

Advisory Notes



SEPTEMBER 2014

Cultivating Relationships

30 Years

1984 - 2014



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Third Quarter Brings Volatility

As the third quarter comes to a close, the volatility indicators are beginning to rise again in the face of stronger U.S. economic data. (See Chart 1 on page 2.) Markets have pushed again into new record highs (Market



Table). The NASDAQ composite, which includes many small capitalized companies, has led the way this quarter and the broader S&P 500 has trailed. On a year-to-date basis, the S&P 500 broader index has outpaced the NASDAQ and the focused Dow Industrials has lagged. Interest rate forecasts, as well as inflation prospects, have undermined fixed income returns in the third quarter and we expect continuing pressure on returns from the removal of QE3 into 2015. Higher

yields on bonds continue to become difficult to obtain without going too far out on the yield curve (maturity dates) or down in credit quality (overall financial health) to achieve reasonable yields.

Geopolitical events like the global tensions in Russia and the Ukraine have kept investors on the sidelines for most of the year. As we approach the earnings season, the added conflict in Iraq and Syria against the burgeoning terror group ISIS has investors even more nervous.

On the economic front, the U.S. economy is improving as the data suggests the self-supporting expansion is taking hold. The midterm elections may create some buying opportunities as uncertainty creeps into the markets. Oil prices continue to drop as the dollar continues to strengthen, creating a tailwind for U.S. consumers and domestic companies. Although the U.S. Federal Reserve is tightening policy, the European Central Bank and others are begin-

See *Third Quarter* on Page 2

Market Table

| Valicenti Advisory Services, Inc. Comparative Index Period Returns From 06-30-14 THROUGH 09-30-14 | | | | | | |
|---|-------|---------|--------|------------------------|--------------------------------|-----------------------------------|
| | DJIA | S&P 500 | NASDAQ | Lehman Muni Bond Index | Citi Corp Corporate Bond Index | U.S. Treasury Bill Index (90 day) |
| 06-30-14 to 07-31-14 | -1.35 | -1.31 | -0.87 | 0.19 | -0.10 | 0.00 |
| 07-31-14 to 08-31-14 | 3.43 | 3.94 | 4.82 | 1.34 | 1.54 | 0.00 |
| 08-31-14 to 09-30-14 | -0.14 | -1.39 | -1.90 | 0.11 | -1.50 | 0.00 |
| Cumulative Returns-Q3 | | | | | | |
| 06-30-14 to 09-30-14 | 1.88 | 1.15 | 1.93 | 1.65 | -0.07 | 0.00 |
| YTD Returns | | | | | | |
| 12-31-13 to 09-30-14 | 4.61 | 8.35 | 7.59 | 8.44 | 5.62 | 0.06 |

Third Quarter

(continued from Page 1)

ning to loosen monetary constraints, which are drawing money inflows to the U.S. economy.

We have witnessed some pickup in merger and acquisition activity as well as an increase in IPO's (initial public offerings). The release of the Chinese Alibaba global online retail giant sparked much interest from investors. Since the month of September has historically been one of the most volatile months, we will continue to monitor risk/reward scenarios for opportunities appropriate to the overall goals of the portfolios.

We continue to reflect on our 30th year of providing wealth management services to our clients and cannot believe how fast the year has gone. We strive to continue the support to our existing client base and future customers as well. Our 2014 CNBC Top 100 Fee-Only Wealth Managers' recognition validates our dedication to our most valuable asset, you, the clients. We are looking forward to the fourth quarter. Please refer to the other Advisory Notes articles discussing economics, investment strategy, taxes and insurance.

Joseph M. Valicenti
President/CEO

Oil Market Headwinds Strengthen

Oil prices rallied in the first half of the year based on international tensions and concerns over supply disruptions. However, during the 3Q, oil prices declined as military intervention slowed the pace of ISIS's advancement in Iraq and military conflicts in Israel and Ukraine de-escalated. While geopolitical tensions are likely to remain a constant threat to energy markets, the slowing pace of the global economy and the success of the U.S. energy revolution may reduce their influence on energy prices.



