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FINANCIAL PLANNING

The rally in US stocks continued into the second quarter as enthusiasm for stocks prevailed. Until late May, consecutive down days were a rarity for the S&P 500 Index. In June, volatility increased and stocks pulled back off their highs. Stocks in the S&P 500 still managed to mark a gain for the quarter, but much smaller than the previous quarter. Year-to-date, the S&P 500 is now up 13.9% and the DJIA is up 15.2%. Small cap stocks are also up 15.9%. Most international stocks have not faired as well. Japanese stocks have given up nearly half their gains this year but still finished the quarter with a year-to-date gain of 16%. European stocks have a small gain of around 2% for the year while Chinese stocks are down about -12%. Overall, international stocks in developed markets posted 2.2% gains while those in emerging markets posted losses of more than -9%.

After dismal fourth quarter US GDP growth of only 0.4%, first quarter rebounded strongly with initial estimates of 2.5%. This strength fueled much of the stock market rally as confidence was restored. With this strength, the Federal Reserve started discussing tapering the quantitative easing (QE) policy it had been providing through bond purchases. This alarmed investors and was the catalyst to a selloff in all asset classes except cash giving support to the argument that QE has been bolstering asset prices. When first quarter GDP growth was revised down to 1.8% at the end of June, the stock market reversed its downward trend as investors hoped the lower GDP growth would mean the Fed would not withdraw QE anytime soon. It's not often that the stock market rallies on weaker than expected GDP growth.

GDP growth is expected to pick up over the rest of the year. While second quarter consensus GDP is currently projected to be 1.8%, third and fourth quarter GDP growth is projected to be 2.3% and 2.6%, respectively. The housing recovery, pent up demand for autos, and increases in consumer spending are fueling these stronger growth forecasts in the US. Elsewhere, Europe is still projected to be in a slight recession during 2013 while China is expecting GDP growth of about 7.5%.

The Fed had given previous guidelines that it would not raise interest rates until unemployment was down to 6.5% and their expected inflation rate was 2.5% or higher. Over the past year, unemployment has been falling and now sits at 7.6%. The labor force participation rate had also fallen during the recession as less people were in the workforce or actively looking for work. Initially, many analysts believed that as unemployment improved, more people who had left the workforce, would start looking for jobs again resulting in a rising labor force participation rate. They feared this rise in more people looking for jobs would make it difficult for the unemployment rate to decrease. Now, five years later, the labor force participation rate hasn't really risen and analysts are beginning to wonder if the rate will stay at these lower level because people who were near retirement age and lost jobs just decided to retire early at a lower standard of living. If it does, the unemployment rate may continue to decline and the Fed's target unemployment rate may be reached sooner than many believed possible. Inflation remains in check below 2%.

Yields on the 10-year Treasury soared from 1.85% at the end of the first quarter to a an intraday high of 2.66% before settling back at 2.48% at quarter end. The dramatic rise in yield has resulted in a –2.5% year-to-date loss in the Barclays Aggregate Bond Index. Fixed income investors may not be accustomed to seeing such large negative returns in their "safe" bonds and may be surprised that their bond funds lost money. The losses come about because yields and bond prices are inversely related. When yields go up, bond prices go down resulting in depreciation in bond portfolios if the decline in bond price is higher than the yield on the bond. Treasury bonds with long maturities are most susceptible to movements in interest rates while high yield bonds and

2013 BENCHMARK RATES OF RETURN

INDEX	SECOND QUARTER	YTD
S&P 500	2.8%	13.9%
DJIA	2.8%	15.2%
NASDAQ	4.2%	12.7%
Russell 2000	3.1%	15.9%
International	-2.1%	2.2%
Fixed Income	-2.3%	-2.5%

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convertible bonds are less so.

