First American Trust
WEALTH MANAGEMENT SERVICES

Spring 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®

Are you in Good Hands?

It happened again. While reviewing a prospective client's portfolio, I was dismayed to find mutual funds with high-end loads, an excessive amount of individual stocks and annuities, and an investment allocation far too aggressive, risky and expensive for this individual's circumstances and comfort level. Unfortunately, this is not an uncommon scenario for those individuals who rely on the advice of an advisor who does not follow the fiduciary standard of care as outlined under federal securities law.

Fiduciary Standards

- *Serve the client's best interests*
- *Act in the utmost good faith*
- *Disclose all material facts and conflicts*
- *Avoid conflicts of interest*
- *Act prudently with professional care, skill and judgment*
- *Control investment expenses*

In the investment world, primary parties able to offer investment advice include investment advisors and investment brokers who work for broker-dealers. Many people find the investment advice received from these entities similar, and expect that an investment professional is acting in their best interest when providing the advice. In reality, there lies a key difference between the two in standards of practice, which has important implications for you as a client.

Investor confusion in this area has long been a source of concern for regulators and Congress. The Securities and Exchange Commission (SEC) completed a 2011 Study on Investment Advisors and Broker-Dealers, required as part of the Dodd-Frank Wall Street Reform and Consumer Protection Act.

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Market Watch

By Jerry Braakman

Index	*2012*	*Q1 2013*
Dow Industrials	10.24%	10.93%
S&P 500	16.00%	10.60%
Russell 3000	16.41%	11.07%
All Country World x US	16.83%	3.17%
Barclays Int. Gov't/ Credit	3.89%	0.26%
Merrill Lynch 3-7 Muni	2.93%	0.86%
Gold (SPDR Gold Trust)	6.60%	-4.66%

Source: Bloomberg

Market Review

Strength in the U.S. economy has allowed the domestic stock market to set new highs in spite of additional tax burdens applied to the consumer. Consumer spending failed to slow down as anticipated with the payroll tax increase in effect. Fueled by increased optimism, investors poured money into the markets.

Renewed wealth effects are contributing to consumer confidence. As equity markets and housing prices are rebounding, personal balance sheets have dramatically improved. With renewed interest in equities and risk assets, investor sentiment has changed. Asset classes such as gold and U.S. treasuries, deemed safe havens, underperformed as fear dissipated.

But while the U.S. has exceeded expectations, global sentiment is still mixed. The Cypriot crisis brought Europe and its issues back to the forefront. Still plagued by slow growth and significant unemployment, Europe remains stuck in its financial quagmire while political fiscal solutions are teased out in public forums. In Asia, Japan has decided to follow Bernanke's lead and flood the market with monetary stimulus to boost the export driven economy. For the first time in more than a decade, Japan is anticipated to grow its economy beyond a snail's pace.

Economic Outlook

The market euphoria undermines the tough road still ahead for the economy. Structural issues, like spiraling entitlement cost as a result of an aging population, persist in the U.S. and have not been resolved. Given the level of frustration most of us have with the political processes, we do not expect any rapid resolution to these problems. These issues will cause drag on economic expansion until the federal deficit and debt are back to sustainable levels.

With the government trying to unwind support previously extended to the economy, GDP growth will be constrained. We are expecting GDP growth to be just over two percent for the year.

Companies will struggle to find additional revenue to meet top-line growth expectations domestically. Firms will continue to expand in emerging markets to capture the growth experienced there.

Investment Outlook

The most prevalent question we face after the equity market performance of the past few years is: *When will this run end?* Since March 2009, we've experienced a very significant bull market with heightened volatility. Each time fear resurfaced, the market was supported by additional monetary stimulus. The current equity market is supported by two factors. The first, record earnings, is a fundamental driver based on the efficiency of corporations.

