Highlights

- After preparing the market for a QE taper, the Fed chose not to act at its September meeting. This had a positive effect on markets at the end of the quarter. Most of our portfolios benefited from an improvement in emerging markets.
- Economists had relatively high expectations for the fourth quarter, most of which are now watered down. The Fed's non-taper leaves the economy muddling through.
- Despite a move higher in interest rates and a disappointing August employment report, we believe the Fed should have begun the taper. The unprecedented level of stimulus is no longer justifiable.

Markets

		Returns (%)	
GIA*	Average Quality	3Q13	12 Months
Global High Yield Composite	(BB-)	1.93	6.33
Global Credit Plus	(BBB-)	1.53	1.34
Core Plus Composite	(A)	0.86	0.50

**Returns are net of fees*

Benchmark Bonds			
Barclay's U.S. Aggregate Index	(AA+)	0.57	-1.68
Treasury	(AAA)	0.10	-2.09
Credit	(A)	0.73	-1.90
Mortgage	(AAA)	1.04	-1.24
Government/Credit	(AA)	0.36	-1.96
BoA Merrill U.S. Corps & Yankees	(A)	0.85	-1.43
BoA Merrill Corporate Master	(A-)	0.89	-1.27
BoA Merrill High Yield	(B+)	2.28	7.03
JPM Emerging Markets EMBI+	(BB+)	0.51	-5.94
JPM CEMBI Broad	(BBB)	1.40	-0.12
JPM GBI-EM Global Diversified	(BBB+)	-0.43	-3.74
Citi Non-U.S. World Govt. Bonds	(AA-)	4.06	-5.65
Benchmark Equities			
S&P 500	NA	4.69	16.72
Nasdaq Composite	NA	10.82	21.03
Russell 2000	NA	9.85	28.22
MSCI EAFE	NA	10.94	20.35
Europe	NA	13.16	20.66
Japan	NA	5.97	29.23
MSCI Emerging Markets Equity	NA	5.01	-1.52

Markets

If one were to label the third quarter of 2013, like the title of an episode of a television series, it might be called "The Enigmatic Taper." Although there was some softening in risk aversion early in the quarter, most markets began to anticipate the Federal Reserve's initial steps to lessen stimulus. While there were a few other distractions like the threat of Syrian strikes and noise over the Fed's next Chairman, sentiment changed dramatically when the Fed decided not to act on September 18th. Investors speculated about the reasons, perhaps a weaker than expected August employment report or the September/October budget and debt ceiling debates. Either way, higher risk assets rallied in September and the non-move reestablished the optimistic sentiment that prevailed during the first quarter of the year. The S&P 500 returned 4.69% for the quarter with 2.98% occurring in September. Foreign equity markets recovered as investors gained comfort that further aid from the central banks would be forthcoming. In bond markets, 10-year U.S. treasuries rallied with rates declining from nearly 3.0% on September 5 to 2.61% on September 30. Emerging market bonds, which had suffered substantial declines during the second quarter, began to recover their lost ground.

The Bank of America Merrill Lynch U.S. Corporate Index (C0A0) was aided in September by the non-taper and the move lower in interest rates. The Index was up 0.89% for the quarter, but still down -2.45% year to date. For the quarter investment grade bonds modestly outperformed treasuries (on a duration equivalent basis) and were able to retain outperformance year to date. Investment grade corporate spreads narrowed by 12 b.p. to 155 b.p., while the yield to worst of the index declined from 3.40% to 3.31%. Issuance continued to be moderate in July and August, but spiked to the highest ever monthly volume in September on Verizon's record-breaking $49 billion issue. Year to date $851.8 billion in issuance restored a pace that could again top a trillion for the year.