U.S. oil production averaged 6.56 million barrels of oil per day over the past thirty years, with a peak daily production of 8.97 million barrels of oil per day achieved in June of 1985. With the discovery of new oil deposits and the advancement of drilling techniques, namely hydraulic fracturing, U.S. oil production has increased to 8.84 million barrels of oil per day (Graph 1). The resurgent supply of domestic crude oil and a below average economic growth rate should

keep the U.S. energy market well supplied with oil for the foreseeable future.

The growing supply of quality sweet crude and the lack of refineries currently structured to process the higher quality oil have also left energy producers in a state of excess supply. Many of these companies are petitioning federal lawmakers to revise U.S. oil export restrictions that were established in the 1970s as part of the oil embargo. It bears watching whether lawmakers revise export regulations or keep the tighter standards which could, if left in place, spur spending on new U.S. refineries or expansions to existing refineries. An increase in U.S. refinery capacity would benefit U.S. consumers through additional gasoline production and potentially lower gasoline prices.

Another influence on global energy markets is the slowing of the once powerful BRIC nations – Brazil, Russia, India, and China – that were forecasted to be major consumers of oil as their economies emerged into developed economies. The BRIC economies' growth rate has slowed from an average of 9.2% in 2010 to just 3.3%, which will negatively affect the growth of their respective oil consumption (Graph 2). In a further sign that world oil consumption may slow, the International Monetary Fund (IMF) also



Source: FactSet Research Systems, Inc.

Chart 1

recently reduced its global economic forecast to 3.4% from 3.8%.

An additional headwind to higher oil prices is the strengthening U.S. dollar, which has appreciated 7.0% over the past four months. With crude oil still primarily priced in U.S. dollars, a strengthening of the currency means fewer dollars are needed to purchase a single barrel of crude oil. With the U.S. Federal Reserve prepared to end its money printing efforts next month and many foreign central banks increasing their stimulus measures, the U.S. dollar should hold, if not increase, in value going forward. The more the U.S. dollar strengthens, the greater the headwind to crude oil prices.

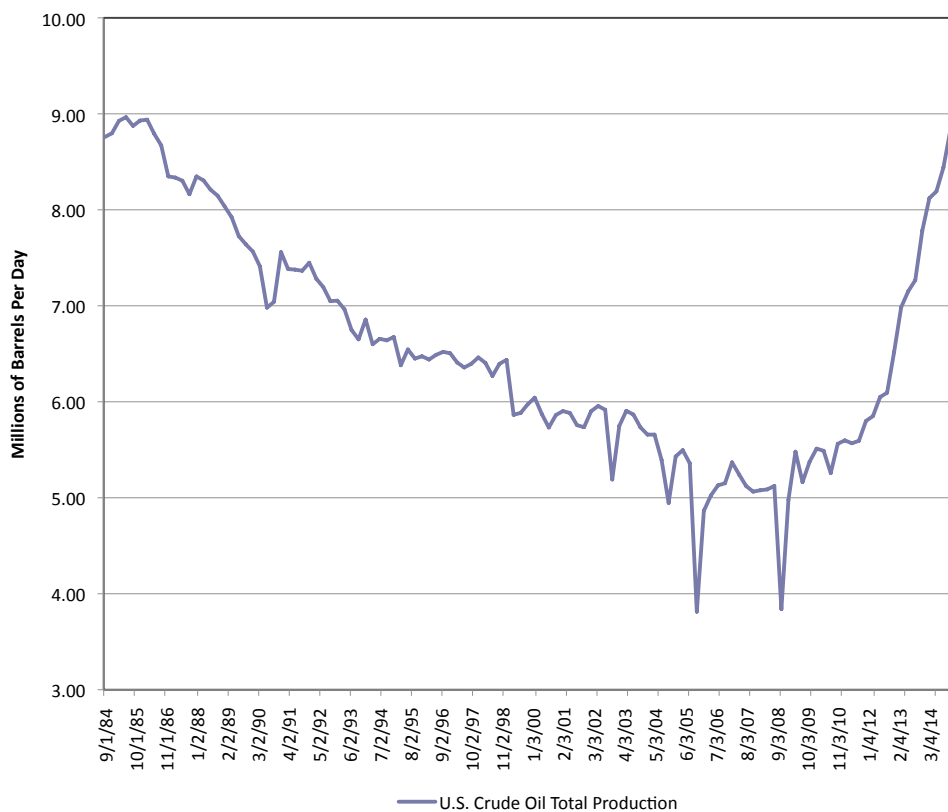
As geopolitics have a smaller influence on U.S. energy prices and domestic production continues to grow, U.S. oil prices should remain better contained over the long run. However, while a significant decline in energy prices may jeopardize the profitability of new oil exploration and may halt the expansion of U.S. energy independence, in the near term, we expect the recent headwinds to help consumers and the U.S. economy in the form of lower energy costs.

