First American Trust
WEALTH MANAGEMENT SERVICES

Fall 2013

# QUARTERLY UPDATE

*First American Trust provides investment advisory and fiduciary services for individuals, families, non-profits and corporations.*

## My Two Cents

*By Kimberly Dwan Bernatz, CFP®, AEP®*

### Protecting Your Digital Footprint

Many of us spend time creating an estate plan focused on how to distribute assets to loved ones or charity. We plan for the transfer of bank and investment accounts, real estate and business interests and other items of personal property, such as jewelry, artwork or other treasured family collectibles. But, in this age of technology, we often overlook planning for our digital assets and information stored online.

Have you considered what will happen to your digital assets, that vast array of virtual information left on sites like LinkedIn, PayPal, Facebook and Twitter? After you are gone, family members and estate executors are left to sift through email messages, blogs, pictures and connections that may have significant personal or financial value. Without proper planning, important and sensitive content may be lost, released or even publicized to inappropriate parties. It's important to consult with your estate planning attorney to plan for the management and disposition of digital assets.

Similar to other assets, having a plan in place to transfer, or have access to, your digital assets will assist your agent, trustee and/or executor. As yet, there is not a universal means for accomplishing this task because each Internet-based service agreement might govern how the digital asset or access is transferred for a particular provider.

> *"Designate a gatekeeper over your digital legacy."*

Another challenge in this new age of technology is that many of us have opted to receive paperless statements or utilize online bill pay. Without proper planning, your successor trustee or personal representative could have a tough time locating and accessing accounts traditionally found by watching for statements to arrive in the mail. So, it's a good idea to keep precise records of where online accounts are located with log-in IDs, passwords and responses to security questions. Of course, be sure to keep any information in a secure location disclosed only to someone who is trustworthy and savvy with the Internet.

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## Market Watch

*By Jerry Braakman*

### Market Review

In the third quarter, the markets continued to extend their gains for the year despite concerns the Federal Reserve would taper its open market bond purchases and the debt ceiling impasses.

**Total Return as of 10/31/2013**

| Index | Q3 2013 | YTD |
|---|---|---|
| Dow Industrials | 2.11% | 21.02% |
| S&P 500 | 5.24% | 25.30% |
| Russell 3000 | 6.35% | 26.46% |
| All Country World x US | 10.09% | 14.08% |
| Barclays Int. Gov't/ Credit | 0.62% | -0.23% |
| Merrill Lynch 3-7 Muni | 0.63% | 0.60% |
| Gold (SPDR Gold Trust) | 7.61% | -21.16% |

Source: Bloomberg

Treasury market rates rose as a result of U.S. Federal Reserve Chairman Ben Bernanke's comments in late May, and the market expected stronger economic data to support the commencement of Fed monetary tightening. However, the economy is still sluggish; thus, the Fed decided to delay implementation of taper until economic data confirms the economy can handle a tighter monetary environment.

Asset values continue to be supported by the easy money in the system. Lack of inflation, specifically wage pressures, allows a favorable corporate earnings environment to continue. Based on earnings, the S&P 500 is close to fairly valued. Expectations of earnings growth for the remainder of 2013, and into 2014, should support ongoing market appreciation if those expectations are met.

International markets, which had not fared well in the first half of the year, finally started to recover. With a pause in the rise of Treasury rates, foreign asset flows back to the U.S., which mostly hampered emerging markets, is abating.

Economic growth continues to be slow, but growth continues, and markets are rewarding investors who can look past the government induced turmoil and interventions.

### Economic Outlook

We've had quite a bit of debate here internally regarding two hot issues: the Fed's monetary policy and the debt ceiling. Regarding the Fed, the primary question is how they'll unwind the massive monetary stimulus program started in 2008, followed by several rounds of quantitative easing (QE). QE is the government monetary policy to purchase bonds in the open market, which lowers long term interest rates, in turn promoting increased lending and investment.

The debate now centers on just how long the Fed can continue to keep the monetary stimulus in place without long term harm. Is the easy money provided by the Fed producing short-term results with unsustainable long-term detrimental side effects? The Fed instilled confidence back in the markets, but unwinding an almost $4 trillion balance sheet is unprecedented.

To its credit, the Fed has increased transparency, including providing rate forecasts, and memos detailing internal discussions that pundits dissect upon release. What is clear is that the Fed has reiterated its objectives of full employment and price stability (with controlled inflation preferred). With inflation expectations tepid, wage pressures subdued by high global unemployment, and commodity prices undermined by low global demand growth (with Europe in the doldrums), Fed monetary policy is expected to stay especially accommodative until the U.S. unemployment rate reaches the Fed's 6.5 percent target.