High yield bonds continued their outperformance of other fixed income markets and experienced a favorable reversal in fund flows. The Bank of America Merrill Lynch High Yield Cash Pay Index (J0A0) was up 2.28% for the quarter and 3.77% year to date. Spreads narrowed from 507 b.p. to 468 b.p., and the yield to worst declined from 6.46% to 6.04%. Mutual fund investors returned to high yield after a huge cash exodus in May and June. During the quarter about $8.0 billion came into the market partly reversing the $16.4 billion that exited in the last two months of the second quarter. The default rate remained at 1.09%, well below the historical average of 4.0%. New issuance for the quarter was $91 billion, paced by a record $53 billion in September, and year to date was ahead of the same period last year.

Emerging markets debt began to recover from the hits they took at the end of the second quarter and early in the third quarter after the pace of outflows subsided, and the Fed's non-taper renewed confidence in the sector. In addition, during the summer, China reported better than expected economic data, suggesting the world's second largest economy was in better shape than pessimists feared. The J.P. Morgan Emerging Markets Bond Index Plus (EMBI+), a dollar denominated sovereign index was up 0.51% for the quarter, but still down 8.89% year to date. The JPM Corporate Emerging Markets Broad Index (CEMBI Broad) also recovered ending up 1.40% for the quarter, but down 2.88% year to date. The JPM Global Bond Index – Emerging Markets Global Diversified (GBI-EM Global Diversified), a local markets index, rallied in September, but was down 0.43% for the quarter and -7.56% year to date. During the quarter, the flow out of funds eased, although the first inflow in 17 weeks occurred the last week of September. Year to date flows are now negative $2.3 billion.

Portfolios

Our *Global High Yield Composite* consists of portfolios investing primarily in U.S. high yield, higher yielding investment grade credit, and emerging markets corporate bonds. The Composite underperformed the Bank of America Merrill High Yield Cash Pay Index by 35 basis points, net of fees, in the quarter, and was behind the index by 70 basis points over the last 12 months. While, as a whole, emerging markets recovered during the quarter, our Global High Yield portfolios held some bonds that deteriorated further. These bonds held back the performance of the Composite and were the primary source of the underperformance. Our high yield holdings outperformed the high yield index, but not by enough to offset the drag from emerging markets. Over the past twelve months emerging markets performed worse than high yield and the Composite's exposure to that sector caused the underperformance.

Our *Global Credit Plus Composite* consists of portfolios holding investment and non-investment grade credit related securities. The Composite is measured against a benchmark consisting of 70% of the BofA Merrill Lynch U.S. Corporate Index and 30% of the BofA Merrill Lynch U.S. Cash Pay High Yield Index. The Composite outperformed the benchmark, net of fees, by 23 basis points during the quarter and was ahead by 18 basis points over the last 12 months. The portfolios had an allocation of approximately 39% U.S. investment grade, 24% high yield, and 33% emerging markets. During the quarter emerging markets recovered from their poor second quarter performance helping deliver about half of the excess returns. The other half came from the portfolio's investment grade exposure. The portfolio's high yield holdings performed well, but only kept up with the strong market and did not deliver excess returns. During the last twelve months the Composite's investment grade holdings delivered strong relative returns that were partially offset by the emerging markets exposure and holdings of government bonds as a portfolio funded in the second half of 2012.

Our *Core Plus Composite* consists of portfolios that can hold up to 30% in securities rated below investment grade. The Composite outperformed the Barclays U.S. Aggregate Index, net of fees, by 29 basis points for the quarter, and was ahead by 218 basis points over the last twelve months. High yield credit outperformed during the quarter and year to date, after a slight lapse at the end of the second quarter. Emerging markets, which detracted last quarter, recovered to contribute nearly half of the excess return. The portfolio's underweight to mortgages and treasuries provided a slight negative contribution and investment grade credit was marginally positive. Over the last 12 months investment grade credit, high yield and emerging markets all outperformed. The Composite was overweight credit during all twelve months, leading to the excess returns.

