

# THE EAST END FINANCIAL GROUP

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Dear

Enclosed please find your investment advisory report for the quarter ending June 30<sup>th</sup>. As discussed in our letter to you from June 17<sup>th</sup>, the remarks made by Federal Reserve Chairman Bernanke have produced a minor sell off in the equity markets, but more importantly, a decline in bond prices over the last six weeks of the quarter. The theme of our quarterly advisory letter will again focus on the bond market's outlook, steps we have taken to reduce price volatility in our fixed income positions and what the plan should be going forward for the remainder of 2013.

## **Review of the Second Quarter of 2013**

The S&P 500 ended the second quarter with its strongest first half of any year since 1998 after reaching record highs in May on a rally underpinned by the Federal Reserve's massive monetary stimulus.

While the S&P 500 closed down for the month of June on concerns that the Fed might begin reducing its bond-buying program, the benchmark index ended the second quarter with a gain - marking its first positive second quarter in four years. The Dow Jones industrial average and the Nasdaq also dipped in June, but rose in the second quarter. For the second quarter, the Dow gained 2.3 percent, the S&P 500 advanced 2.4 percent and the Nasdaq jumped 4.2 percent. Volatility surged in the last 2 weeks after Federal Reserve Chairman Ben Bernanke suggested the central bank could slow its \$85 billion a month in bond purchases before the end of the year if the economy is strong enough.

Treasuries through the iShares Barclays 20-year-plus ETF fell 8.9% in the last three months, its worst performance over the last 10 quarters. The Barclays investment grade corporate-bond index fell 3.3%.

Gold prices fell 23% for the quarter, their largest quarterly fall since gold began trading in 1971. The 27% fall this year is the worst first-half performance since 1981.

*(Note that unless noted all figures represent total rates of return, measuring both price changes and reinvested dividends, supplied by Morningstar)*

**Nowhere to hide**

Even though the broad equity markets, as defined by the S&P 500 Index, ended up +13.75% (year to date through June 30<sup>th</sup>), most major indices are in negative territory for the year. A summary of these indices with returns is provided below:

<b>SECTOR CHART</b>	<b>YTD RETURN THRU 6/28/2013</b>
<b>SPDR S&amp;P 500 ETF</b>	<b>13.75%</b>
<b>SPDR GOLD TRUST</b>	<b>-26.48%</b>
<b>POWERSHARES DB COMMODITY INDEX TRACKING</b>	<b>-9.54%</b>
<b>ISHARES TRUST COHEN&amp;STEERS REALTY MAJORS INDEX</b>	<b>4.16%</b>
<b>ISHARES MSCI EAFE INDEX</b>	<b>2.82%</b>
<b>ISHARES MSCI EMERGING MARKETS INDEX</b>	<b>-12.04%</b>
<b>ISHARES TRUST BARCLAYS 20+YR TREASURY BOND FD</b>	<b>-7.85%</b>
<b>ISHARES BARCLAYS TIPS BOND FUND</b>	<b>-7.22%</b>
<b>GOLDMAN SACHS EMERGING MKT DEBT INSTL</b>	<b>-8.62%</b>
<b>ISHARES SILVER TRUST</b>	<b>-35.41%</b>
<b>ISHARES S&amp;P NATIONAL AMT FREE MUNI BD</b>	<b>-3.91%</b>

*Source: All figures provided by Yahoo Finance*

Especially hard hit were the darlings of the doomsayers, gold and silver. Gold as defined by the ETFs we use in our portfolios (GLD) was off -26.48% for the year and silver (SLV) even worse at -35.41%.

These declines had little impact on our portfolios since our core models only carry a 5% position in precious metals. The major effect on our accounts, which on average are 50% bonds, has been from the massive sell off in fixed income, beginning with Chairman Bernanke's remarks about potentially cutting back the Fed's Treasury buy back (quantitative easing).

These remarks have resulted in the Barclays investment grade corporate bond index losing 3.77% from May 1<sup>st</sup> through June 30<sup>th</sup>. U.S. Treasury Notes with maturities of 10 years or longer have lost an average of 10.8% over the same two month period.

All bond sectors have felt the effects of the rise in interest rates and, most remarkably, even the all-weather or market neutral funds are seeing negative returns for the year. These funds, called absolute return or market neutral funds are designed as defensive funds to provide returns 5% – 6% above the rate of inflation with limited volatility. They are best suited as fixed income alternatives.

The most well-known is the giant hedge fund Bridgewater Associates, L.P., now off -8% for the year. We have incorporated two such funds into our portfolios, Pimco All Asset All Authority which is now -7.01% year to date thru 6/30/13, and John Hancock Global Absolute Return fund, now +1.31% year to date thru 6/31/13. These funds, designed to reduce volatility in portfolios, have not done so over the last two months.

**The Game Plan**

Last fall we became proactive in repositioning our bond portfolios anticipating an increase in interest rates. We analyzed our bond funds, reducing durations and increasing credit quality of the fixed income segment of our portfolios. We shifted money from traditional fixed income and implemented positions in market neutral positions previously discussed. These moves have greatly reduced our

portfolio's losses in the fixed income portions of our accounts but these losses have been impossible to eliminate completely. On average our typical client has felt about 50% of the decline seen in the typical bond fund over the last two months but there are still declines in the value of these positions since May 1<sup>st</sup>.

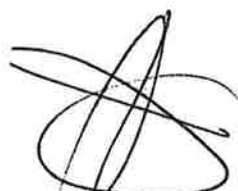
So what do we do now? Going forward rates will probably continue to move up, putting more pressure (negative) on bond prices. This subject was addressed in the business section of the NY Times on Saturday, June 29<sup>th</sup> in its article "Before Dumping Bonds Consider Your Objectives".

As discussed, as long as you have a well thought out and diversified assortment of bonds, they will provide you with stability when stocks inevitably sell off. They also provide a predictable stream of income. **"The main reason long term investors hold bonds, of course, is to provide a steadying force. Bonds still remain the best, if imperfect, foil to stocks."**

The article goes on to mention the adjectives "blood bath" and "devastation" to describe what has happened to the bond market. A -3% return as seen by the Vanguard Total Bond Market Index is not a blood bath – a -38% decline in the S&P 500 (2008) is a blood bath.

We have enclosed this NY Times article for your reading along with your reports. When we call to discuss and review your account, we can talk more in detail about your portfolio and your goals and risk tolerance level. Once again, diversification has always been the investor's best friend and over time a well-constructed portfolio of stocks, bonds and alternative investments will provide predictable returns with betas (risk) lower than the S&P 500. Expect our call to discuss your portfolio and review your long term financial goals.

With best personal regards,



John J. Kosinski, CLU, ChFC, MSFS  
President



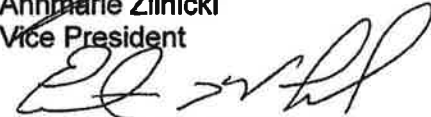
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