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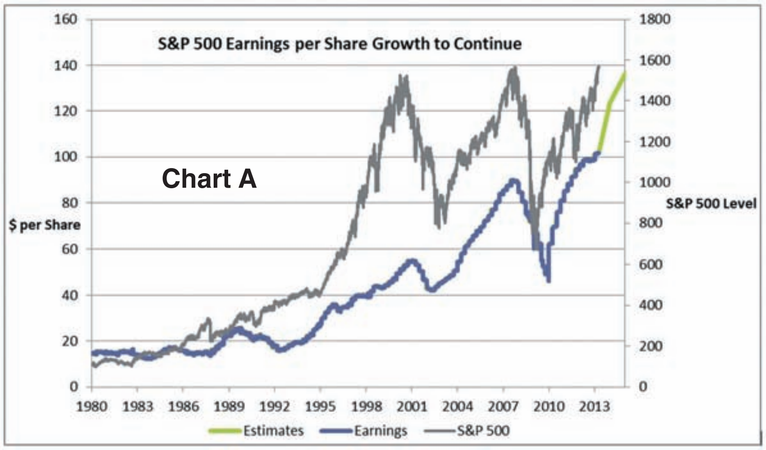
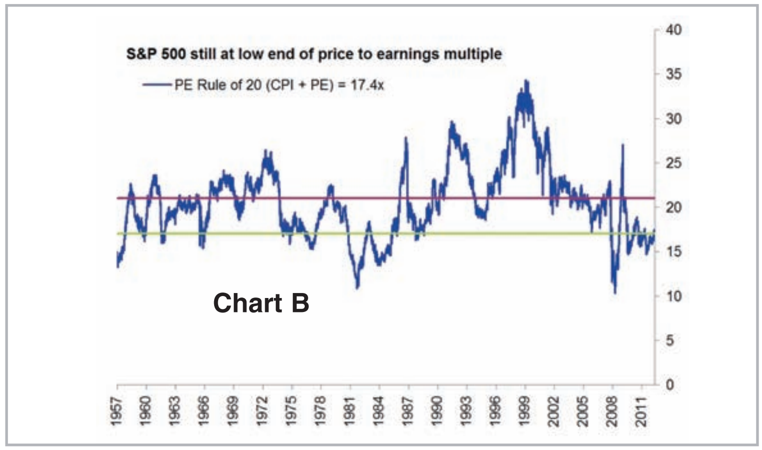
As chart A illustrates, earnings are expected to continue to grow with the consensus estimates of 12.7 percent growth in 2013 and eight percent for 2014. Earnings multiple expansion is the second factor. The outlook in this area again is favorable. As more investors flock back to equities, they are paying more for underlying earnings produced by those companies.

Through the market recovery, we have seen earnings multiple bounce back from historic lows toward the median. The rebound opportunity that existed three to four years ago has been realized, but there is still room to go further. As chart B illustrates, we are now in a normal range of valuations but still at the low end of that range.

