The ACM Journal

"NYLANETICS"

People frequently ask my wife and me how we stay so thin. Blushing, we usually credit genetics for our ectomorphic statures. However, I'm going to admit publicly, for the first time ever, that we have been following a secret regimen all these years that has resulted in our healthy appearances.

Our system is a combination of portion control, appetite control, and physical conditioning. There is only one piece of equipment required: one small child. Ours is a female that answers to the name Nyla. However, any flavor will do, as long as it is under four or so years of age.

Here's how it works:

Portion Control
I wake up early and make myself some breakfast. It could be waffles or toast or cereal, and I sit down to enjoy the fruits of my labor. Nyla then climbs up on my chair, wedges herself between me and the table, and claims my meal for her own, like a pack of hyenas pushing a lioness off its prey. When I finally get my turn at the fare, Nyla has generally ingested a significant portion. In a hurry most mornings, I settle for the uneaten portion and then rush off to get ready for work. I have thus saved myself a significant portion of the calories I would otherwise have consumed.

Appetite Control
Appetite control is the failsafe

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CAPITAL MARKETS REVIEW

The stock market started the second quarter of 2013 on a strong note. By early May the Dow Jones Industrial Average made a new all-time high, and crossed 15,000 for the first time (the previous high was just above 14,000 back in October 2007). The S&P 500 rose above 1,600 for the first time in late May. However, comments by Fed Chairman Ben Bernanke on June 19th seemed to spoil the party. Traders worried the Fed's support of the economy would diminish, and the selling began. The Dow lost over 4% over the subsequent few trading sessions as a new wave of volatility set in.

The second quarter was still largely productive for domestic stocks, with large-cap stocks earning 2.9%. Mid-cap and small-cap stocks were also up, but that's where the good news ends. International stocks declined and the emerging markets were truly horrible, posting a loss of almost 8.0%. Yield-sensitive sectors like real estate and bonds were also down on fears that the Fed would discontinue its stimulus programs after Chairman Bernanke's remarks in June.

Central Banks Front and Center
Indeed, the Federal Reserve in the U.S. and central banks abroad seemed to largely dictate the direction of the capital markets late in the second quarter.

The first set of actions came from the Bank of Japan. Trying to lift the country from two decades of deflation, the B.O.J. engaged in a massive program of bond purchases. The goal was to increase the size of Japan's monetary base (basically to flood the economy with liquidity), thus stimulating the economy and hopefully raising tax revenues to reduce the country's heavy debt burden. The new policy, dubbed "Abenomics" after new Japanese Prime Minister Shinzo Abe, set a target rate for inflation of 2% by the end of 2014, which is a big change from the historical deflation Japan has experienced. This change created some short-term gyrations in the Japanese stock market, to say the least. Japanese stocks rose over 26% early in the second quarter, only to subsequently fall around 20% by

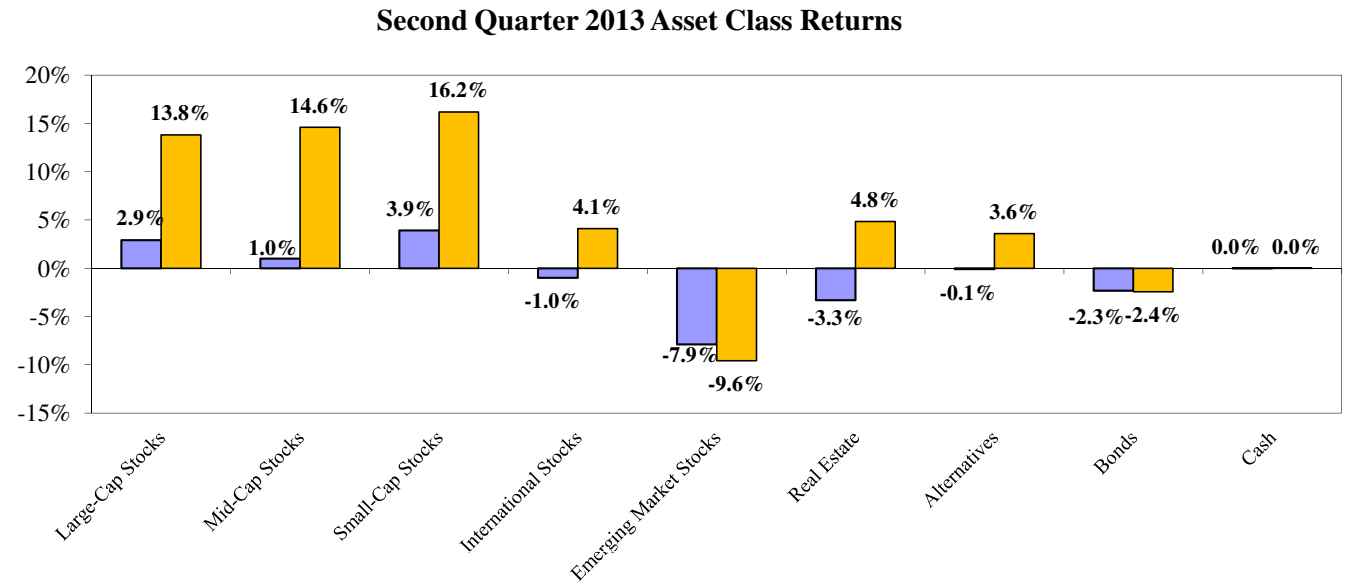
quarter end. Even so, the Japanese economy has shown signs of recovery in the wake of the central bank's asset purchases. Japan's economy has experienced many false starts over the past twenty years, but hopefully Abenomics will produce some longer-lasting positive results.

