Here is our annual Year in Review letter for you. In case you don't care to read the entire letter, here is a brief synopsis:

- 2013 was the "Year of the Stealth Market"
- Although stocks did great, bonds, gold and commodities did not, and many foreign stock markets did better than the USA
- Despite the stock market's gains, stock prices are not too high
- The economy is continuing to improve which bodes well for another good year for stocks, but still risky for long-term bonds and gold
- So, focus on our six Action Steps for you to take this year

Now, on to the letter!

2013 in Review

Financially speaking, 2013 was quite a year, producing some amazing performances for the financial markets — some great, some awful.

Stocks experienced what I'm calling the "Year of the Stealth Market." Instead of headline-generating daily gains behaving like a snowball barreling down a mountainside, stock prices acted more like a simmering heat that caused a pot of water to boil before anyone realized it.

The Dow Jones Industrial Average (an index of 30 of the biggest companies in America) ended the year with a gain of 26.5% — its best performance since 1995. The S&P 500 Index did even better, growing 30% — its best record in 16 years. And the NASDAQ (an index consisting primarily of smaller companies) posted a whopping 38% gain for the year.[1]

Yes, 2013 was a banner year for stocks of all kinds. But what does that bode for 2014? And what is our investment advice to you for the coming year?

I'll explain in this letter. But first, let's review the fascinating twists and turns the markets took during 2013 that led to the results shown above. This will give you a

better understanding of how the markets work, why their behavior is so unpredictable and explain why *not all* financial indicators were rosy last year. (In fact, some did quite poorly.) And all this information can help you make better investment decisions in 2014 and beyond.

First, let's take a closer look at the Dow's performance. Of the 252 days the stock market was open for business in 2013, the Dow rose 146 days and fell 106 — in percentage terms, a score of 58% to 42%. In sports, we'd call that a 6-4 record — a winning season, yes, but not particularly noteworthy and certainly not what anyone would call a record-setting year.

And the closer we look at the Dow's daily performance, the more we might feel rather blasé about the year:

- Average up day: 76 points
- Average down day: 71 points
- Number of days when all 30 Dow stocks were up: 4
- Number of days when all 30 Dow stocks were down: 4

Yet, despite these unimpressive statistics, the Dow hit an all-time, record-high close *52 times* last year!

And no one seemed to notice!

Here's why: ***There was little volatility in the stock market last year.*** **Not a single day saw the Dow rise or fall 500 points, or anything like it. We saw nothing like the volatile days of 2008 and 2009.** Instead the stock market plodded along for 252 days, recording modest gains or losses each day. Despite this, the cumulative result was amazing.

And those 52 record highs? They included two major milestones: The Dow not only broke the 16,000 barrier for the first time, it also crossed 15,000 for the first time. Two major milestones in one year! That's happened only once before in the last 20 years, which was in 2003.

The story gets even more remarkable when you examine the Dow's history since its inception in 1896. It took the Dow 21,653 trading days to go from 0 to 1,000 points. That's 76 years! After that, it moved from:

- 1,000 to 2,000 in 14 years
- 2,000 to 3,000 in four years
- 4,000 to 5,000 in only nine months
- 6,000 to 7,000 in just four months; and
- 10,000 to 11,000 in just one month.

In other words, it took the Dow *twice as long* to reach 1,000 points as it took to get from 1,000 to 16,000.

When the 2008 credit crisis hit, the Dow plummeted from its high of 14,198.10 in October 2007 all the way down to 6,469.95 in March 2009. It then took the Dow nearly six years — from 2007 to 2013 — to reach a new all-time high of 15,000.

And then it went from 15,000 to 16,000 in just 4.5 months!

What does this tell us? Simply that those 1,000-marker milestones are becoming progressively easier to reach. After all, it took a 100% gain to go from 1,000 to 2,000, but it took only a 6.7% gain to get from 15,000 to 16,000.

Thus, it is entirely possible — likely, some would say — that the Dow will therefore reach the next set of thousand-point milestones more quickly than ever. That's a rather remarkable notion.

But let's not get ahead of ourselves. After all, 2013 was *not* a great year for many asset classes. Indeed, some performed quite poorly.

The bond market, for example, suffered one of its worst years in decades. Government bonds dropped almost 4% on average, with longer-term maturities falling the most: 30-year Treasuries lost 15%. (We have been warning for a few years that this was coming; that's why we have sharply reduced, for all clients, and for many even virtually eliminated, long-term bonds from your EMAP portfolio.)

Commodities generally fell last year as well, including corn (down 40%, its worst year on record), wheat (down 22%), soybeans (down 8%), copper (down 7%), platinum (down 11%), gold (down 28%) and silver (down 36%).

Gold deserves more attention here because that asset class gets more attention from consumers, investors and the media than any other commodity. We have warned for at least three years that gold prices were rising to bubble-bursting levels and we've now been proven correct: Gold prices peaked at $1,900 an ounce in 2011 and have fallen ever since, ending 2013 at around $1,200 per ounce. It was even worse for gold mutual funds — which is how those who buy gold tend to invest: According to Morningstar data, the average gold mutual fund lost 49% in 2013. We hope you followed our advice and avoided investing in gold.