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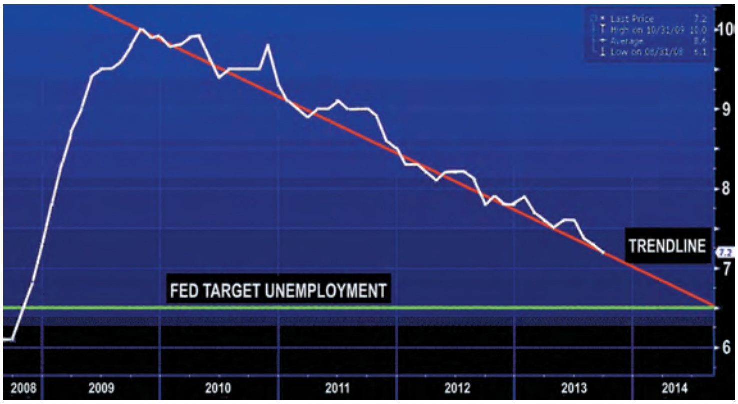
## Market Watch *- from page 1*

On the political front, the debt ceiling debate was temporarily resolved but will need to be addressed again on January 15, 2014. The political polarization and eleventh hour resolution to raise the debt ceiling certainly creates concern for investors. From an investment perspective, we treat the outcome as a binomial event, one in which we either default (low probability) or don't (high probability). Each stand-off allows for the possibility of the low probability event of defaulting on the national debt. We expect no one actually wants to pull the plug and default. Therefore, we continue to stay invested, assuming a favorable outcome. We are not agnostic to an unfavorable outcome but our investment decisions are guided by the highest probabilities and most favorable odds.

***U.S. Unemployment Rate*** Source: Bloomberg




*Following the current unemployment trend line, we expect the unemployment rate to reach the Fed target rate by the end of 2014.*

### Investment Focus

Considering the excellent equity market performance this year, it is wise to assess the durability of this bull market. Since the low set in March 2009, we are now in the fifth year of a significant bull market. Market appreciation has been supported by both an increase in underlying corporate earnings and an expansion of the multiple of such earnings. To put that in plain English, in March 2009, the S&P 500 was trading at 13.4x earnings, while at present, S&P 500 is trading at 16.8x trailing earnings. In historical terms, the S&P 500 is close to fair valuation with a long term average trailing price-earnings multiple of 16.4x. With markets fairly valued on an historical basis, we continue to feel comfortable staying fully invested in the equity markets for a number of reasons.

First, valuations among various industry sectors are not uniform so there are areas of opportunity. For example, the technology sector is trading at a discount to its historic valuation. The discount on the technology sector is partly due to shifting leadership in the sector. Older tech companies, such as Hewlett Packard, Dell, Intel, and IBM, have struggled due to dependence on PC sales that have shrunk with the advent of tablets and mobile computing. Investor concerns that technology earnings can be subject to swift changes undermines faith in the longevity of earning models in the sector. Hence, in our client portfolios we have focused on companies poised to benefit from this shift, such as Apple, Google, Qualcomm, LinkedIn, Cisco and Juniper. From a cyclical perspective, the tech sector typically outperforms during the middle of an economic cycle, which we seem to be entering.

Second, historical averages are simply that—averages. Valuations can be above the mean as much as below the mean. Periods of below average multiples are found during recessionary and sub-optimal economic conditions, as we've experienced since 2008. Above average multiples are mostly coincident with more robust economic growth. Although we are still struggling to find such robust growth, the slow, gradual path of improvement continues to support our belief we are in the midst of an economic expansionary cycle that could lead to further market appreciation.

Third, we expect the current accommodative monetary policy to continue. With slow improvement in the economy, retraction of monetary stimulus will likely also be measured and gradual. As a consequence, low rates will continue to provide a favorable investment climate for corporations, individuals and investors. Rate increases will likely coincide with stronger economic growth and revenue expectations. Higher revenues should continue to support continued earnings growth expectations.

Finally, earnings expectations continue to be met if not exceeded. Low interest rates, acceptable wage growth, and strong balance sheets create a very favorable operating environment for earnings growth. We do not expect wage growth to accelerate until the unemployment rate drops another 1 percent or so. Commodity inflation is similarly subdued based on Europe's weakness and our slow growth path. Therefore, more of the same can be expected. Considering market performance over the last several years, more of the same is very profitable for investors.

***"Our investment decisions are guided by the highest probabilities and most favorable odds."***

With all this optimism, rest assured we continue to look for bear market indicators. Specifically, we monitor the following signs to warn us of an approaching end of the economic cycle:

- Higher interest rates
- Accelerated wage growth – tight labor market
- Commodity inflation
- Late cycle leadership (Energy & Materials industrial sectors)
- Rapid consumer and mortgage credit expansion
- Equity market multiples
- Equity market breadth (less companies leading in a market setting new highs)
- Home price to income disparity
- Global trade and demand growth

We continue to keep an eye out for changing trends and are poised to respond with adjustments as needed. We welcome the opportunity to dialogue with you about our thoughts, process and how we can be of service to you. For our loyal clients, we appreciate the confidence you have placed in us.