An even more serious hit to investors has come from China. A high-growth emerging market for the past several years, China is experiencing possible real estate and credit bubbles similar to those of the U.S. in the early 2000s. China's leaders have tried to reign in economic growth the past few years to curtail any negative impact of an economic "hard landing", but many are questioning their efficacy. The situation came to a head in mid-June, when SHIBOR, China's short-term interest rate, spiked to well over 10%. This caused a dramatic drop in the Chinese stock market and, subsequently, the U.S. stock market. China's central bank did ultimately step in to stabilize interest rates and provide liquidity to the marketplace. However, Chinese stocks have not recovered and the MSCI China Index is down 11.0% for the year.

Back at home, the Fed's announcement that it could scale back its "quantitative easing" program roiled the markets. Chairman Bernanke stated that declining unemployment and strengthening economic growth argue for the Fed's life support to taper and ultimately disappear. He said that the Fed could completely eliminate its stimulus programs by next year, but he also noted that reducing quantitative easing will depend on how well the economy performs. While this caused all manner of hand wringing, we view it as a positive. After all, the premise of Bernanke's announcement is that the U.S. economy has finally begun to recover at a solid pace and can continue to grow without government intervention. Stock returns have largely reflected this economic recovery, with significant gains across all segments of the U.S. stock market the past few years.

Reverberations Abroad

Interestingly, while the Fed is a U.S. agency, its actions have reverberated around the world. Emerging market stocks, not just in China, took a very serious hit during the second quarter, mainly on fears that the Fed would reduce the rate of economic stimulus in



Large-cap, mid-cap, and small-cap stocks are represented by the S&P 500, 400, and 600 indcies. International and emerging market stocks are represented by MSCI indices. Real estate is the Dow Jones Real Estate index. Alternatives are represented by the HFRI Fund Weighted Composite Index. Bonds are the Barclays Aggregate Bond Index. Cash is the yield on the 30-day T-Bill.

the U.S. The logic here is that when the U.S. is awash with money, much of it flows into riskier economies, such as those in Latin America, Eastern Europe, or developing Asia. If the Fed stops pumping money into the system, there will be less to spill over to other countries. In response, emerging market stocks and bonds have sold off dramatically. There are certainly economic imbalances and the possibility of significant inflation in some of these countries, but concerns of a slowdown in foreign investment seem to be the most serious threat to emerging market growth. The good news is that the buying opportunity appears compelling. The price/earnings ratio for a basket of emerging market stocks is around 11 times trailing earnings. By way of comparison, the P/E ratio for the S&P 500 is around 17 times trailing earnings, so valuations in the emerging markets are very low currently. It is never easy to buy into declining markets, but that is often where you find the best opportunities.

Income Strategies Decline

The Fed has also taken a toll on yield-sensitive securities in the U.S. Investments, such as bonds and real estate, that produce high income have benefited from the Fed's low interest rate policy over the past several years, but may soon see a reversal of their good fortune. Bond yields and prices are inversely related to one another, so when the Fed moves interest rates lower, bond prices move higher. Given that we have seen historically low interest rates recently, it is not surprising that bond investors have enjoyed not just income from their bonds, but also a lot of capital appreciation for many years now. However, during the second quarter, after Chairman Bernanke's comments on the possibility of tapering economic stimulus, Treasury bond yields rose substantially. Ten-year Treasury yields effectively doubled to around 2.5% in very short order. While that is still a low level, the rate of change was enough to unnerve bond investors, resulting in a loss for the bellwether Barclays Aggregate Bond Index of 2.3% in the second quarter.