Normally, rising yields are seen as a headwind to growth and are expected to result in lower stock returns. At yields above 5%, this has been true—rising rates have mostly been associated with negative stock returns. However, at yields below 5%, rising rates have been associated with mostly positive stock returns. Since yields had been below 2% and are still only around 2.5%, higher yields may not be detrimental to stock returns yet.

Although bond yields have risen swiftly recently, this pace is not likely to continue. As rates go higher, the amount of interest the US has to pay on its bonds becomes more of a burden. If the deficit each year remains the same excluding interest expense and yields increase by 1% per year, the Federal debt is projected to increase from $17.81 trillion in 2013 to $25.94 trillion in 2017—an increase of 45% in just 4 years!

Even with potentially flat or slightly negative bond returns, an allocation to bonds is still appropriate to provide safety when stocks are more volatile. Bond portfolios may add exposure to high yield, convertibles, and floating rate securities to help protect against depreciation. Likewise, investment in real assets like real estate, gold, and other commodities can also reduce volatility long term even if short-term these assets do not have high returns. Stocks may outperform bonds longer term but will likely be more volatile, too. It's possible that within stocks, dividend paying stocks may become less attractive if interest rates continue to rise and yield seekers shift back to bonds. We still believe most stock portfolios should also have exposure to international as well as small and mid cap stocks. Diversification can help reduce risk and smooth out total returns over the long term.

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Mortgage Rates

With low mortgage rates, most people who wanted to buy a bigger house have already done so. In addition, those who wanted to refinance their existing loans also took advantage of the record low rates during the past year. Unfortunately, for those who haven't, they may have missed their chance to lock in at the most favorable low rates. In May, the average 30 year mortgage rate was only 3.35%. At the end of June, the rate had jumped to 4.46%. According to Bankrate.com, that increase could add more than $45,000 to the cost of a $200,000 mortgage over its 30 year lifetime. Even at the higher rate, though, 4.5% financing is closer to historical lows so people should still consider refinancing before rates go higher if they haven't already.

QUESTION: *Should I take on debt to go to college?*

ANSWER: A recent survey by Fidelity showed that the average 2013 grad had $35,200 in college related debt. Many graduates were surprised at the amount of debt they had amassed through government loans, private loans, and credit card debt. When confronted with the reality, 39% said they would have done things differently. They cited strategies such as saving earlier, better researching financial aid options, and looking for ways to cut their spending while in school. Half of those surveyed expected that it will take them more than 9 years to pay off their debt while 7% don't think they will ever be able to pay off their loans. Although 12% of graduates thought their college education didn't justify the debt burden, they may be mistaken. The unemployment rate for those with a college education is now 3.9% compared to the national average of 7.6%. In addition, the difference in earnings can be substantial. In 2012, the typical full-time worker with a bachelor's degree earned 79% more than a similar worker with just a high school diploma. A study by the Hamilton Project at the Brookings Institution estimated that a four-year college degree was similar to an investment that returns 15.2% per year even when accounting for missed income during the years spent in school.

CAMBRIDGE ADVISORS NEWS

Cambridge Advisors has a fiduciary duty to act in the best interests of our clients. As a registered investment advisor, we are regulated by the SEC and are held to this high standard of care. Not all financial professionals have this—broker/dealers and other financial representatives who are governed by FINRA are held to a less stringent suitability requirement Under Dodd-Frank, the SEC has been tasked to analyze the standards of care applicable to advisers and broker/dealers and make a recommendation for a uniform standard of care. Recently, a coalition of organizations urged Mary Jo White, chairman of the SEC, to establish a fiduciary standard that is no less stringent than the one under which registered investment advisors currently operate. Anything less would not be in the spirit of Dodd-Frank as it would not protect investors as vigorously as Dodd-Frank intends. If you have friends or family who are evaluating investment advisors, encourage them to ask potential candidates if they are a fiduciary and what standard of care they are held to. We would be happy to answer any questions that arise in their decision making process. We also offer a free discovery meeting to explore whether our services would benefit them. We always want to make ourselves available to help the people who are important to you.