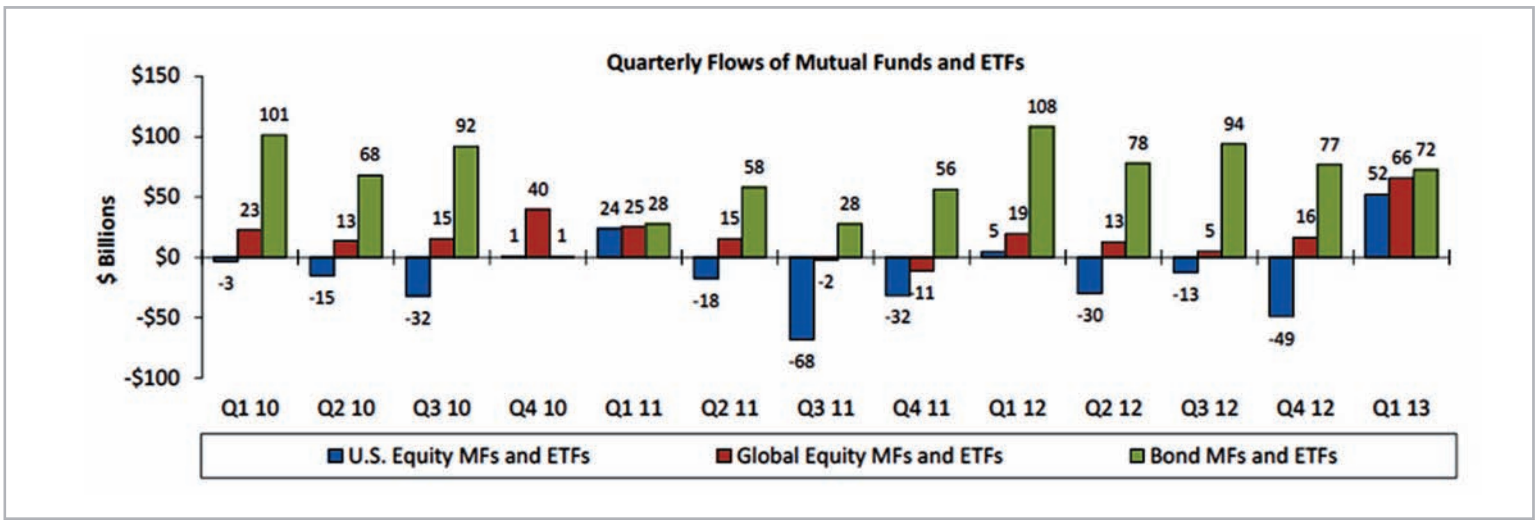


Source: Bloomberg



Source: Bloomberg

The return to normal valuations is driven by retail investors resuming inflows into equities. As illustrated in the chart below, in Q1 2013, domestic equity funds and ETFs added over $50 billion in assets, the first significant increase since 2009.



Source: TrimTabs Investment Research

To summarize, we expect the equity market rally to continue as long as money flow into equities and underlying earnings continues to support the valuations. The valuation of the equity market is still attractive by historical standards. In the near term, aggressive earnings expectations may be ahead of actual results considering the slow pace of GDP growth, which may cause a temporary pull back from market highs as expectations get calibrated to actual results. To best position our portfolios in this environment, it will be important to stay disciplined with our strategy of rebalancing on a quarterly basis the allocations of our clients' portfolios to maintain diversification.

"The valuation of the equity market is still attractive by historical standards."

That said, we will continue to be vigilant on behalf of our clients, taking advantage of opportunities that enhance returns. As always, feel free to contact us to discuss your financial objectives or further explore the wide array of wealth management services we offer. We thank you for your continued confidence in us.

— Jerry Braakman is
Chief Investment Officer and
Treasurer of First American Trust
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The Study highlighted that investment advisors and broker-dealers are subject to different standards under federal law, and that many retail investors do not understand the difference between the standard of care with which each must comply.

> **"Investment advisors and broker-dealers are subject to different standards under federal law."**

A core difference is that investment advisors are fiduciaries under the federal securities laws, while broker-dealers, in general, are not. Regulations by the SEC or state securities regulators hold investment advisors to a fiduciary duty that requires them to act in the best interests of clients and to avoid or disclose conflicts. Broker-dealers, on the other hand, are jointly regulated by the SEC and Financial Industry Regulatory Authority (FINRA). The standard of conduct for broker-dealers is to primarily deal fairly with customers and to fulfill a suitability obligation for their clients. While most investors expect brokers and other investment professionals to act in a client's best interest, the fact remains that only a portion of investment management professionals are bound by the higher fiduciary standard.

Ultimately, the Study recommends that the SEC should "engage in rulemaking to implement the uniform fiduciary standard of conduct for broker-dealers and investment advisors when providing personalized investment advice about securities to retail customers."

As recently as March 2013, the SEC has called for more information from industry members and other stakeholders about the potential impact of this recommendation.

