PATRIOT INVESTMENT MANAGEMENT

Dear Clients & Friends of Patriot Investment Management

Another new year is upon us, and 2013 turned out to be a stellar year for stocks. With the financial crisis now firmly in the rear-view mirror, and the US economy heading into what is shaping up to be a normalizing expansion cycle, will 2014 be as spectacular? Well, yes and no.

First, how did we get here? For the last five years, we have been constantly bombarded by a 24/7 negative news cycle, implying we could slip back into crisis at a moment's notice. With all the gloom and doom, you would never know that we have actually been in a slow but steady recovery since March of 2009. Add to that setting the emotional excesses one would expect to accompany a financial crisis, and it may seem rather unexpected that the year turned out so well, but there are some very good reasons why it shouldn't come as a surprise at all. So, instead of with euphoria or fear, let's turn a rational eye toward the markets in 2014.

2013 is the year that the recovery began to really take off, with unemployment dropping under 7% for the first time since the crisis began (full employment is 5%), which in turn was helped by increased spending in the business sector. Consumer spending and housing have steadily strengthened, and consequently GDP jumped to an annual rate of 4.1% in the third quarter. As a result, the Fed has announced its long-awaited plan to taper, or cut back, its $85 billion per month bond buying program by approximately $10 billion per month.

With the addition of 2013's performance, the S&P 500 has experienced 5 up years in a row; that has only happened twice before (1995-1999 and 2003-2007), along with an 8 year run (1982-1989). Since 1926, the S&P 500 total return has been positive 64 out of 88 years, or 73% of the time. While all this positive news does lend itself to another year of growth, it is also likely to not be as dramatic. For years when the S&P 500 returned greater than 25%, the average return in the following year was just 6%. Since the end of World War II, the broad equity market has experienced thirteen bear markets, or about one every six years.

<u>The Year Ahead</u>: Expect continued growth, but at a much more moderate pace. We anticipate inflation to gradually increase to close to 2%, although it will likely remain well below the long-term average of 3% for the foreseeable future. Unemployment will continue to slowly decrease as business spending increases, and the Fed will likely keep interest rates near zero well into late 2015.

It is likely to be another good year for the markets, but by the same token, don't be surprised if we see a correction in 2014. If it happens, it will be short-lived, but it will not be a return to crisis. Regardless of what the market does in the short run, we need to stay focused on our long-term objectives.

When faced with negative headlines, remember that we are not investing for today, or next week, or next month. We are not even investing for a retirement date. Funds invested for retirement must continue to work for you for the rest of your life. With today's life expectancy rates, that means twenty or thirty years past your retirement date, long after those headlines will have been forgotten.

The bottom line – ups and downs are a normal part of investing. The really good news is we are leaving crisis behind and returning to a normal cycle, where there will be good days and bad days in the short run, but the long-term trend continues upward.

2013 Annual Returns

S&P 500	29.6%
Dow	26.50%
Russell 2000	38.82%
Emerging Markets	-4.98%
Barclays Aggregate Bond Index	-2.03%

Returns are price-only unless otherwise noted

10 yr Bond yield as of 12/31/13	3.03%

Inflation	1.5% thru Dec 2013
Unemployment	7.4% annual avg; 6.7% in Dec

2014 Estate Tax Update

The federal estate tax was made a permanent part of the tax law in January of 2013, and increases to the federal estate and gift tax exemption are now pegged to inflation. For 2014, the exemption increases to $5,340,000, and the tax rate remains at 40%. The annual gift tax exclusion remains at $14,000 per person or $28,000 per couple for 2014.

Qualifying farm or business realty can receive a discount estate tax valuation of up to $1,090,000, and if a closely held business makes up more than 35% of an estate, up to $580,000 of tax can be deferred, with the IRS charging a nominal interest rate. For those who qualify, these options may mean the difference between keeping an inherited asset or selling it to pay the estate taxes. The rules are complex, so consult with your Patriot advisor and estate attorney to evaluate your unique situation.

In the state of Tennessee, we are seeing a big change from the past as the inheritance tax is gradually phased out from 2013-2016. The Tennessee exemption increases to $2,000,000 in 2014.

It's Tax Season Again

Due to the government shutdown last fall, the IRS is running ten days behind, and won't be ready to accept individual returns until January 31st. The IRS is also implementing new procedures to detect identity theft; for those due a refund, expect delays due to these two factors.

Watch for our annual Tax Guide, coming in February, with a summary of the new 2014 tax rules, retirement plan and IRA contribution limits, and much more.

Patriot News & Community Events

Check out our new website! We are pleased to announce that we have updated our website with an all-new design, user-friendly navigation and more information about who we are and what we do. Check back often, as we will continue to add new content and features, and let us know what you think!

Patriot is proud to be recognized in the Knoxville News-Sentinel Book of Lists as ranked #2 in both assets under management ($566 million), and for the number of Certified Financial Planners™ (8 CFP®s) available to serve you.

Thank You!

We value the confidence and trust you have placed with us, and we welcome your questions and comments. Our goal is to be our clients' trusted resource for all things financial.

Do you know someone who could benefit from our expertise? We appreciate your introductions and the opportunity to help your friends and colleagues meet their financial goals.