Foreign stocks? Some of them performed wonderfully, even outpacing the U.S. stock market (which ranked ninth worldwide). But we doubt you'd be able to guess which nations had the most profitable stock markets. Here are the top eight:

Rank	Nation	2013 Gain
1	Dubai	108%
2	Argentina	89%
3	Abu Dhabi	63%
4	Japan	57%
5	Pakistan	49%
6	Nigeria	47%
7	Bulgaria	42%
8	Ireland	34%

And those weren't the only surprises on the world's economic stage in 2013.

Remember the BRIC nations? Brazil, Russia, India and China were expected to take over the world, and many pundits encouraged investors to move their money to stocks of those countries. On the other extreme, the PIIGS (Portugal, Italy, Ireland, Greece and Spain) were supposedly headed for bankruptcy.

So how did the BRIC markets and the PIIGS do in 2013? Here's how:

BRIC		PIIGS	
Brazil	-16%	Portugal	+16%
Russia	+2%	Italy	+17%
India	+9%	Ireland	+34%
China	-7%	Greece	+28%
Average:	*-3%*	Spain	+21%
		Average	*+23%*

What's the takeaway?

It is impossible to accurately predict what stock prices will do in the short-term. You should not even attempt to do so.

Instead of beating yourself up for not having all of your money in stocks last year, remember *why* you didn't: You could not have predicted that the U.S. stock market was going to rise 25% or more last year. And you surely never would have predicted that the best foreign markets were going to include such nations as Pakistan, Nigeria and Bulgaria. (Pakistan, Nigeria and Bulgaria? Seriously?!)

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Even the press got it wrong all year long. Take a look at these headlines:

January 12	"Rebirth of Equities Ain't Necessarily So" *Financial Times*
February 8	"Scant Pickup in Economic Growth Seen for 2013" *The Wall Street Journal*
March 7	"Stock Markets Defy Economic Woes" *Financial Times*
April 2	"Lesser Expectations: Earnings Hopes Dim for First Quarter" *USA Today*
May 18	"Stock Market Optimism on This Scale Hard to Explain" *Financial Times*
July 7	"As Investors Rush in, Stocks Are Sending Warning Signals" *The Wall Street Journal*
August 24	"Lofty Profit Margins Hint at Pain to Come for U.S. Shares" *The Wall Street Journal*
October 7	"Get Ready For a Drop in Stock Prices" *The Wall Street Journal*
November 16	"Is This a Bubble?" *The Wall Street Journal*

With the media expressing their skepticism all year long, how can you criticize yourself for not investing more of your money in stocks? Clearly, doing so would have been speculative and considered far too risky.

But you didn't panic, either. You didn't allow the naysayers to cause you to shift out of stocks. Instead, you chose the wiser course and stayed focused on your long-term goals.

So pat yourself on the back: By staying invested, your returns were obtained with lower levels of volatility and risk than you might have expected.

Looking Ahead to 2014

Will we see a repeat of 2013's stock market's success this year?

Ben Bernanke, chairman of the Federal Reserve for the past seven years, told the American Economic Association in early January that, "The combination of financial healing, greater balance in the housing market, less fiscal restraint and of course continued monetary policy accommodation bodes well for U.S. economic growth in the coming quarters."

Bernanke had good reason to wax optimistic. The economy is steadily improving. For example:

- Housing prices ended last year higher than at any point in the previous six years, according to the National Association of Realtors.

- The automotive industry sold more than 15 million vehicles in 2013 — its best year since 2007 — and expects to do even better in 2014, according to the National Automobile Dealers Association.

- Oil prices are stable and dropping, with no fears of energy shortages, according to the Energy Department.

- Inflation remains low. Its rate of 1.2% last year was the lowest in more than 10 years, with the exception of 2008. There is no indication that inflation will increase sharply in the near future.

- Corporate profits are at an all-time high and America's public companies have amassed record levels of cash — some $2 trillion among the companies in the S&P 500 alone — ready for deployment into the economy, according to Standard and Poor's.

Some people, though, are worried: Now that the Dow has passed 16,000, are stock prices *too* high?

The simple answer is: No.

Consider the P/E ratio of the S&P 500. This comparison of stock prices (P) to corporate earnings (E) shows that while stock prices have risen sharply from a year ago, so have corporate profits. As a result, the P/E is largely unchanged. The lower the figure, the better — it was 17 a year ago and it is 19.5 now. (To give these figures some context, realize that the P/E ratio hit 71 in 2008. No wonder the market crashed.)

The stability and continuing strength of corporate profits helps explain why we are in a "virtuous cycle" — as profits rise, companies deploy more cash. As they do, the economy improves, which helps them earn more profits that they can then further deploy.