Andrew R. Clark, CFP®
 Vice President of Investment Research,
 Portfolio Manager



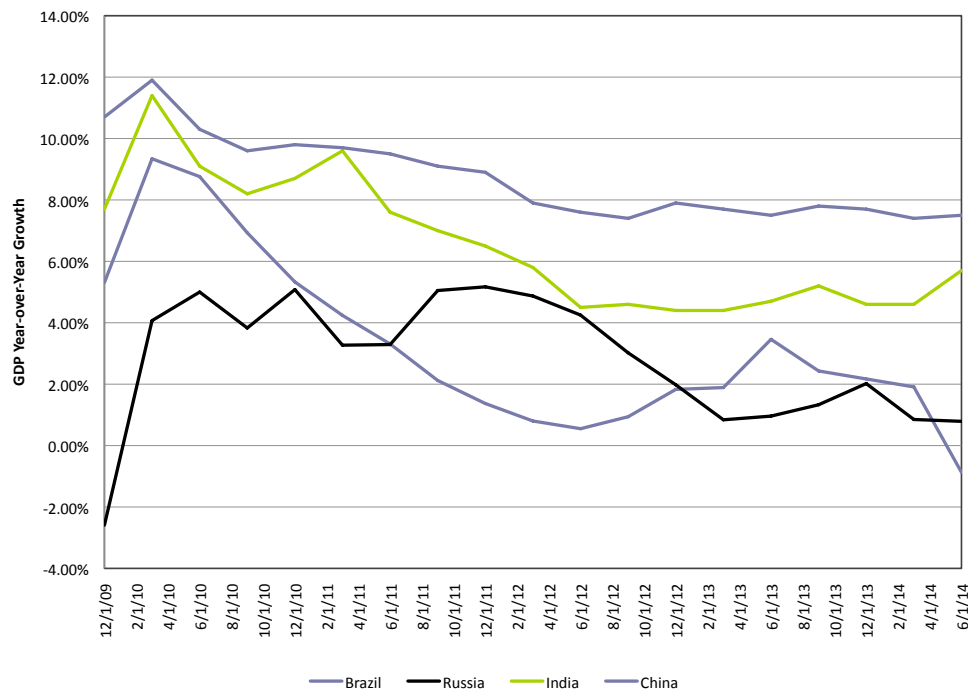
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U.S. Crude Oil Total Production



Graph 1

BRIC Economies



Graph 2

Market Symmetry

The third quarter of 2014 can be characterized as a period where geopolitical conflicts around the world grew in intensity. On the other hand, it was also a time when market participants received additional clarity in regards to the state of the



economy after the conflicting results seen in Q1 and Q2 GDP figures. Monetary policymakers in programmed fashion continued the tapering of asset purchases as more jobs, growth and inflation data has led to a deepening discussion of cyclical economic issues versus structural ones. The U.S. has emerged in a relatively strong position versus Europe, Asia and the Emerging Markets but, at the same time, overall global growth expectations have once again been reduced. As a result, clear divergences have emerged from both monetary policy and real growth perspectives which are just now beginning to find their way into growing interest rate differentials and shifting currency exchange rates. Further discovery on how this back-drop will drive asset prices, expectations for inflation and growth, and corporate earnings in the intermediate term is an investor focus.

