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WealthManagement

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Market Insights

A periodic newsletter from Idaho Trust

Since the start of 2013 stock markets have performed well, conversely since May bond markets have performed poorly. Bond yields have risen sharply this year and have only recently stabilized. The market is digesting the schedule outlined by the Federal Reserve for trimming its current quantitative easing program and an estimated time frame for its termination.

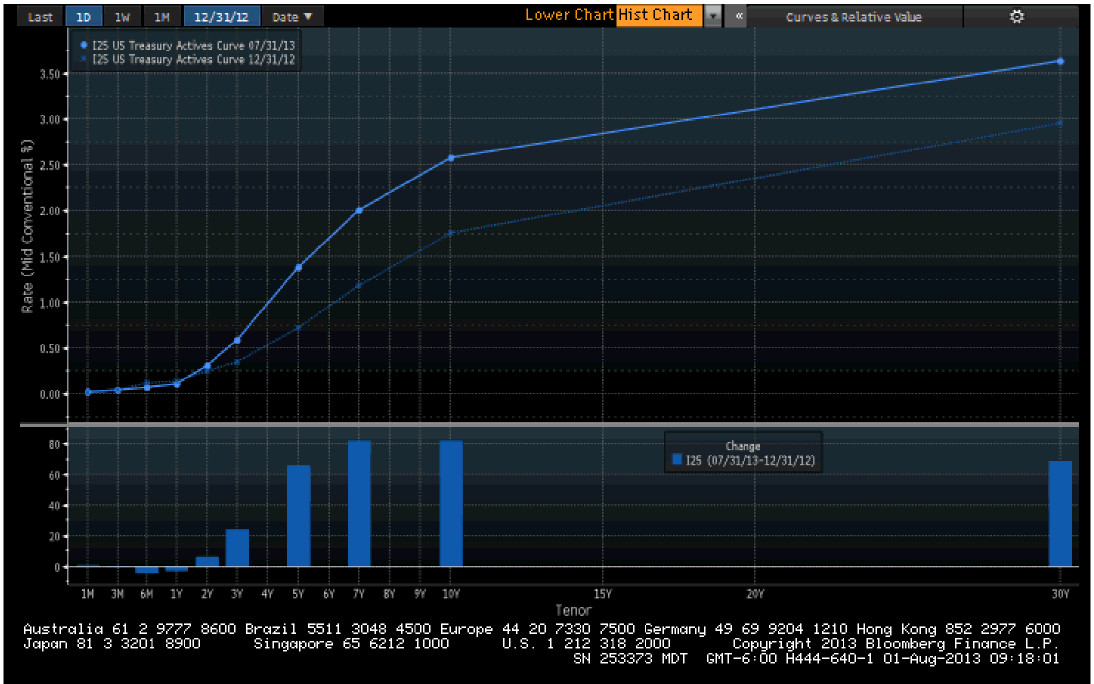
Interest Rates

So far this year, bond markets have witnessed the largest increase in bond yields in the last couple of years. The largest increase in yields this year occurred in the month of May. Overall, the 10-year US Treasury bond yield has increased from 1.76% to 2.58% year-to-date (YTD). However, since mid-June, treasury yields appear to have settled at their current level.

Benjamin Bernanke, Chairman of the Federal Reserve, recently gave three reasons why yields have increased. First, the market has been unwinding some leveraged positions, which is probably a good thing. Second, the outlook for the economy is getting better which will call for higher rates in the future. Third, the market appears to have incorrectly anticipated Chairman Bernanke's June 19th comments and overreacted by shunning bond investments. On June 19th, Mr. Bernanke stated that the Federal Reserve would start to reduce its stimulus measures later this year if the economy is strong enough but the market reacted as if the Federal Reserve was at the brink of ending their easing programs and ready to implement fiscal tightening. Given the fact that in the second quarter of this year, 4/1/2013 to 6/30/2013, the 10-year treasury yield rose 41%, future

Idaho Trust Bank offers total wealth solutions including its LifeNeeds™ investing process. The LifeNeeds™ investment process utilizes proven strategies and techniques delivered by a highly trained staff of wealth management professionals.

LifeNeeds™ wealth management accounts feature optimized asset allocations, robust security screening and Idaho Trust's unique TacticLogic™ investment process. All of which are tailored to our clients' unique financial needs.



