APPLETON PARTNERS, INC.

QUARTERLY MARKET OVERVIEW – QIII 2013

The stock market proved to be resilient during the third quarter, shrugging off tensions in Syria, the tapering debate, the subsequent rise in yields, and the looming political debate in Washington D.C. As was the case in the second quarter, cyclical stocks led the market higher with the Materials, Industrials, and Consumer Discretionary stocks outperforming their less economically sensitive counterparts. A number of positive catalysts potentially remain. With the S&P 500 flirting with all-time nominal highs, valuations have crept up, but remain well within normal ranges. Companies remain flush with cash and we have seen signs that management teams are willing to return that cash to shareholders in the form of buybacks and/or increased dividends. Lastly, merger and acquisition activity has picked up, most notably with Verizon buying the remaining stake in Verizon Wireless from Vodafone, Microsoft buying Nokia's mobile technology platform, and Amgen buying Onyx Pharmaceuticals.

The second quarter was a volatile one for the fixed income markets. Intermediate and long-term yields rose in anticipation of a Fed decision to reduce its asset purchase program - the so-called "taper". After peaking at 2.98% on September 9th, the 10Yr treasury yield benchmark snapped back 0.3% following the Fed's surprise decision to defer any tapering (likely into 2014). Our position that rates had widened too far, too fast benefited us well in the quarter as most intermediate bond indices were up by one percent or more. Given the leadership transition at the Fed and antics in Washington, we expect short-term volatility to continue, but remain constructive long-term on fixed income as the market adjusts to a higher interest rate environment.

It is evident that both the stock and bond markets were focused on the Fed and the continuing debate regarding tapering. Both markets had essentially priced in a reduction of asset purchases by the Fed, and it seemed a foregone conclusion that it was going to be announced at the September meeting. Although the decision not to taper was a surprise to most, it is justifiable when looking back at the economic data, and the spectacle in Washington. The jobs reports have been decent, but most gains are coming from the addition of part-time workers, and the labor participation rate is lower with little to no wage growth. The mere anticipation of tapering caused yields to rise, which flowed through to mortgage rates, dampening the nascent housing recovery. The Fed was also concerned about the impact of tapering on the economy in the face of the fiscal showdown. Their intuition that our elected officials would not be able to reach an agreement over the budget and debt ceiling in a timely manner proved to be correct.

As of this writing, the U.S. government has been shut down for over a week and the ripple effect is sure to be felt by individuals and businesses alike. However, investors seem to be putting more emphasis on the impending debt ceiling breach. Unfortunately, government shut downs are not as rare as one would think, occurring 17 times since 1976. A potential debt ceiling breach or default is what grabs attention, and markets have been reacting to each headline, positive or negative. But we have been here before, and Congress has proven its ability to bring us to the brink, ultimately kicking the can down the road and pushing the debate into the near future. We do not favor the "Band-Aid for a broken leg" approach, but feel that the markets would welcome any sign of resolution, albeit a temporary one.

Moving into the fourth quarter, we expect further volatility as the show in Washington plays out. Any resolution could bring a relief rally in the equity market, and we will be closely monitoring third quarter earnings and management outlooks for next year to provide us with longer term direction. Also, the economic outlook remains cloudy; a soft labor market, disappointing retail sales excluding autos, and slower housing/refinancing activity all offset by lower gasoline prices and decreased inventories. We look for the equity market to potentially hit new highs, but not without some bumps in the road, thus remaining range bound. For bonds, the nomination of Janet Yellen as the next Fed Chairman should signal to markets that the accommodative policies of the Fed will continue, and should place a resistance level on bond yields.

As always, we welcome your comments and questions. Please contact us if there are any changes to your financial situation or investment objectives.

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