Talbot Asset Management Quarterly Report

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Dow 20000?

Welcome to what I believe is the most hated bull market in history. The market is hitting all time new highs despite constant news reports of Obamacare, government shutdowns, Iran's nuclear ambitions, and a total loss of confidence in the "nimnods" in Washington, DC, etc., etc., etc. Despite all of the problems, the market moves higher with very little selling pressure. The reason is quite simple… too much money chasing too few stocks. Many institutions and individuals are significantly underweighted in stocks and still overweighted in bonds or money market funds. They hate this bull market and continue to try and "buy the dips" or continue to predict a "correction". So many people got burned in 2008 that they have yet to return to the markets even with the Dow at 16,000.

I do believe a correction is probably coming. However, the odds are, it doesn't occur until later in 2014. From now until May 1, you have money coming in from year-end bonuses, pension plan contributions and IRA contributions and I find it very hard to believe that people will want to add it to bond funds or money market funds. This will provide additional fuel to the market at the same time people are still trying to get a little more invested. That doesn't mean that things will go straight up. In fact, my point and figure charts (the X's and O's) have been cautious since August. From my point of view, the market is at levels that suggest that buy and hold may not be the best strategy. Active management will be important for many investors as we enter into another election year. Overall, I believe the next 5-10 years will be good for stocks and equities in general have the potential to move significantly higher with some increased volatility. Most U.S. companies are probably in their best shape ever. They have spent the last five years becoming quite lean and mean. They have restructured their companies and refinanced their balance sheets to put themselves in a terrific competitive position. Corporate after-tax profits are at AN ALL TIME HIGH while corporate leverage is AT AN ALL TIME LOW (source: Raymond James). Most market strategists believe the market is trading around historical valuations. This means they aren't overvalued or undervalued but rather fairly valued. However, the historical valuations are calculated and occurred with interest rates at significantly higher levels. With interest rates this low and probably remaining low for quite some time, historical valuations are somewhat useless in my opinion. This is all occurring at the same time the US is rapidly becoming one of the low cost producers of energy IN THE WORLD.

The energy independence story is a total game changer. In Texas, the Eagle Ford Shale field produced 352 barrels of oil A DAY in 2008. In 2013, the same field, thanks to "fracking" and new technologies, yielded 536,117 barrels of oil per day. In North Dakota (want to find a job-move to North Dakota), the Bakken Shale Field there yielded 172,000 barrels of oil per day in 2008. In 2013, that same field is yielding 793,216 barrels of oil per day. As a by-product of this, they are finding so much natural gas they have to burn off a significant amount of it. In fact, some of the burning of the natural gas can even be seen from the International Space Station! This low cost energy environment has sparked a huge investment in new manufacturing plants from all over the world. I guess you could call it "onshoring." Over the last two years, Samsung (South Korea) announced they would be building a $4 **Billion** plant in Austin, TX. Michelin (French) tires would build a $750 million plant in South Carolina. Denso (Japan) would build plants in five states for a total investment of $750 million. Airbus (French) would build a $600 million dollar plant in Mobile, AL (source: Jeff Saut, Raymond James). The list goes on and on. Due to the government delay in pipeline construction, most of this oil and gas is being transported by railroad to refineries. Refineries that convert natural gas to liquefied natural gas are being constructed so we can EXPORT natural gas to places all over the world. The International Energy Commission has predicted we will be energy independent by 2020. Actually, it's happening a lot sooner. A total game changer and the investment implications are quite interesting.

We're in a bull market and everybody hates it.

The Great Rotation

I have said in numerous past newsletters that the biggest risk is probably investing in bonds. With interest rates this low, the margin of safety is minimal and the only way people will make money in bonds over the next 3-5 years is if we head into another recession, which I find unlikely at this point. Several market commentators and strategists have been calling for the "The Great Rotation". This is where investors start rotating out of their bond funds and into stocks. Bond funds and bonds in general have been in a 30 year bull market. That bull market is most likely over. Statistically, it's almost impossible for bonds to do well over the next 3-5 years with rates where they are at. A one percent rise in rates on a ten year government bond would create almost a ten percent drop in the price of the bond if it occurred rapidly. With a ten year bond yielding 2.77% as of 12/3/2013, a one percent rise in rates could wipe out three years of interest payments. A two percent rise is not out of the realm of possibilities since the historical range of the ten year has been in the 4+% range. As more investors become concerned about this, it's very possible they could rotate out of bonds into stocks. That's where the Great Rotation comes in. Since the bond market is over twice the size of the stock market, even a small rotation could provide even more fuel (source: Zacks Research). I believe this rotation is still in its infancy but the money flows are starting to look like it has begun.

From January 2008 through May 2013, there was over $1.63 Trillion more going into bond funds over stock funds. Just imagine if it started to go the other way.