Source: Bloomberg

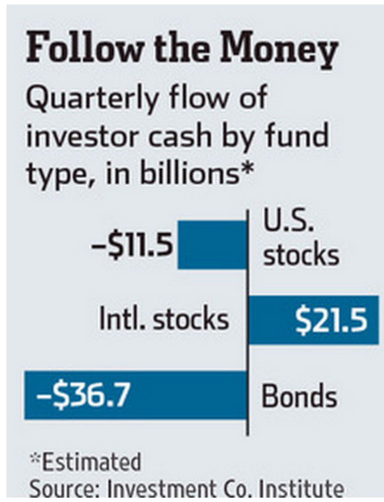
monetary policy changes may already be priced into current yields. This may mean that going forward rate changes may be more muted in reaction to future monetary policies.

According to the continuing language from the Federal Reserve and economists' projections, it is predicted that the Federal Reserve will start to temper its current quantitative easing program in September of 2013 and that it will end in mid-2014. Chairman Bernanke has been quick to add that a tapering or ending of the Federal Reserve's current program is not a tightening of monetary policy but an adjustment to their already loose monetary policy. Even if the quantitative easing program is terminated in 2014, the Federal Reserve is likely to continue to maintain its loose monetary policies by maintaining a low Federal Funds rate which is still being targeted at 0% to 0.50%.

Bonds in a Diversified Portfolio

Portfolios comprised of a strategically derived blend of asset classes enjoy diversification benefits. For example, the recent rise in yields has been hard on overall bond returns. The Barclays Aggregate Bond Index now has a trailing one-year return of -1.90% and -2.31% YTD. However, for diversified investors who invest in blends of asset classes, 2013 has provided good overall returns thus far because the S&P 500 has returned 19.61% YTD. Conversely, bonds act as ballasts to portfolios by counteracting the volatile nature of stock holdings. Just as shock absorbers in cars smooth out the bumps or potholes in roads, bonds take the edge off of volatile stock exposures in diversified portfolios. A study conducted by Vanguard Group demonstrates how bonds can temper poor stock returns in a hypothetical diversified portfolio of 40% stocks and the rest in bonds. In this example, the stock market returned -20% for a given year but because of the diversification benefits of the bond exposure the overall portfolio would have returned -3.6%. Keep in mind that poor stock markets are typically much worse than poor bond markets in relative return terms. The worst 12-month trailing return for bonds in history was -9.2%, period ended March 31, 1980. Whereas, a bear stock market is typically defined as -20% or worse. Bond positions not only help to offset losses but also provide income. This vital role that bonds play in a diversified portfolio is a fundamental reason why investors should understand the role that bonds play in their portfolio and not make short-term investment decisions regarding them.

However, many bond investors continue to worry about their bond positions because of the historically low interest rates and their lackluster forecasted performance over the next decade. Investment Company Institute (ICI) data shows that when treasury yields increased in May, investors were still putting more money into bond funds than they were taking out. That all changed in June. In June, rates continued to rise, bond returns turned negative and bond funds started recording record net outflows. Just as investors changed their sentiment about bonds, treasuries rallied when Chairman Bernanke assured markets that the Federal Reserve would continue its monetary easing policies.



Tax Exempt Bonds

Municipal bond markets have had quite the adventurous five years. In 2008, the municipal market took plenty of bumps during the financial crisis. About two years later the municipal market had rebounded back to normal market conditions. Then at the end of 2010, securities analyst Meredith Whitney appeared on 60 Minutes with a prediction that there would be imminent defaults of many large municipal issuers which once again sent the municipal market reeling. A few years later, it is clear that Meredith Whitney's prediction was vastly overstated and since then returns have been quite robust. For 2011, municipal bonds returned 10.70% and in 2012 6.78%. Currently, municipal bonds are trading at higher yields than treasuries bonds at about 125% to 140% of treasury yields. Historically, municipal bonds have traded at 80% to 85% of treasury yields because of their attractive federal tax exemption status. Currently, municipal bonds are priced attractively offering higher before-tax yield on municipal bonds than treasuries and providing federally tax free interest payments which only makes them more attractive.

Conclusion

2013 may end up being a year in transition. Already, we have witnessed an increase in treasury rates, the Federal Reserve appears poised to change their quantitative easing program and Chairman Bernanke may no longer be in his current position given that his term will end next January. Fortunately, the market has realized that the economy is improving and that fact may warrant higher interest rates.

S&P 500 Index

3 Month	6.10%
Year-to-Date	19.61%
1 Year	24.98%
3 Year	17.68%
5 Year	8.24%

MSCI EAFE Net Index

3 Month	-0.67%
Year-to-Date	10.10%
1 Year	24.27%
3 Year	9.31%
5 Year	1.76%

Barclays Aggregate Bond Index

3 Month	-3.17%
Year-to-Date	-2.31%
1 Year	-1.90%
3 Year	3.18%
5 Year	5.23%

As of 7.31.2013

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