// Talbot Asset Management
Quarterly Report

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1982?

I joined E.F. Hutton at the tail end of 1980. Interest rates on money market funds were 21% at the time. I was an untested rookie trying to take in everything I could from the Wall Street veterans that surrounded me in our office. Most of these guys had ten to twenty years of experience in the industry. Our institutional trader was a "big hitter" because he would place trades of 1000 shares or more. We would assemble every day in the institutional traders office for the incoming conference call hoping to get insight on what the day would bring or whatever stock E.F. Hutton thought was going to do well in the near term.

A stock market guru, Joe Granville would be on TV a lot with trained chimpanzee's touting his stock market theories and saying the market was going to zero and a lot of people believed him. Another guru, Robert Prechter was also saying the market was going to crash due to his "Elliott Wave" theories based on theories developed by R.N. Elliott in the 1920's where they believed everything moves in waves including the stock market. All of the research we had was fairly negative as the stock market hadn't done much for almost 20 years. The public absolutely hated the stock market. And who would blame them when they could do nothing and still make 20% in a fairly low risk investment such as a money market fund? All the long time brokers in our office were very negative towards stocks. Oil prices had been going up. We were coming off a time in America where we had the Iran hostage crisis and turmoil in the Middle East. We were viewed internationally as being very weak and we were experiencing huge bouts of inflation. And did I mention that interest rates were **21%???**

I taught a lot of investment classes and gave a lot of seminars at that time. The theme of most of my seminars was "Renewing Your CD" and I would discuss the options available to them. I developed several clients during this time but most of them were risk averse and it's hard to blame them when stocks had done nothing and you could get 20% in a money market fund. They didn't really want to hear about the stock market, especially from a 24 year old rookie. Actually they didn't want to hear about the stock market from a 65 year old veteran either.

I was a student of the stock market from the time I was 14 years old. I had studied numerous periods of stock market history. Something changed in August of 1982. The market took off and no one knew why. Most of the guys in my office were "bearish" and continued to disbelieve the upward movements in stocks. In fact, they used the rallies to get out of the market. Some of these guys even "shorted" the market meaning they were making bets that stocks would go down (when you short stocks-you sell the stock first hoping to buy it back later at a lower price). Believing the market would continue to go down had been a very profitable strategy for years. Not this time. The market continued to climb and very few people participated because they were negative from the political and economic environments that had occurred in the prior several years. Everyone kept believing a correction was coming and still felt comfortable in those CD's or money market funds because you theoretically can't lose money in those investments. The stock market kept going up and hardly looked back for almost **FIVE** years.

John Templeton of the Templeton Funds told me once, "The most dangerous words in the English language are: This time is different". I totally agree with that statement-most of the time. I believed that something was different in the market that time. I started to get those infamous "gut feelings" that would lead to some of my investment processes and trading strategies. I was buying stocks while everyone around me was bearish and negative.

This brings us to 2013. Oil prices are up. Political unrest is occurring all over the Middle East. We're still in Afghanistan (Who the Russians invaded in 1979). We just emerged from the

most hostile political environment in our history. Twenty four hour news channels make it look like our country is going down the tubes. However…interest rates are almost ZERO for most money market funds and CD's. Corporate profits are AT AN ALL TIME HIGH. Corporate cash levels ARE AT AN ALL TIME high. This is making me think this is 1982 all over again and no one believes in the rally that began almost 3 years ago and is finally gaining traction since January 1 of this year. EVERYONE (including foundations and most professional money managers) are significantly overinvested in bonds and cash and underinvested in stocks. I have mentioned several times over the past year is that the biggest risk lies in bonds, not stocks. According to Federated Investors market strategist Phil Orlando-"Stocks are the cheapest in the history of civilization".

Every corporate executive watches the same news reports you do. They have refinanced their balance sheets and have made their companies lean and mean. Earnings have DOUBLED over the last four years while interest rates have come DOWN. This stock market could go significantly higher even from these levels. I mentioned in a past newsletter that based on interest rates, the market could go significantly higher. A new twist has now been added to the mix which makes me even more bullish long term. Just as people need to save more, the number of publicly traded companies is shrinking dramatically. Companies have been gobbled up in mergers or gone private. Some have thrown up their hands with government regulations and stayed private. And there has been very few companies come to market as new public offerings.

