In our second quarter client letter we wrote: "Given this potpourri of market signals our strategy is to remain *diversified* and *flexible*. This is not the time to take big bets." The stock market has made remarkable progress since the depths of the financial crisis. Year-to-date returns, especially for domestic markets, have truly been exceptional. As I'm sure most of our peers do, we follow the sentiments and musings of several investment professionals. Usually there is broad agreement among the cognoscenti we track, but today's environment is resulting in divergent outlooks.

Economist Nancy Lazar of Cornerstone Macro is optimistic and predicts the stock market will continue to move higher as a result of expanding market multiples. Two successful and influential hedge fund managers are likewise bullish. According to *Barron's,* Ray Dalio of Bridgewater Associates fame wrote to investors that "the economy is growing at a moderate pace that is fast enough to bring the unemployment rate steadily lower, while inflation pressures are falling…Liquidity is flowing freely, and credit conditions are improving." He believes domestic stock momentum will continue even as the Fed pulls back on stimulus. Recently on CNBC David Tepper, the founder of Appaloosa Management, said: "Stocks are still reasonable; probably only place to be. If I was super bullish before, I'm just bullish now."

Some equally successful investors are as bearish as the above are bullish. According to website Zerohedge.com value guru Seth Klarman wrote a very somber letter to clients titled: "If The Economy Is So Fragile That Government Can't Allow Failure Then We Are Indeed Close To Collapse." David Levy, chairman of the Jerome Levy Forecasting Center, told *Barron's* he expects the U.S. economy to eventually fall into a recession, smothered by excessive debt. Marc Faber, publisher of the Gloom Boom & Doom Report, has even been bold enough to predict a 20% correction in the U.S. stock market by yearend. These divergent views reinforce our position to stay diversified and flexible.

We've had another earnings season since our last communication. Unfortunately the actual results can only be described as disappointing, although you wouldn't know it by looking at the stock market. Stocks have come off their recent all-time highs but just barely.

Recently we've made several sales and have chosen not to reinvest the proceeds. We're having trouble finding value, are worried about rising interest rates and what will happen in the often volatile September/October time period. Buying a little insurance (i.e. raising some cash) seems the prudent thing to do at the moment even if the long-term outlook for stocks remains positive.

We often are queried by consultants and clients about issues of economic collapse echoing sentiments of the financial crisis. We are forwarded newsletters of doom and gloomers insisting that the global economic system will implode. While we don't totally disagree with some of the arguments about global debt and deficits we find that in many cases these writings are sensational and usually geared in some way to profit the writer.... not necessarily you! While we certainly do not have a corner on the market for perfect analysis, we try to synthesize valid analyses from numerous sources.

At present Governments are working to repair previous damage, prescribing stimulus for their economies to grow out of the recent malaise, hoping that the medicine is not worse than the disease itself. We will continue to examine risks in the marketplace to determine the direction of our investment strategy hoping to err on the side of the conservative investor.

James G. Tillar, CFA Steve Wenstrup

OUTSIDE COMMENTARY

Wells Capital Management

August, 2013 (Outtake)

Economy stands on its own?

Although the stock market is currently digesting changes which may cause it to trend sideways for a time (a 3 point rise in the price-earnings valuation on stocks since last year, a major upward re-pricing in bond yields, and an imminent start to Fed tapering), we do not believe the bull market has ended. Indeed, a resolution to the very thing which is causing so much anxiety today (Fed tapering) may be the primary catalyst driving stocks higher again next year.

If Fed tapering begins in September and both the economy and the stock market do not fall apart as many fear, "confidence" as we enter 2014 could be boosted as the economic recovery is finally perceived as standing on its own! Could "debunking the Great Fed Myth" prove more stimulative for the economy and the stock market than was QE?

The Chart below highlights the potential payoff which could come from winding down QE. It overlays the trailing price-earnings (PE) multiple on the S&P 500 Index with an index of consumer confidence. PE multiples have mostly declined since 2000 in line with a slow but steady erosion in economic confidence. While fear has been the best friend of the bond market, it has proved the stock market's worst enemy. **This has started to change! Confidence bottomed during the U.S. government ratings disaster in 2011 and has since been slowly recovering**.