*— Jerry Braakman is Chief Investment Officer*
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## My Two Cents *- from page 1*

Here are a few steps you can take now to plan for your digital assets and online accounts:

- Take an inventory of all your online accounts (social networks, email, online bill-pay accounts, blog sites).
- List log-in and password information for each account with responses to "security" questions.
- Security of this information is critical. Save this information on your computer in a complex password-protected document and/or place a copy in your safe deposit box.
- Designate someone to be in charge of your online accounts and let them know how to access this information. Consult with your attorney about the best way to make this designation given your circumstances.
- Give clear instructions to that individual about what you would like them to do with your digital assets after life. You may wish to establish a memorial site on Facebook, for example, for a period of time for people to post remembrances. You may wish to shut down others or have photos and content transferred to family members.

It's important to be aware that state and federal laws and companies' terms of service govern certain access to computers and online accounts. The digital asset provider's terms of service may supersede the relevant estate planning documents charging an individual with this authority, even if the individual was provided his or her username and password. Again, be sure to talk with your estate planning attorney about how to properly plan for and protect your digital legacy.

*— Kimberly Dwan Bernatz, CFP® Senior Vice President*
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## Events & Happenings

### A Day at the Races!

A buffet lunch was served at the Del Mar Thoroughbred Club's Pat O'Brien Suite in late August as we partook in First American's annual event to show our appreciation for 40 guests that included clients and advisors.

*Pat Hodgkin with guests at the Del Mar racetrack.*

## Events & Happenings *- continued*

### Don't Just Reach for a Star, Yank it from the Sky!

As a company that likes to support non-profits, in September we hosted an inspirational luncheon to highlight Mission Hospital Foundation, recognize its guild supporters, and connect with our clients.

Some 80 attendees included a panel of inspiring women who represented three generations and shared individual passions that became a purpose.

After raising her children, UCI Professor Emerita, Dr. Judy Rosener, earned a Ph.D. and served as a catalyst for unearthing workplace gender issues. Authoring several books since, she's taught classes at UCI's Graduate School of Management for more than 30 years now and is considered a foremost expert in her field.

Traveling non-stop as a senior corporate executive, Sue Parks would burn off energy and stay fit walking thousands of steps a day no matter where she was. This inspired her to take a risk as an entrepreneur to establish her current company, Walkstyles, Inc., a corporate wellness company.

*A lively panel discussion inspired luncheon attendees.*

As chief executive officer of Big Brothers Big Sisters of Orange County and the Inland Empire, Melissa Beck once was with a CPA firm with a focus on athletes before relocating to California. Health problems made her seek a more meaningful purpose in life, and after earning an MBA, her exposure to underprivileged kids captivated her to impact the lives of young people.

*L to R - Melissa Beck, Sue Parks, Dr. Judy Rosener*

# Events & Happenings *- from page 3*

## A Social to Thank Our Advisors

With the focus on CPAs, we gathered a full house for a mid-summer evening cocktail reception to thank our extended network of key advisors.

### "In the News"

**Jerry Braakman, Chief Investment Officer quoted in:**

- "U.S. Stocks Trim Gains." *The Wall Street Journal* 8 July 2013.
- "Stocks Rise on Fed Comments, Better U.S. Growth." *NBC News* 31 July 2013.
- "U.S. Stocks Beat BRICs by Most Ever Amid Market Flight." *Bloomberg* 19 August 2013.
- "Syria Weighs on U.S. Stocks." *The Wall Street Journal* 27 August 2013.
- "U.S. Stocks Advance on Microsoft Buyback as Fed Meets." *Bloomberg* 17 September 2013.
- "U.S. Stocks Gain While Oil Retreats, Treasuries Advance." *Bloomberg* 17 September 2013.
- "U.S. Stocks Drop After 5-Day Rally on Earnings Forecasts." *Bloomberg* 23 October 2013.

**Kimberly Bernatz, Director, Wealth Advisory featured in:**

- "Managing Emotions When Selling Family Property." *Wall Street Journal* 1 October 2013.

### Annual Alzheimer's Walk

This October, the Alzheimer's Association Walk to End Alzheimer's®, an annual fundraiser, saw some 3,000 participants rally their support. Held in Balboa Park, Pat Hodgkin, vice president and wealth management advisor for First American Trust San Diego, acted as team captain for her group, bringing in $2,000 of the $330,000 raised overall.

### Pretty in Pink!

For Breast Cancer Awareness Month, the San Diego office remembered those diagnosed with the disease by wearing pink tops and bringing in pink cake, pink ice cream and a pitcher of pink lemonade.



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