At the present time, there is 38 TRILLION DOLLARS in bond funds right now (source: Raymond James). And there is still 12 TRILLION dollars in money market funds yielding almost zero. The value of all of publicly traded companies is $12 Trillion dollars. The number of publicly traded companies has gone from 6639 in 2000 to 3687 at the end of 2012. (source: Matt Krantz, USA Today). The long term historical average for the ten year Treasury note is 4% and is currently 1.67%. Should the bond market slowly move up to the historical interest rate of 4% over the next FIVE years, the total return in most of these bond funds will be ZERO and most likely a negative return when you factor in fees. With interest rates at zero, it makes sense to borrow money for companies to buy other companies and was highlighted in the first quarter by Warren Buffett buying Heinz. This is going to continue. Should investors decide that shifting even a small amount of bonds into stocks could send this market significantly higher.

Made in America: The Next Boom

America was not decimated by World War II, so the US once made 40% of the goods on the planet. Today, that number is 18% (Source: Barrons). After decades of outsourcing, the tide is turning back the other way. The reason: A US energy boom. By extracting oil and gas from shales, North America produces far more natural gas than any other continent. Unlike oil, natural gas is not easily transported across oceans. In fact, we're finding so much gas we're having to BURN off a significant amount that is being found. Natural gas is roughly $4.00 per million British thermal units (BTU) versus $12 in Europe and $16 in Japan. Cheap energy reduces our trade deficit, lowers our dependence on oil from the Mideast, and makes our factories more competitive globally. Some of the biggest benefactors will be chemical producers and steel manufacturers which use lots of natural gas in their manufacturing processes. Even foreign companies are relocating plants and equipment to the US. Industrial land in China can go from $10.22 a square foot upwards to $21 a square foot in coastal cities like Shenzhen compared to $1.30 to $4.65 in Tennessee and North Carolina (source: Barrons).

Right now, this manufacturing boom is only in year two or three. Our corporate tax rates are the highest of any industrial country in the world at roughly 38%. The average corporate tax rate globally is 25%. If we could possibly get some sort of meaningful corporate tax restructuring out of Washington DC, this boom could accelerate. Right now, this boom is moving forward in spite of Washington.

The investment implications of this boom are very dynamic. Everything from pipelines that transport the gas to chemical companies to steel companies to even railroads. There is so much gas and oil being produced in places like North Dakota and Ohio that a lot of this oil and gas is being transported by railroads.

Observations from the Raymond James Investment Conference

I just returned from the annual Raymond James Conference in Dallas where Raymond James brings in people like me to listen to different economists, market strategists, portfolio managers and other guest speakers. This year's key note address was delivered by President George W. Bush who was speaking two days before the opening of his Presidential Library. Some of the general observations I gained from the conference (not the President) are:

Avoid bonds

There is a better than even chance we're in a new bull market. Over 1 trillion dollars have gone into bonds over the last five years while ½ Trillion has come out of stocks.

The Federal Reserve is penalizing savers but rewarding investors. This trend will continue for quite sometime.

Raymond James' market strategist Jeff Saut believes there is a fundamental shift going into the mix of people being elected to Congress and this will continue. Political novices are being elected over career politicians and he believes the political tone may well improve over the next few years.

Because so many people took capital gains at year end to avoid what was perceived as higher tax rates, the government could report some decent tax revenue numbers when they report the tax revenues for April 15th. It is similar to 2000 and the tech bubble era when tax revenues shot up because tech stocks were going through the roof.

The Gross Domestic Product (GDP) over the last several years has been very slow moving. So the government has decided they are going to change the index. They will now include "intangible capital" in the GDP numbers. An example of this is Apple's iTunes. It is a product but it's intangible so they are calculating that by including things like iTunes into the GDP numbers. You will probably start to see the GDP numbers be over 3% in July and the government will be touting how the economy is definitely growing because the percentage is up, never mind the fact that the real reason is because they changed how it's calculated.

53% of stocks in the Standard and Poors 500 yield more than the ten year Treasury Note.

Europe's problems have been well publicized and a lot of European money has come to the US. This makes European companies incredibly cheap but I'm not really wanting to venture that way just yet. The issue is with the governments of countries in the Eurozone, not necessarily some of the companies in the Eurozone.

Emerging markets have lagged in performance over the last several years. They may start to improve.

Commodities will finally be driven by supply and demand and not so much by the printing money machines of central banks.

Economic growth does appear to be accelerating.

An economic headwind could become a tailwind.

Emerging markets could play catch up and possibly return 10-15% by the end of 2013.

