FAIRPORT ASSET MANAGEMENT
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The Compass

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

As of November 27, 2012

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

They say the equity markets like to climb a “wall of worry” and as we cross over the halfway mark of the fourth quarter, that statement seems all the more evident. After closing the books on the third quarter, the S&P 500 Index recorded a total return gain of 16.45% so far for the year and the global benchmark MSCI All Country World Index (or ACWI for short) banked a gain of 13.39% through the first nine months. However, several factors culminating in the month of November led the S&P 500 to pull back a little over -7% from the high reached on September 14^{th}.

The election was much closer than most pundits would have guessed earlier in the year with most polls showing a dead heat with a week left before the election. The results showed a fairly close election (not so in the Electoral College) causing many in the market to unwind trades based on a Romney victory. After the dust had settled, the markets had to adjust to the fact that the status quo prevailed as the President was reelected and the majorities in Congress remained intact. During the same time, Hurricane Sandy was wreaking havoc on the New York tri-state area causing damage, flooding and power outages along the New Jersey coast as well as in New York City forcing the financial markets to close for two days. Initial estimates on the economic damages inflicted by Hurricane Sandy could total between $30 and $50 billion. Finally, renewed focus on the “Fiscal Cliff” returned to center stage right after the election. The fear is, with no resolution, the drag could be as much as 3-5% of Gross Domestic Product (GDP) causing the economy to fall back into recession as we start 2013.

However as we have pointed out before, corrections within equity markets are quite normal, although painful at the time, and we were overdue for a pullback since the steady climb out of the lows of June earlier in the year. According to Ned Davis Research, the average time between corrections of 5% or more is 49 days. With the election behind us and the cleanup of Sandy well underway, the equity markets should start to benefit from the strong seasonal trends heading into year-end. December and January tend to be two of the best months for equities, with December posting positive returns in 19 of the last 22 years, according to research from MFS International, with an average return of 2.1%.

As we look towards the New Year, several positives could help drive the economy and markets through 2013. The current consensus of Bloomberg’s economist survey sees fourth quarter GDP growth at 1.7% and 2013 at an annualized rate of 2.0%. Third quarter GDP, which was reported last month at 2.0%, could be revised up in the coming days indicating the economy was growing faster than originally anticipated.

All signs are indicating that housing has bottomed and could in the coming months become a tailwind for the economy heading into 2013. New housing starts for the month of October reached 894,000 (annualized) – an increase of 42% over last month. ISI Group is forecasting housing starts to reach 1.3 million by the end of 2013. Mortgage rates remain at historic lows and rising home prices may finally start to push fence sitters into the market.

Fairport Global Asset Allocation

The global markets, outside of Europe, are starting to show some signs of improvement. We continue to see value in the Emerging Markets as well as Asia ex-Japan (Australia, New Zealand and Singapore). Productivity measures led by China, Brazil, India and Mexico have all increased over the last few months indicating better markets ahead. All indications point to a successful leadership transition in China setting the stage for more economic stimulus in the coming months.

Commodities, gold in particular, should benefit in the coming months from all of the economic stimulus (over 300 actions in less than two years) by global governments. As a result, we recently added positions in gold and gold mining stocks to take advantage of the actions as well as seasonal strength heading into the end of the year.

Fairport Large Cap

With over 95% of the S&P 500 companies reporting earnings for the third quarter, 66% beat expectations which were slightly below the average of 73% since the recovery started back in 2009. Earnings were flat versus last year, falling less than 0.5% during the period. However, balance sheets of Large Cap companies remain strong and dividend payouts continue to climb as companies look for the best ways to allocate excess capital. The S&P 500 Index as it relates to forward earnings is still undervalued at 13.3 times next year's forecasted earnings of $108 according to Baseline. The Technology sector (our biggest weighting) has come under pressure during the quarter due to softer earnings overseas. The Consumer Discretionary sector continues to outperform as consumer confidence recently rose to its highest level in almost five years. Utilities (our biggest underweight) are again lagging the benchmark this quarter.

Fixed Income Commentary

The resolution of the Fiscal Cliff, or lack thereof, will likely be the primary factor behind where yields end the year in 2012. A falling off of the Fiscal Cliff scenario is likely to result in even lower yields, with investors heading for safety and the economy bracing for a possible recession. On the other hand, agreements to avoid the Fiscal Cliff without any credible long-term budget reform will likely lift yields sharply higher. Ned Davis Research Inc.'s base case scenario calls for partial avoidance of the Fiscal Cliff without the credible structural reforms, resulting in moderately higher Treasury yields. Looking further down the road, aggressive monetary policy, anemic economic growth and a benign inflation outlook should help limit the extent to which interest rates rise in 2013. More credit sensitive segments (e.g., investment grade corporates, high yield) of the fixed income market should continue to reap the benefits of the Fed's portfolio rebalancing as investors continue their search for yield.