Real estate also took its lumps, losing 3.3% in the second quarter. With the low interest rate environment of the past few years, investors have been starved for yield. As a result, they have aggressively shifted their portfolios toward high dividend paying stocks and other high-yielding investments, like real estate investment trusts (REITs). However, with bond yields now starting to rise, income-oriented investors may reconsider the extra risk they have taken on by investing in stocks. If they can generate the income they need with relatively lower risk bonds, they will likely move out of high-yielding stocks. Such a move was overdue, even without a significant rise in interest rates, because high-dividend paying stocks have risen so much in value the past few years.

In fact, high-dividend paying stocks currently trade at significant valuation premiums to the overall stock market. The search for income has driven investors to largely ignore risk. Those who may previously have invested in bonds and used the periodic coupon interest payments to meet their living expenses, have shifted to high-dividend paying stocks in search of more income. They may very well achieve their income goals with such a strategy, but they also take on a lot of downside risk if the stock market declines. Valuation imbalances within segments of the stock market can only last so long, and it is likely that high-income investors will soon experience the downside of their strategy.

Alternatives Disappoint

Alternative investments have been a disappointment for us. The performance has largely been flat in a period where the stock market has performed very well. The idea behind these investments it to reduce risk, but we also want to earn a fair return. Our alternative portfolios have certainly reduced risk, but have not produced much as far as return. We made some changes in this part of the portfolio during the second quarter. We previously held high-yield or "junk" bonds and emerging market

bonds, but given the ultra-low interest rate environment, we judged that there would be limited upside in these investments going forward. Accordingly, we sold these funds, focused on others where we have higher confidence, and added a new strategy that should offer more upside potential when the stock market is rising. We will of course continue to monitor these investments closely. Long-term, we still believe in the concept of earning returns that are uncorrelated with the stock market as a way to diversify our portfolios.

The second quarter was a mixed bag as far as returns go. Domestic stocks performed the best and we think the outlook is still positive for stocks. There will unquestionably be volatility along the way, but we expect the stock market to continue to rise for the next few years (though not necessarily in a linear fashion). Valuations are still reasonable in most stock market segments, corporations are generally healthy, and the economy continues to slowly improve.

WHAT IS ARMBRUSTER CAPITAL MANAGEMENT?

Armbruster Capital Management, Inc. (ACM) is a boutique wealth management firm serving high-net-worth individual and institutional clients. The firm's innovative "Passive Quant" investment approach incorporates cutting edge financial research to help control risk and pursue superior returns. ACM uses index funds, exchange-traded funds (ETFs), and other investment vehicles to build portfolios designed to reduce investment-related costs and taxes in order to maximize net returns.

Located in Pittsford, New York, ACM is employee owned, independent, and free of conflicts of interest. Acting as a fiduciary, the firm creates truly customized investment portfolios tailored to each client's unique objectives.

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mechanism should you try to adjust to the portion control strategy, discussed above, by making a larger meal for yourself. Nyla, after eating her fill of my meal, then decides there is a further approach to keeping her daddy svelte. She tires of eating my food and moves on to touching, playing with, and possibly sneezing upon what is left. This pretty much signals the end of the meal for me.

Physical Conditioning

Diet is only one component of staying fit. The other is a regular exercise regimen. Nyla ensures that my wife, Nipa, and I stick to this. The range of activities can be anything from a brisk game of "Hide & Sneak" to more rigorous activities like carrying a 35 pound object (called Nyla) through the aisles of the grocery store while pushing a shopping cart, reaching for items on the top shelf, and ensuring that older brothers do not burn down the store. Fortunately for me, Nipa is more inclined toward participating in this last activity.

Follow this regimen each day and I guarantee you will lose weight too. I've been losing weight for years. I've been losing other things too, like sleep, sanity, my temper, and general control. But, as I write this, I'm realizing what a great opportunity we have to create a best-selling diet book and possibly produce an infomercial. Send $19.95, plus shipping and handling, and you can be the first to get in on our secret method to living "healthy".

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