The top 20% of taxpayers account for 40% of consumer spending.

The Medicare doctor fix was deemed a "slow train wreck" as 1/3 of all the doctors in the US are over the age of 55. A lot of these doctors are opting out of insurance and you must pay in full which in turn reduces the number of Medicare doctors. As of October 1, there could be 30 million new Medicare recipients at the same time you have a decrease in doctors which could cause bottle necks.

The housing recovery is in great shape.

The sole reason the unemployment rate has slowly come down in the US is because people have left the workforce.

Introducing Goals and Monitoring

I spent the first five years of my career developing financial plans for clients and both clients and I would get excited when I would complete those plans. It was frustrating after six months that most clients either didn't follow the plan or didn't pay too much attention to it. Thus, I decided at that point to go towards my passion which is the money management path since that's the direction that most clients desired and needed. I have always had sophisticated software programs to allow us to create plans for clients and we have done a few over the years. However, the result was similar to my experiences with EF Hutton, most clients couldn't remember where they placed the plan six months later.

Raymond James, however, has rolled out a new Goals and Monitoring program which should make this process easier for you to understand and allow you reach your short and long term goals. This innovative tool is simple to use and allows us to monitor your situation better to give you a more complete analysis. The process begins by identifying your financial objectives including retirement, college for children or grandchildren, housing, travel or whatever your goals are for life ahead. The Goals and Monitoring software will allow us to analyze the likelihood of achieving your goals.

My son, Ryan Talbot, Financial Advisor, RJFS, will be the lead person on this project for those clients who want to take advantage of the program. We are offering this as an additional service at Talbot Asset Management. Our emphasis will continue to be the management of portfolios but the user friendly tools created by Raymond James makes this an exciting addition that we can provide clients.

The data we use to input into the program will involve some work on your part but we have the checklists available to get started. We are also available to meet in person or via phone to discuss your goals and to assist you in completing the checklists. We're excited about implementing this new technology into our practice.

Late Night Revelations & Useless Information...

- If you are a golfer, I'm sure you have seen the Bubba Watson hovercraft golf cart on TV. It's a golf cart that floats nine inches off the ground and lets you float over the rough, sand traps and even ponds. It was supposed to be a marketing stunt for Oakley sun glasses but now the demand from amateur golfers has poured in and starting in July you can have your own hovercraft golf cart for the low price of $65,000.
- I just went to an REO Speedwagon concert. I've seen them play dozens of times since they are from Champaign-Urbana, Illinois (my home town) and the bass guitar player (Bruce Hall) even married the sister of one of my best friends from high school. They got their name from a car company in the 1930's. The car company was called Reo and their trademark car was the Speed Wagon. Thus, REO Speedwagon.
- In 2010, the average college graduate had accumulated approximately $25,000 in student loan debt.
- According to the book "Academically Adrift: Limited Learning on College Campuses", 45% of US college students exhibit "no significant gains in learning after 2 years of college".
- In the US today, about 1/3 of college grads end up taking jobs that don't even require college degrees (source: USA Today).
- Over 18000 parking lot attendants in the US have college degrees (source: USA Today).
- 317,000 waiters and waitresses have college degrees (source: USA Today).
- Twenty-five percent of all retail sales people have college degrees (source:USA Today).
- 14% of all students that graduate with student loan debt default on their loans within 3 years of making their first student loan payment (source: USA Today).
- Groundhog Day was February 2. Over the last 117 years Punxsutawney Phil has NOT seen his shadow 17 times. This year was one of those years. It was supposed to be an early spring. I guess he missed the memo.

Notes from Nancy (Office Manager, RJFS)…

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.

REMINDERS:

- our address for our "world headquarters" is **32 S. Main St., Winter Garden, FL 34787**. Please remember this when sending correspondence and checks. Please feel free to call for an appointment to meet with Rod, we would love to see you!

- When sending checks for deposit, please make all checks payable to Raymond James & Assoc., **NOT** Talbot Asset Management.

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 new 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!

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* Individuals cannot invest directly in any index, and index performance does not include transaction costs or other fees, which will affect actual investment performance. Investing in emerging markets can be riskier than investing in well -established foreign markets. International investing involves special risks, including currency fluctuations, differing financial accounting standards, and possible political and economic volatility. Investments in commodities may be affected by overall market movements, changes in interest rates, and other factors such as weather, disease, embargoes and international economic and political developments and may experience greater volatility than investments in traditional securities.