West Orange Healthcare District

I was recently appointed by the Governor of Florida to the West Orange Healthcare District Board of Trustees. The West Orange Healthcare District was formed by the Florida Legislature in 1949 as a tax district to build healthcare facilities on the west side of Orlando. The primary asset of the district was Health Central Hospital in Ocoee. Recently, the hospital was sold to a larger hospital system with net proceeds totaling over $200,000,000. This money is theoretically owned by the residents of West Orlando. Since it would be impossible to return this money to the tax payers who funded it, the mission of our Board is to grant this money back to the community for projects that benefit the health and well-being of the residents of west Orange County. It has been an interesting experience to say the least.

Every Board meeting, we receive updates from the President of Health Central Hospital about the challenges they are facing and updates about the Affordable Health Care Act (AKA Obamacare) that is currently being rolled out. Some of the things he reports are quite startling. For example, 79% of the births at our hospital are paid for by Medicaid. Sixteen percent of patients who come to the hospital are uninsured. Almost fifty percent of ambulance bills go unpaid and that almost 10 percent of ambulance deliveries are for non-serious illnesses where the person basically called the ambulance just to get a ride to the hospital. The strangest thing I had to vote on thus far was to approve a $2.9 million dollar grant to the hospital to buy about 25 new medical devices of some sort (I couldn't even pronounce half of these devices). Why was this strange? Because Federal Medicare laws allow you get reimbursed at a higher amount if the hospital spends money to buy equipment. The hospital could bill Medicare for an additional $4.9 million in Medicaid reimbursements if we spent $2.9 million to buy equipment that I had no idea whether they needed it or not. How goofy is that? Needless to say, I'm getting a crash course in healthcare.

The last report we received from the President was discussing Obamacare. As I write this, the website has had multiple problems and enrollments are falling far short of expectations. The website is but a minor factor in the big picture. The website allows you to enter into the "exchanges". The exchange allows you to shop for various policies that fall into Bronze, Silver, Gold, and Platinum levels. The only real difference between these levels appear to be the amount of the premium you are willing to pay and the amount of the deductible you are willing to absorb. The benefits for these plans have been established by the government regardless of whether you need them or not. The hospital believes that most new policy holders will buy the bronze options because that creates the lowest premium yet has the highest deductible. The deductible with a bronze plan could be as high as $6000. You are responsible for paying almost 100% up to the deductible amount. Our hospital's past experience has shown that people with high deductible plans usually leave about 50% of their bills unpaid. Rather than having a business model that assumes 16% of your patients are uninsured, you now have to migrate to a model where 50% of the bills just go unpaid. Why does this occur? This happens because people do not save any money to cover the deductibles. Therefore, whether you believe in the merits of the health care system or not, every American who qualifies should open a Health Savings Account (HSA).

Health Savings Accounts

If you choose a high-deductible health plan, HSA can help to manage costs and sustain health benefits. I have had a Health Savings Account for over ten years through Optum Health Financial (optumhealthfinancial.com). You need a qualified financial institution to manage your HSA. Raymond James currently does not offer this option. Contributions made to the HSA are usually tax-deductible when used for eligible health expenses. Anyone can fund your HSA . Your employer, your family, or you could fund it. Your employer could also offer it as a payroll deduction. Unlike a Flexible Spending Account where you have benefits but if you don't use them by the end of the year they go away, an HSA belongs to you and can be carried over from year to year. It is not a "use or lose it" rule. It can also be transported between employers. It can be used to pay eligible medical costs for your spouse or dependents, even if they are not covered under your HSA plan. The deposits earn interest or can be deposited into mutual funds for longer term accumulation. Usually you have to leave a certain amount (mine is $2000) in the money market fund to cover any charges you incur using your Health Savings Account debit card. You can also reimburse yourself for eligible expenses or you can even pay your health care bills online. Almost every medical procedure except elective cosmetic surgery is considered an eligible medical expense. Even crowns to the dentist qualify or your eye glasses!

I would consider looking into this because at the end of next year we will all be looking at:

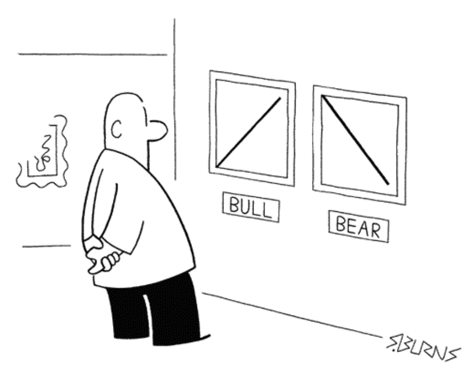
Private Exchanges

The Government has tried to play down the fact that a good number of individual health policies have been cancelled with the excuse that 80% of America is still covered by their employer's coverage. As most of you know, the employer "mandate" was delayed until the end of next year. If you think that the Affordable Care Act is going to work smoothly from here - next year is going to separate the men from the boys. I recently listened to excerpts to the Aetna quarterly earnings call. They must have used the term "private exchanges" over ten times. What Obamacare is doing to corporate America is forcing companies to move from a defined benefit health care package to defined contribution. This is similar to moving from the old pension plans to a 401k. These new defined health contribution packages will change the employer health coverage dramatically. It is estimated that 80-123 million people could have their health packages cancelled or altered (source: Duke University study). In this scenario, employers will say: " Here's $5000, go shop for whatever healthcare package you want and we'll give you the more efficient exchange to shop on." Therefore, if you want to buy a Platinum package - go for it. If you want the Bronze package - go for it. It will be totally up to you. In any event, this earthquake is coming. In fact, in several cases it costs the employer less to drop coverage and pay the fine (tax) than it does to continue coverage. With the assumption that companies still want to provide benefits to their employees, they would prefer to get out of the health care buying scenario and let the employee choose. In this way, their costs are much more predictable to their bottom line if they know exactly how much to allocate for their employees.