As monetary policy normalizes, we are likely at a place in our market and economy where business leaders and fiscal, tax and regulatory policymakers will have higher

Investment Strategy

The third quarter of 2014 was very turbulent as the U.S. economy continued to show modest strength. Despite the better U.S. economic conditions and lower commodity prices, the Federal Reserve's exit from Quantitative Easing and its impact on interest rates, along with international political concerns and slower growth in Europe and Asia have investors more concerned.

We still believe the U.S. economy and the U.S. equity markets can move forward in the fourth quarter and into 2015. Our focus remains with large capitalized companies with positive earnings growth and strong balance sheets.

Our asset mix remains flexible as we work through all the economic uncertainty, with equities ranging from 40% to 65%, fixed income ranging from 25% to 35% and cash from 5% to 20%. This asset mix will vary based on client specific goals, risk tolerances and income needs.



Jeffrey S. Naylor
Executive Vice President/CFO

Positive Influence

- Consumer Confidence
- Low Inflation
- Increased Job Openings & Labor Turnover
- Improving Household Balance Sheets
- Adequate Financial Sector Liquidity
- European Central Bank Action
- Increased M&A Activity
- Lower Relative Eurozone Growth & Interest Rates

Negative Influence

- Chinese Credit & Growth Concerns
- Israel-Gaza Conflicts
- Ukraine Conflict & Increased Russian Sanctions
- ISIS Threat
- Rising Real Interest Rates and Dollar Strength
- Lack of Business Fixed Investment & Capex
- Fed Taper
- Suppressed Volatility

expectations for constructive results beyond the status quo. As we conclude 2014 and begin to look into next year, we are looking for any signs of increased opportunities for workers, higher wages, changes in business productivity and increased business capital expenditures in order to shape our outlook and understanding of where asset prices, policy and the economy are headed.

Positive Market Influences:

- Consumer Confidence – Consumer confidence is at the highest level since 2007. The increased confidence should continue to be supportive of higher levels of consumer spending.
- Low Inflation – As a counter to the recent modest rise in real interest rates, goods and services price inflation and expectations remain in the 2% range.
- Increased Job Openings & Labor Turnover – Job openings in Professional and Business Services as well Healthcare and Education Services have strongly trended

higher. Corresponding trends in Hires as well as Quits suggest modest but meaningful improvements in the jobs picture.

- Improving Household Balance Sheets – Households have significantly repaired their balance sheets and increased their savings since the 2008-09 recession.
- Adequate Financial Sector Liquidity – The Federal Reserve has pumped the U.S. banking sector full of money with banks now holding nearly \$2.0 trillion in excess reserves.
- European Central Bank Action (ECB) – The ECB will launch Asset Backed Security and Covered Bond purchases in an effort to incentivize business and consumer lending. This follows earlier efforts which lowered rates in order to provide unlimited access to liquidity for the banking sector.
- Increased M&A Activity – Global Mergers and Acquisition Activity in 2014 is at a multi-year high. In the U.S., the deal value and the number of deals for 2014 surpass activity of last year with several notable consolidations occurring in the Health Technology, Technology and the Commercial Services sectors year to date.
- Lower Relative Eurozone Growth and Interest Rates – Euro growth rates range from extremely low to contractionary across member countries. U.S. 10-year rates stand at 2.6% relative to 0.60% in Japan and 1% in Germany, supporting global financial flows towards U.S. paper.

Negative Market Influences:

- Chinese Credit & Growth Concerns – After a multi-year investment binge fueled by an expansion of credit which produced significant growth levels in the country, planners are managing a reform process to put the nation on a sustainable growth path.
- Israel-Gaza Conflict – Israel conducted an extensive air and ground campaign in Gaza

See *Market Symmetry* on Page 6

Medicare Planning

Individuals who currently receive Medicare benefits are quickly approaching the Annual Election Period (AEP). The AEP allows Medicare beneficiaries to review and select the type of supplemental coverage to enhance Medicare Part A and Part B. It also allows beneficiaries to select a prescription drug plan. During the AEP, you may add, drop or change your Medicare coverage. This is the only time of the year that you can do this unless you qualify for an exception. The AEP for 2014 begins October 15, 2014 and will run through December 7, 2014.



During this period, you are likely to examine the types of coverage available, benefit cost sharing and premium. The chart below

provided by medicare.gov illustrates the two primary ways in which you receive your Medicare coverage – original Medicare or a Medicare Advantage Plan.