Economy

The third quarter of 2013 ended with a decisively mixed set of events. After putting the world on notice that it would begin to taper its bond purchases, the Federal Reserve passed on that action at its September 18th meeting. The announced reason was that they feared economic activity had weakened, and their tapering might drag growth down further. Long term interest rates had risen sharply since Mr. Bernanke hinted at the move in May, but there was limited evidence higher rates were depressing the economy. While housing data showed some softening during the quarter, manufacturing and consumption held up well. In fact, the only disappointing piece of data during the quarter was the August employment report, which surprised on the downside after the same report did the opposite in July. We believe the economic case for passing on the taper was weak and, instead, the Fed reacted to the likelihood that Congress would disrupt the economy with its budget and debt ceiling negotiations.

We began the fourth quarter with the government shut down and the Affordable Care Act open for enrollment. September's employment report was a victim of the shutdown and little data has been released since the Fed met in September. Having indicated that their tapering will be data dependent, it is unlikely they will now act before their December meeting. The effect of higher rates was plainly visible in J.P. Morgan's and Wells Fargo's third quarter earnings reports, which showed a reduction in mortgage activity. While the banks reported that most of the decline came from reduced demand for refinancing, it does illustrate some of the economic drag the Fed's eventual withdrawal will have.

Adding to the economic confusion caused by the Fed and the government shutdown, the IMF announced in early October that it was lowering global growth forecasts. The bulk of the reduction came from emerging markets, particularly China and Russia. On the positive side, the IMF marginally upgraded its growth forecasts for Europe, but, on balance, economists and investors published more growth downgrades than upgrades by the end of the quarter.

As we look forward, we would say enthusiasm for better economic growth in the U.S. and around the world, seen as likely at the end of last quarter by many economists, has given way to a grudging acceptance that little is happening. Favorable factors like energy prices, solid consumer and business balance sheets, and robust manufacturing activity are repeatedly set back by head winds like the Syrian conflict, a government shutdown, and slower emerging market activity. In aggregate, the outlook becomes "blah," just an ongoing muddle-through at subpar rates.

Scenarios

We propose three scenarios for the U.S. economy over the next 6 months:

1. Our most likely case has the economy growing 2.0% to 2.5% in 4Q 2013 and 1Q 2014. The solid foundation that has been built around the U.S. economy should prevent a meaningful decline in activity, but acceleration to trend, or above trend, growth requires support from government policy, private investment and exports. The Fed will likely delay its withdrawal from the market, but its presence may no longer add to growth. Because of the Fed, interest rates may only rise modestly through the end of the year, and their effect on housing, especially in refinancing, has probably been seen. The government shutdown will likely end shortly having only a marginal effect on 4Q growth. We believe the likelihood of a meaningful agreement on deficit and debt reduction is small, so a growth catalyst from policy remains elusive. PROBABILITY 65%

2. A second scenario has the economy recovering to trend or perhaps above-trend growth of 3.0 to 3.5% over the next six months. We believe the U.S. economy enjoys many favorable factors which could support a faster rate of growth if they could be joined by supportive measures from the government and more favorable global activity. A credible government debt reduction plan or meaningful investment incentives could put the laggard economy into a higher gear. Many indicators like employment, consumption, and confidence suggest this is possible, even though it remains largely unexpected. PROBABILITY 20%

3. A third scenario has the economy declining to 0.0% to 1.0% growth due to a crack in business and consumer confidence. Coming cost increases due to the Affordable Care Act could lead some companies to curtail their hiring or even reduce employment. In addition, interest rates increased sharply since May and could douse the momentum from the housing market even further. Should these two factors lead to a loss of confidence, consumers might retrench instead of maintaining their consumption patterns. In this scenario, the economy's growth could be snapped taking the activity back into a lethargic phase. PROBABILITY 15%

Market Outlook

During the quarter the good news: better economic data in China, robust production and employment data in the U.S., slight improvement in European economic performance, was offset by: scares related to a Syrian strike, a government shutdown, and the looming burden of the Affordable Care Act. Into this combination, the Fed held back the taper. Unfortunately, we believe the Fed's continued stimulus is no longer beneficial to the long term well-being of the U.S. economy. Over the near term, assuming the U.S. government reopens and does not default, the Fed's actions will support financial markets, which will benefit credit markets in general and higher risk markets in particular. However, by the end of the fourth quarter, we expect interest rates to rise modestly from current levels. Given these mixed signals, we expect high yield and emerging markets to outperform in the fourth quarter, although absolute returns from bonds may not match up to returns delivered by equities and other risky assets.