Municipal bond yields set 45-year lows in November, as investors placed a bet that low rates are here to stay and taxes will inevitably rise. Yields on 20-year general obligation bonds sank to 3.41% on November 15, the lowest since 1967, according to the Bond Buyer Index. The recent grind lower in yields has made muni bonds the most expensive in 17 months, as the muni/treasury ratio has sunk to 85.6%, the lowest since June 2011. This ratio, which serves as a gauge of relative value between asset classes, has averaged 109% in 2012. In our view, the recent rally has made longer-dated municipal bonds less attractive. In terms of defaults, municipalities have held up fairly well in 2012. According to Municipal Market Advisors, 67 issuers failed to make a payment on $1.2 billion in bonds. For all of 2011, MMA reported that 126 issuers skipped debt service on $6.46 billion in bonds. As far as Chapter 9 bankruptcy filings, there have been 12 so far this year, with only three of those pertaining to a "municipality" (i.e, city, town, or county). All three were in California: Stockton, San Bernardino and Mammoth Lakes. This compares to 13 Chapter 9 bankruptcy filings in 2011.

Welcome to the Fairport Team!

Please help us welcome Lindsay Suster to Fairport as Client Service Representative.

Lindsay brings over three years of client service experience and supervisory responsibility to her new role at Fairport. Her friendly, client centric attitude will be invaluable in helping us to exceed the expectations of our clients.

Year-End Service Requests

We want to ensure that your service requests are processed in a timely fashion during this busy stretch of the year. As such, please be aware that our custodians (Charles Schwab, Fidelity and banks) have strict deadlines for year-end service requests, including charitable gifts, retirement plan contributions, establishing new accounts and required distributions.

We encourage you to contact your Client Service Manager now to inquire about applicable deadlines and begin the process of charitable gifting, required minimum distributions and any other time-sensitive service requests.

Client Survey

We've extended the deadline for the client survey to this **Friday, November 30th**.

If you have already responded to this survey, either on-line or by mailing a printed survey, thank you! If not, we certainly would appreciate your input. The process should take no more than 5 or 10 minutes and your responses will be invaluable. We'll use this information to shape the service that we offer and, where there is an interest or need, to provide you with more information on our current and future products and services. If you need the link or a paper copy, please contact Kristen Gall at 216-431-3447 before Friday.

Thanks again. We look forward to sharing the results.

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.

Chris Isabella was accepted into the premier group of CPAs who have achieved the Chartered Global Management Accountant designation. The CGMA mission is to promote the science of management accounting on the global stage. The designation champions management accountants and the value they add to an organization. Congratulations on earning your CGMA!

Fairport is pleased to be included on the AdvisorOne 2012 Top Wealth Managers list. The rankings include firms from across the country as measured by total assets under management. Thanks for helping Fairport achieve this national distinction.

Fairport achieved recognition as a United Way "Pacesetter" in conjunction with the 2013 United Way campaign. The pacesetter award recognizes firms that conduct an early campaign, but more importantly increase their prior year pledge/contribution by 5% or more. Fairport increased its pledge by over 50%!

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.

This November, **Ken Coleman, Peter DeVito, Heather Ettinger, Kristen Gall** and **Paul Zappala** attended the annual Schwab IMPACT conference in Chicago. IMPACT is the premier industry conference for registered investment advisors featuring a dynamic lineup of keynote speakers, networking opportunities and education sessions. A particular highlight of the conference was the keynote session with Erskine Bowles and Alan Simpson, Co-Chairs of the National Commission on Fiscal Responsibility and Reform (2010). The entertaining pair shared a sobering view of the tough choices that Washington must make to avoid an economic crisis and achieve long-term prosperity. **Heather** was also a panel member in a highly attended session "Engaging, Serving and Retaining Female Clients: Strategies for Building a Successful Practice," moderated by Suzanne Siracuse of *Investment News*.

Peter DeVito, Chris Isabella, Tom Seifert and Emily Shacklett recently attended the Smith & Condeni Estate Planning Seminar and earned continuing education credits in understanding concepts and strategies for insurance and estate planning.

Rachel Margulis attended the Ohio Society of CPAs Financial Planning Conference in October and will be attending a Federal Tax Update seminar at the end of this week.

John Silvis joined Vanguard's key investment experts and thought leaders to share their views on ETFs, investing and the economy at the Vanguard 2012 Investment Symposium held in Malvern, PA in September.

Paul Zappala kept current on industry technology and compliance issues by attending the Orion Annual User Conference in Dallas in September and the Schwab/Compliance11 Annual User Conference in Chicago in the beginning of October.

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.