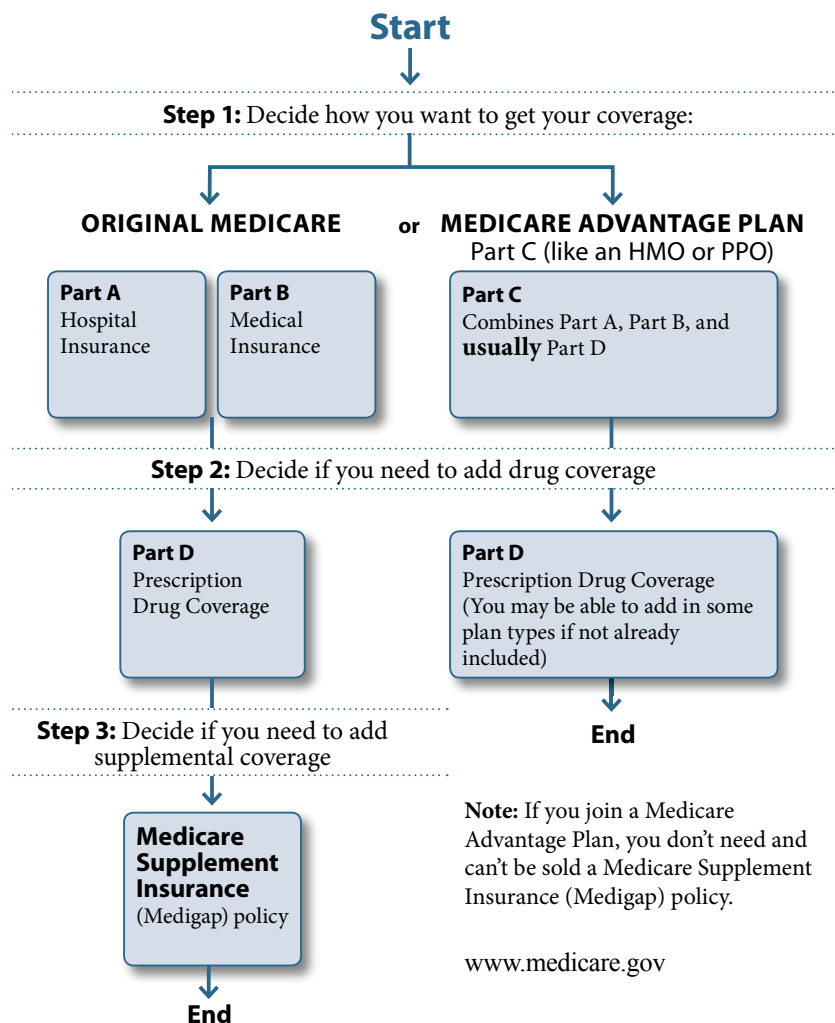
As illustrated below, the Medicare coverage choices include original Medicare Part A (Hospital Insurance), which helps to cover inpatient care in hospitals, skilled nursing facility care and hospice care. Medicare Part B (Medical Insurance) helps to cover physician services, outpatient care, home health care, durable medical equipment and various preventive services. Medicare Part C (Medicare Advantage) includes all benefits and services covered under Part A and Part B. Medicare Advantage plans are facilitated by Medicare-approved private insurance companies and may include Medicare Prescription Drug Coverage (Part D) as part of the plan. Medicare Part D (Medicare Prescription Drug Coverage) helps to cover the cost of

prescription medications and is also facilitated by Medicare-approved private insurance companies.

For most individuals who are Medicare eligible, you generally do not pay a monthly premium for Medicare Part A (Hospital Insurance) coverage if you or your spouse paid Medicare taxes while working. You pay a premium each month for Medicare Part B (Medical Insurance). The standard premium amount for 2014 is \$104.90 per month; however, if your modified adjusted gross income reported on your IRS tax return from two years ago is above a certain amount, you may be charged an Income Related Monthly Adjustment Amount (IRMAA). This is an extra charge added to your premium.