Commentary – It's time Ben

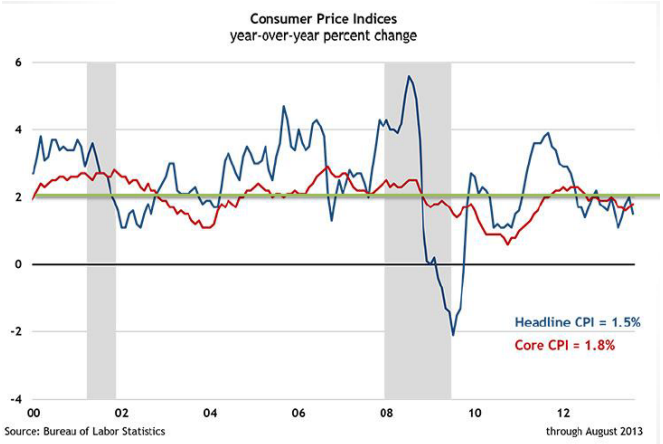
After preparing the market for the beginning of the reduction in the Federal Reserve's quantitative easing (QE) policy, the Fed chose to delay the tapering at its September 18th meeting. In their press release the Fed said, "The Committee sees the downside risks to the outlook for the economy and the labor market as having diminished, on net, since last fall, but the tightening of financial conditions observed in recent months, if sustained, could slow the pace of improvement in the economy and labor market." The tightening of financial conditions the Fed cites is the move higher in long term interest rates that occurred between May and September, after the Fed began its hints. From May 2, 2013, the low point in rates during 2013 to September 5 the 10 year U.S. treasury moved from 1.63% to 2.995%. However, 10 year interest rates had risen above 2.0% during the first quarter well before the Fed began its tapering commentary.

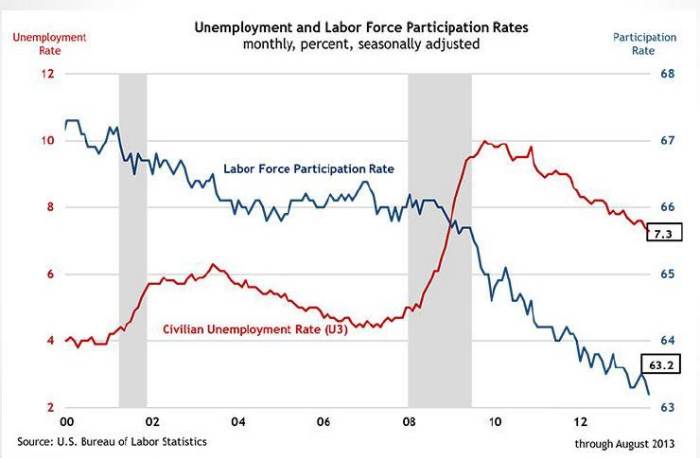
Among the Fed's responsibilities, it has the well-known, and sometimes contradictory, duty of "conducting the nation's monetary policy by influencing the monetary and credit conditions in the economy in pursuit of maximum employment, stable prices, and moderate long-term interest rates."[1] The recession of 2008-2009 caused a sharp rise in unemployment and, with the collapse in economic activity, a decline in inflation. Historically, the Fed limited its policy actions to targeting short term interest rates by managing the money supply. The crisis in 2008 was so severe that the Fed quickly lowered rates and provided ample liquidity. It recognized the dangers to the economy and rescued a seized-up money market by expanding repurchase agreement collateral and creating various liquidity-oriented programs. Early in 2009 the Fed implemented the first QE program. During the ensuing three years the Fed implemented two more QE programs and a few variants expanding its balance sheet from about $900 billion to $3.8 trillion.