How do companies deploy their cash? As you may have heard me explain on my radio show in the past couple of years, corporations amassing cash do one of three things with the money. They:

- buy other businesses (called mergers and acquisitions)
- increase dividends to their shareholders
- buy back their own shares (which they believe are low in price relative to their current and projected profits). These buybacks help their stock prices rise.

And these three actions are exactly what have been occurring. Consider, in 2013:

- There were nearly 10,000 mergers and acquisitions worldwide in 2013, involving public companies, venture capital and private equity. The total value of these deals was nearly $1 trillion, according to factset.com. Wall Street firms earned more than $72 billion in investment banking fees — the most since the 2008 financial crisis.
- Of the approximately 10,000 publicly traded companies in the U.S., nearly 3,000 increased their dividends; only 299 decreased them. The total amount paid in dividends was $57 billion more than in 2012 — a record, according to Standard and Poor's.

- The companies of the S&P 500 spent nearly $500 billion buying back their own stock, says Standard and Poor's.

S&P also reports that only 16 of the 500 companies in its index neither paid a dividend nor did a stock buyback (the smallest number since 2005), while 369, or 74%, did both (the highest figure ever).

All of this bodes very well for 2014, but can we expect the stock market to grow another 25% or more this year?

Highly unlikely. Such back-to-back results are rare, having last occurred in 1997-98, according to S&P. Still, there is sound basis for anticipating continued recovery of the economy and thus a good year for the stock market.

We continue to be concerned about the bond market, which will fall in value if interest rates rise. Therefore, we continue to avoid significant exposure to long-term bonds to help reduce the risk of rising interest rates.

And although we expect the economy's recovery to continue, dangers lurk. Natural disasters, terrorism, budget battles in Washington and unforeseen events could interrupt or even derail the progress we've made over the past five years. For these reasons, maintaining extensive global diversification remains the best approach, supported by our rebalancing strategy.[2]

That's a crucial point and worth elaboration. **Our focus on rebalancing allows us to take advantage of short-term market corrections. This helps us to reduce volatility in your portfolio, while potentially improving returns over the long-term. Thus, you needn't fear the possibility that stock prices might be too high and could decline during part of 2014, because our daily review gives us the opportunity to take advantage of a short-term decline.**

In short, we remain confident that the Edelman Managed Asset Program® will continue to deliver the returns you are counting on to achieve your personal financial goals.

Your Action Steps for 2014

Here are the six steps you should take this year and rely on us to help you accomplish this to-do list:

If you're not already fully invested, talk to us

A new Gallup poll shows that half of Americans believe the stock market is too risky. Indeed, 54% of Americans currently invest in stocks or stock mutual funds — the lowest in Gallup's 16-year trend of asking this question. Failure to invest and stay invested can lead to a retirement in poverty. **If you have uninvested assets, such as with a former employer or bank account, talk with us about it.**

Maintain the extensive global diversification that EMAP provides you

Diversification helps reduce the worry that stock prices are high — by the mere fact you aren't invested too heavily in stocks in the first place.

Allow us to continue rebalancing your account for you

We have found no better way to control risks and optimize returns than by our strategic daily rebalancing review. We will continue to perform this important function for you.

Examine your need for long-term care insurance

There is no greater threat to your financial future than the risk of incurring long-term care costs, and the longer you wait to address this topic, the more difficult it is to resolve it. If you haven't already talked to us about this issue, please do so this year.

Mortgages

Most people expect interest rates to rise. That means today could be your best opportunity to lock in historically low rates. Talk with us to see if you should obtain a mortgage or refinance a current one.

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Estate planning
When was the last time you reviewed your documents — including beneficiary designations — with us? And if you have revised your documents, have you told us about your revisions?

As we move through the new year, you can be certain that we will continue to monitor the financial markets and your portfolio closely, serving you as attentively and effectively as we can. And as the above six-step list suggests, please let us know if anything — such as your job, income, health, marital status, goals or risk tolerance — has changed in your life, so we can give you the advice you need.

Wishing you the very best in 2014!

Regards!

Ric Edelman
Chairman and CEO

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[1] An index is a portfolio of specific securities that measures the value of the stock market or a sector of the stock market (common examples are the Standard & Poor's 500 (S&P 500), Dow Jones Industrial Average (DJIA), and NASDAQ-100), the performance of which is often used as a benchmark in judging the relative performance of certain asset classes. Indices are hypothetical portfolios and investors cannot invest directly in an index.

[2] Investing strategies, such as asset allocation, diversification, or rebalancing, do not assure or guarantee better performance and cannot eliminate the risk of investment losses. There are no guarantees that a portfolio employing these or any other strategy will outperform a portfolio that does not engage in such strategies.

Ric Edelman is Chairman and CEO of Edelman Financial Services LLC, a Registered Investment Adviser, and CEO, President and a Director of The Edelman Financial Group Inc. He is an Investment Adviser Representative who offers advisory services through EFS and a Registered Principal of (and offers securities through) Sanders Morris Harris Inc., an affiliated broker/dealer, member FINRA/SIPC.