> **"Our commitment to our clients is to always put their interests first."**

The good news is that you don't have to wait for a uniform code of ethics. You can select with care an investment advisor who complies with the fiduciary standard or voluntarily adopts and adheres to such a standard.

First American Trust has long upheld the highest fiduciary standard of care when working with clients. Our commitment to our clients is to always put their interests first, to provide complete, well thought out advice free of conflicts of interest, and to deliver services in an objective and cost effective manner.

By the way, the prospective client mentioned at the beginning of this column is now in good hands with us!

— Kimberly Dwan Bernatz is a CERTIFIED FINANCIAL PLANNER™
and Senior Vice President at First American Trust
kbernatz@firstam.com

Events & Happenings

Joanna Averett, Wealth Management Advisor, elected President of NAEPC

First American's vice president and wealth management advisor in our Inland Empire office was recently voted in as president of the National Association of Estate Planners & Councils, a national non-profit organization of some 27,000 members focused on the team concept of establishing and monitoring the highest professional and educational standards in the estate planning profession. NAEPC is also dedicated to the development and maintenance of the Accredited Estate Planner® (AEP®) designation.

First American's General Counsel Educates Estate Planners

As part of a professional continuing education seminar, General Counsel Steve Minana presented a talk, with three other attorneys, at a daylong seminar in Long Beach attended by some 50 estate planning attorneys and CPAs. The four attorneys covered estate planning topics such as discretionary distributions, fiduciary accountings, and the importance of diversification of trust assets.

Dancing for Tomorrow's Stars!

As long-time supporters of the Assistance League of Newport-Mesa, First American sponsored the sixth encore of "Dancing for Tomorrow's Stars" that took place at The Grove of Anaheim in March. The annual event features six of Orange County's well known philanthropists paired with six professional dancers. Funds raised support programs for local children.

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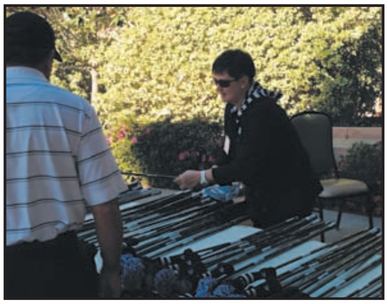
Golf Tourney raises $80,000

We supported the annual Crean Golf Classic hosted by the Orange County Chapter of the Alzheimer's Association, dedicated to providing services, education and advocacy for those affected by the disease. First American vice president & relationship manager, Jody Hudson, who served on the golf committee, said a full field of golfers at Mesa Verde Country Club helped raise some $80,000 to support various community programs. Professional golfer Ken Venturi gave a clinic prior to the event. The evening was capped off with a silent auction and dinner. Golf umbrellas were donated by First American Trust as part of the golf giveaway package.

L to R:
Steve Huntsinger, Sr. Portfolio Manager
Kimberly Bernatz, SVP
Tim Carlyle, Board Member
Kelly Dudley, President

All That Jazz!

In February, Ken Petersen, vice president and wealth management advisor, attended the Annual Jazz Festival and Dinner Extravaganza at Dana Point's Ocean Institute, where he sits on the fund development committee. Known for its hands-on marine science, environmental and ocean education, and maritime history programs, the Ocean Institute draws more than 120,000 students and teachers who participate in immersion style programs offered every year.



Jody Hudson, VP, Relationship Manager

Ken and Pam Petersen

First American makes Forbes® List of America's 100 Most Trustworthy Companies

This recognition acknowledges First American Financial Corporation's excellence in management and financial integrity, and ranks First American in the country's top one hundred companies from a list of 8,000 establishments traded on U.S. exchanges. A longstanding corporate tradition of honesty and reliability extends into the daily business at First American Trust, and we look forward to continuing to provide our clients and prospective clients with the service and integrity from an industry leader.

Give Us Feedback!

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