In the early stages of the crisis and recession, the Fed's actions were vital to prevent a complete market collapse and economic depression. Now, after five years of aggressive stimulus, the Fed's actions may not be achieving the desired results and may even be counterproductive. In the process of taking unprecedented actions, the Fed gave the market tangible objectives for its mandates, inflation around 2% and unemployment around 6.5%. As can be seen in the

[1] Board of Governors of the Federal Reserve System, Mission – www.federalreserve.gov

graphs[2], it would appear both of these measures allow for ongoing stimulus. However, if these exact conditions existed without the recession precedent, the Fed would likely be providing stimulus by targeting a low Fed Funds rate. In addition, the distortions that are now causing the Fed to pause on the tapering would not be present.





Through its quantitative easing the Fed has successfully lowered long term interest rates, which have helped reactivate the housing market by providing cheap mortgages, induced corporate America to fortify capital structures and reduce the cost of debt, and effectively fund a massive government deficit at "subsidized" rates. In addition, the stock market hit record highs this year, housing prices have risen well beyond inflation, and capital allocation decisions are being made based on interest rates that are not market determined. Even though economic growth may not be robust, it is also not recessionary. In aggregate, it is hard to argue that the U.S. economy still needs unprecedented central bank measures to stand on its own.

In our 2013 first quarter letter we wrote about the labor market and the demographic challenges the U.S. economy faces, leading to a depressing participation rate. Labor market conditions have not returned to pre-recession levels and, judging from our demographic characteristics, may not be for a long time. The Fed's efforts to boost employment by keeping long-term rates artificially low may be powerless to alter those dynamics. Similarly, inflation has been well-behaved for many reasons, including moderate growth prospects abroad. Significant efficiency gains due to rapid technological advances and well-supplied commodity markets after a period of high price driven expansions also alleviate price pressures. While few expect an inflationary spike, the Fed may be coincidentally fortunate on prices, in spite of the policies it insists on pursuing.

Mr. Bernanke has repeatedly told the market the Fed has the tools and ability to withdraw the stimulus. However, when the market reacted, as should have been expected, by taking interest rates where prevailing economic conditions suggest they should be without subsides, the Fed balked. Surely members of the Open Market Committee must know that the market will discount their actions as soon as they are foreshadowed. It would be a complete surprise if the Committee would expect 10 year rates to stay near 2.0% with the economy growing at a 2.0% real rate and inflation hovering near 2.0%.

We believe the U.S. economy is robust enough to stand on its own. Despite the severity of the recession, the Fed's actions may now be creating more distortions than producing the Fed-mandated results. The longer the Fed maintains its interest rate subsidies, the harder the withdrawal will become. For now, a move higher in interest rates to a level that is

[2] Federal Reserve Bank of Atlanta

still low by historical measures, seems like a reasonable market reaction. As more markets get distorted by subsidized rates, more unexpected reactions will accompany the eventual withdrawal. The Fed should avoid making unprecedented policy actions a standard part of its arsenal.

October 14, 2013

GIPS requires GIPS Disclosure Statement (please see attached disclosure)
GIPS requires GIA fee schedule disclosure "GIA's fees are (i) .35% annually for standard USA fixed income, (ii) .50% annually for enhanced fixed income and (iii) .75% annually for specialized products"

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Management Fees, as well as account minimums and other important information are described in GIA's Form ADV - Part II. Since management fees are deducted quarterly, the compounding effect will be to increase the impact of such fees by an amount directly related to the account's performance. For example, an account with a 10% gross annual return and a 1% annualized management fee that is deducted quarterly will have a net annual return of about 8.9%.

*Important GIPS disclosures pertaining to composite performance may be found at the back of this letter.

Index Definitions

Barclays US Aggregate Index
The Barclays U.S. Aggregate Index represents securities that are SEC-registered, taxable, and dollar denominated. The index covers the U.S. investment grade fixed rate bond market, with index components for government and corporate securities, mortgage pass-through securities, and asset-backed securities. These major sectors are subdivided into more specific indices that are calculated and reported on a regular basis.