The investment implications of this could be quite dynamic. First, companies with high health care plan costs (like General Motors) could save millions by changing to a defined contribution plan but would probably have a hard time getting it through their unions. However, the cost savings by most large companies could be quite large and play a big role in upward earnings revisions. Second, there are only two major companies right now who operate private exchanges. This is like being able to invest in the New York Stock Exchange or the American Stock Exchange. Third, there will be several companies who operate benefit administration who will be brought in to the large companies for consultation and several are publicly traded. And lastly, employees may start diverting 401k money to HSA money (which is already starting to occur in companies that offer this option).

Scam Alert

Unfortunately, an unwanted side effect of the rollout of Obamacare has been the rise of scam artists trying to get sensitive information from you. I had one client receive THREE calls in one day claiming to be Obamacare "navigators" and offering their services to help her sign up for it. This would NOT happen. I have heard other instances where a person with a government looking ID shows up at the door saying they are there to help you sign up. Again, that would not happen. And lastly, there are fake websites that you get routed to if you don't type the exact name of the government website, www.healthcare.gov correctly. They look similar to the official site but they extract all your information illegally. Be careful with your sensitive information.



Late Night Revelations & Useless Information...

The Nobel Prize for Economics was recently awarded to Professor Robert Shiller for his work analyzing the movement of prices regarding real estate in the US. Most people know little about Alfred Nobel (born in 1833) and how he got the money to endow the money that is given out to recipients of the Nobel Prizes. His estate left $270 million to fund the prizes. He had amassed over 350 patents but the one that made him famous was his invention of dynamite. Dynamite is a mixture of nitroglycerin with diatomaceous earth which can be turned into a paste that can be molded into any shape.

While politicians do not want to broadcast it, tax revenues in general are up 13% over last year and individual income taxes are up an amazing 15.8% (source Congressional Budget Office).

J.P. Morgan was named after his uncle, James Pierpont (thus the J.P. part of J.P. Morgan). James Pierpont is probably most famous for writing "Jingle Bells" in 1857.

The amount of cash Apple has on its books is now equal to the Gross Domestic Product of Hungary and more than the GDP of Vietnam. (source: Firmex)

Since 1928, the Dow Jones Average has increased more than 10% in a day 8 times and declined by more than 10% 4 times. It has gone up or down more than 5% in a day 136 times (source Firmex)

My first car was a 1972 Ford Mustang. I must admit the newly designed Mustang coming out in 2015 is one hot car.

I've been a Hall and Oates fan for decades. Daryl Hall has a show on the Palladia Network that is outstanding called, "Live from Daryl's House." He brings in various artists from Smokey Robinson to more modern artists to sing their songs and hang out at his house. The music is terrific. If you want to see back episodes of the show, go to www.livefromdarylshouse.com

Notes from Nancy (Office Manager, RJFS)…

THANK YOU: We would like to take this time during the holiday season to say thank you for trusting the team at Talbot Asset Management with your investment needs; we truly appreciate your loyalty and your friendship. We wish you and your family a very Merry Christmas and a happy and healthy New Year!

RMD: I'm pleased to introduce a new IRA account feature that automatically calculates and pays out your required minimum distribution (RMD) for the year – whether you select monthly, quarterly, semiannual or annual payments. The distribution amount is calculated at the beginning of each year, and payments from your retirement account will remain in effect for as long as you wish – simplifying the process for you.

Assuming sufficient funds remain available, your payments will go out like clockwork on the scheduled date. If you like, we can also adjust the frequency and pay date to suit your needs. Should you opt to take an additional distribution outside the scheduled payments, any remaining RMD payments will be adjusted to ensure you receive only your RMD for the year.

If you are required to take a minimum distribution from your IRA, you can begin to take advantage of this convenient periodic payment feature at any time. I will be happy to help you establish a schedule that makes the most sense for you.

IRA: For 2013 contributions, individuals who have "earned income" may contribute 100% of their earnings to an IRA up to $5,500 per year. An additional "catch up" contribution of $1,000 may be made by those who are age 50 or older by year-end. The limit on IRA contributions for 2014 will continue to be $5,500 per year.

REFERRALS: If you have a friend or relative you feel would benefit from our services, please feel free to refer them to our website or have them call the office. We are so thankful for the referrals we obtain from clients, it is the best compliment we could receive!

www.talbotasset.com **Please view our website**! It has been updated with information that pertains to our business processes and services and offers a plethora of financial resources. The pictures are a true reflection of our quaint downtown of Winter Garden!