!

Security Reminder for Tax Time

Fairport would like to remind our clients to beware of “bogus” IRS emails. The IRS has issued a warning to taxpayers who receive emails claiming to be from the agency. The IRS does not initiate contact with taxpayers by e-mail or social media channels to request personal or financial information. If you receive an email claiming to be from the IRS, you should NOT

- Reply to the message
- Open attachments
- Click on any links in a suspicious e-mail or phishing website
- Enter confidential information

Practice Group Spotlight
Family Business Owners Wanted for Assessment Opportunity
By Andrew R. Connors, CFP®
Partner

As the economy has struggled with unemployment and anemic growth, rarely is attention paid to the impact privately-held businesses play in creating jobs and growing the economy. Even less thought is given to the role family-owned and controlled businesses have in this process. Family-owned businesses are truly the backbone of the economy, accounting for an estimated 64% of U.S. gross domestic product. They also generate 62% of the country's employment and account for 78% of all new job creation. Family businesses also tend to be more successful than nonfamily run businesses, reporting ROA (return on assets) 6.65% higher than nonfamily firms. What is also interesting is that, when surveyed, 85% report that the unique culture that fosters loyalty and family provides a competitive advantage with employees and customers. The past few years have seen many changes across the family business landscape. Going forward, many family businesses will be faced with unique challenges both on the family front as well as the business front that will require them to plan and evolve in order to be successful.

On the family front, one of the main issues that will affect all family business owners at some point is how to handle the issue of transitioning ownership and engaging the next level of leadership. When surveyed, 40.3% of owners said they plan to retire over the next four years. Staggering is the fact that roughly half these owners also say that they have not identified a suitable successor who is willing and capable of taking over. At the speed with which business moves, this can be a small window with which to address this succession challenge – one of the leading struggles for family business owners. Of note: while 24% of family businesses are currently led by a female CEO, 31% indicate that the next successor will be a female.

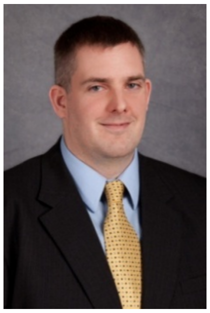
On the business front, expanding the business' geographic footprint will continue to pose both an opportunity and a challenge. As customers become larger and more globally focused, it becomes that much more important for family businesses to "scale up" their footprint, regionally, nationally and globally to keep up with their customers. Currently, only 7% of sales of U.S. based family businesses represent exports to other countries. The average for family businesses for the 30 largest global economies is 26%. Those businesses that are able to address this issue will continue to grow and create sustainable business entities.

Working with family business clients through both family and business transitions gives us an appreciation and understanding of the challenges and opportunities they face. We understand the importance they place on not only transferring their financial wealth, but also their values, to subsequent generations. The process of aligning personal family goals with long term business goals results in both sustainable family wealth and business success.

In order to improve this process and better understand unique family dynamics, business strategy, and ownership and leadership transfer challenges that occur at the intersection of family and business, we are asking family business owners to complete a confidential assessment: https://www.surveymonkey.com/s/BOIT. Upon completion and analysis, respondents will receive the results, allowing for comparison to other family business owners, as well as a better understanding of the behaviors and activities of top performing family businesses. Please feel free to forward the link to other family business owners in your network. Thank you for your participation in advance.

Sources: Global Data Points, The Family Firm Institute (FFI); Cal State Fullerton Center for Family Business; University of New Hampshire Center for Family Business. Family Business Facts, November 2012

Fairport News
Fairport believes in supporting the community as a company and through encouraging employees to participate and hold leadership positions in charitable, professional and community organizations. Read about our most recent accolades and community involvement.



We are pleased to announce that **Aaron Nuti** has achieved the distinction of the Chartered Financial Analyst® designation, or CFA charterholder. He joins John Silvis and Rick D'Amico, who both hold the CFA designation. The CFA Program is a globally recognized, graduate level curriculum that provides professionals with a strong foundation of the real-world investment analysis and portfolio management skills needed in today's investment industry. It also emphasizes the highest ethical and professional standards. The Program is organized into three levels, each culminating in a six-hour exam. CFA Program candidates report dedicating in excess of 300 hours of study per level. Completing the entire Program is a significant challenge that takes most candidates between two and five years. Congratulations, Aaron!

Andrew Connors has been elected as Treasurer of Esperanza Inc.'s Board of Directors.

Emily Drake has been appointed to Treasurer of the The Benjamin Rose Institute on Aging Board of Directors for 2013. She is also the Chair of Finance and Chair of the newly formed Investment Advisory Committee.

John Silvis has joined The Benjamin Rose Institute's Investment Advisory Committee. He also won the 2012 S&P Forecast contest sponsored by the CFA Society of Cleveland for which he received a plaque at their January Luncheon.

Joyce Zak joined the Northeast Ohio Chapter of the Financial Planning Association (FPA) in the fourth quarter of 2012.

Fairport Continuing Education

Fairport employees frequently attend conferences, continuing education seminars and informational webinars to keep up-to-date with new strategies and industry trends relating to the wealth management needs of our clients. From investment management to client service to technology, read more about the conferences we've recently attended.

Heather Ettinger met with the members of the Family Wealth Advisors Council (FWAC) in Washington, D.C. in February.

Rachel Margulis and **Joyce Zak** attended the Financial Planning Association's "Tax Planning Update for 2013" program in February. Topics included the impact of the American Taxpayer Relief Act of 2012, implications of the Affordable Care Act on 2013, Ohio updates for both individuals and businesses, municipal tax update and new planning opportunities.

John Silvis attended the Inside ETFs conference in January. The three-day event was highlighted by a world-class speaking faculty that featured keynote addresses from Biz Stone (Twitter) and Brian Cashman (New York Yankees), as well as market insight from industry experts. With over 1,275 attendees, the 6th annual conference provided all participants the opportunity to hear from thought leaders, share best practices and strengthen their ETF knowledge.

Paul Zappala and **Ken Coleman** attended the WealthTrust compliance seminar at the beginning of February.

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.