Barclays US Treasury Index
This index is the U.S. Treasury component of the U.S. Government index. Public obligations of the U.S. Treasury with a remaining maturity of one year or more.

Barclays US Government/Credit Index
The Government/Credit Index includes securities in the Government and Credit Indices. The Government Index includes treasuries and agencies. The Credit Index includes publicly issued U.S. corporate and foreign debentures and secured notes that meet specified maturity, liquidity, and quality requirements.

Barclays US Credit Index
This index is the U.S. Credit component of the U.S. Government/Credit index. Publicly issued U.S. corporate and specified foreign debentures and secured notes that meet the specified maturity, liquidity, and quality requirements. To qualify, bonds must be SEC-registered.

Barclays US Mortgage Backed Securities Index
This index is the U.S. MBS component of the U.S. Aggregate index. The MBS Index covers the mortgage-backed pass-through securities of Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC).

Bank of America Merrill Lynch US Corporate & Yankees Index
The Bank of America Merrill Lynch US Corporate & Yankees Index tracks the performance of US dollar denominated investment grade debt publicly issued in the US domestic market by US and non-US corporations and non-US quasi-governments.

Bank of America Merrill Lynch US Corporate Index
The Bank of America Merrill Lynch US Corporate Index tracks the performance of US dollar denominated investment grade corporate debt publicly issued in the US domestic market. Qualifying securities must have an investment grade rating (based on an average of Moody's, S&P and Fitch) and an investment grade rated country of risk (based on an average of Moody's, S&P and Fitch foreign currency long term sovereign debt ratings).

Bank of America Merrill Lynch US High Yield Master Cash Pay Only Index
The US High Yield Master Cash Pay Only Index tracks the performance of below investment grade US dollar-denominated corporate bonds publicly issued in the US domestic market.

JP Morgan Corporate Emerging Markets Bond Index (CEMBI)
The CEMBI tracks total returns of US dollar-denominated debt instruments issued by corporate entities in Emerging Markets countries. Two variations are available: CEMBI Broad and CEMBI. The CEMBI Broad is the most comprehensive corporate benchmark followed by the CEMBI, which consists of an investable universe of corporate bonds. Both indices are also available in Diversified versions.

JP Morgan EMBI+ Index
The EMBI+ tracks total returns for U.S-dollar-denominated debt instruments of the emerging markets: Brady bonds, loans, Eurobonds. The EMBI+ currently covers 104 instruments across 15 countries.

JP Morgan Government Bond Index-Emerging Markets (GBI-EM)
The GBI-EM is the first comprehensive, global local Emerging Markets index, and consists of regularly traded, liquid fixed-rate, domestic currency government bonds to which international investors can gain exposure. Variations of the index are available to allow investors to select the most appropriate benchmark for their objectives.

Citigroup Non-US World Government Bond Index
The Index is comprised of foreign government bonds with maturities over one year.

S&P 500 Index
An index of 500 stocks chosen for market size, liquidity and industry grouping, among other factors. The S&P 500 is designed to be a leading indicator of U.S. equities and is meant to reflect the risk/return characteristics of the large cap universe.

Nasdaq Composite Index
An index that tracks the change in the total market value of all companies listed on the Nasdaq Stock Market.

Russell 2000 Index
An index measuring the performance of the 2,000 smallest companies in the Russell 3000 Index, which is made up of 3,000 of the biggest U.S. stocks. The Russell 2000 serves as a benchmark for small cap stocks in the United States.

MSCI EAFE Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe, Australasia and the Far East.

MSCI EAFE- Europe Index
The index is a capitalization weighted index that monitors the performance of stocks from Europe.

MSCI EAFE- Japan Index
The index is a capitalization weighted index that monitors the performance of stocks from Japan.

MSCI Emerging Markets Equity
The MSCI Emerging Markets Index is a free float-adjusted market capitalization index that is designed to measure equity market performance in the global emerging markets.