In addition to the premiums listed above, a beneficiary must also consider the cost of supplementing Medicare Part A & Medicare Part B coverage. Medicare Supplemental Insurance policies also referred to as Medigap policies are sold by private insurance companies. This coverage supplements Medicare benefits to pay some of the health care costs that Medicare doesn't cover. If you remain employed after age 65 and have other insurance, such as employer group health coverage, there are specific rules that determine whether Medicare or your other insurance is primary or secondary. It's important to understand the rules under which Medicare and other plans integrate. Please contact Valicenti Insurance Services, Inc. at 607-215-0242, if you would like to discuss the Medicare planning resources we have available to you.

Suzanne M. Valicenti
Vice President/Director of Insurance Services



Note: If you join a Medicare Advantage Plan, you don't need and can't be sold a Medicare Supplement Insurance (Medigap) policy.

www.medicare.gov



IRS Phone Scam Warning

The IRS is again warning the public about phone scams that continue to claim victims all across the country. In these scams, thieves make unsolicited phone calls to their intended victims.



Callers fraudulently claim to be from the IRS and demand immediate payment of taxes by a prepaid debit card or wire transfer. The callers are often hostile and abusive.

The Treasury Inspector General for Tax Administration (TIGTA) has received 90,000 complaints about these scams. TIGTA estimates that thieves have stolen an estimated \$5 million from about 1,100 victims. To avoid becoming a victim of these scams, you should know:

- The IRS will first contact you by mail if you owe taxes, not by phone.
- The IRS *never* asks for credit, debit or prepaid card information over the phone.
- The IRS *never* insists that you use a specific payment method to pay your tax.
- The IRS *never* requests immediate payment over the phone.
- The IRS will *always* treat you professionally and courteously.

Scammers may tell would-be victims that they owe money and that they must pay what they owe immediately. They may also tell them that they are entitled to a large refund. Other characteristics of these scams include:

- Scammers use fake names and IRS badge numbers to identify themselves.
- Scammers may know the last four digits of your Social Security number.
- Scammers spoof caller ID to make the phone number appear as if the IRS is calling.
- Scammers may send bogus IRS emails to victims to support their bogus calls.
- Victims hear background noise of other calls to mimic a call site.
- After threatening victims with jail time or driver's license revocation, scammers hang up. Others soon call back pretending to be from the local police or DMV and caller ID again supports their claim.

We want to bring these warnings to your attention, so that you are aware of these atrocious acts and will not fall victim to them. If you do receive one of these phone calls, please do not give the caller any information. Next, call our Tax and Business Services Department at 607-733-9022. Our trained tax staff will assist you in dealing with this unpleasant and intrusive situation.

Paul E. Hornbuckle, CPA
Vice President of Tax and Business Services

Market Symmetry

(continued from Page 4)

in 2014. This follows in the wake of 2012 clashes with a notable difference being an increase in severity and intensity.

- **Ukraine Conflict & Increased Russian Sanctions** – A power struggle for eastern Ukraine has been raging between pro-Russian and government forces feeding general geopolitical anxiety. While a tentative agreement to cease armed hostilities has been reached, continued Western sanctions against Russia are making economic maneuvering the main deterrent force.
- **ISIS Threat** – A growing and organized threat across parts of Syria and Iraq is being increasingly recognized by world leaders and a combined policy against it is being formulated.
- **Rising Real Interest Rates and Dollar Strength** – Higher real interest rates and dollar strength are not negatives; however, adjustments to their levels are likely to serve as headwinds to corporate profits and asset prices via higher exchange rates and discount rates.
- **Lack of Business Fixed Investment and Capex** – The fundamentals of investing in company assets and enterprise in order to grow output will have to have its place alongside share repurchase plans and M&A.
- **Fed Taper** – The Federal Reserve continues to taper outright asset purchases. The current support level stands at \$15 billion a month.
- **Suppressed Volatility** – Extraordinary policy actions globally have seemingly produced a suppressed level of market volatility across equity, bond and currency markets. While bond and currency markets have recently seen some uptick in volatility, persistent low levels of equity volatility builds on fears that a trend reversal in equity prices is around the corner.

Daniel P. Burchill
Security Analyst

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