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MARKET COMMENTARY

US stocks continued their upward path during the third quarter with only minor interruptions. Investors have been quick to buy on dips so when market corrections do occur, they have been less than 5% in magnitude and relatively short-lived. Year-to-date, the S&P 500 is now up 19.9% and the DJIA is up 17.7%. Small cap stocks have outpaced their larger counterparts and are up 27.7%. Internationally, European and Japanese stocks have experienced strong gains this year while less developed markets in Latin America and India have had double-digit losses. Chinese stocks showed improvement this quarter and were able to erase prior losses and produce a positive year-to-date gain. Overall, international stocks in developed markets posted 13.4% gains while those in emerging markets have year-to-date losses of -2.8%.

US GDP growth has started to improve. After the fourth quarter's dismal growth of only 0.4% followed by first quarter's slightly better growth of 1.1%, the second quarter's GDP growth was most recently estimated at 2.5%. Prior to a government shutdown, JPMorgan was estimating third quarter GDP growth of 1% - 2% and fourth quarter to grow in the 2% - 3% range. They also estimated 2014 GDP growth of 3%. Expectations for higher growth are based on an increase in personal net worth creating confidence, pent up demand for cars and homes, and a pickup in the global economy which will help US exports. However, the government shutdown could affect GDP growth depending on how long it lasts. The analysts' predictions of the impact vary greatly from very minimal to 1.4 percentage points estimated by Mark Zandi of Moody's Analytics Inc.

The unemployment rate has been declining. Although seen as an improvement, it most likely doesn't adequately reflect the true picture. Part-time jobs have been increasing at the expense of full-time jobs. The labor participation rate is still at lows meaning there are not as many people working. If GDP growth can reach 3%, it may be enough to fuel higher-quality job growth which could further support the economy and lead to meaningful improvements in the employment picture.

2013 BENCHMARK RATES OF RETURN

INDEX	THIRD QUARTER	YTD
S&P 500	5.3%	19.9%
DJIA	2.2%	17.7%
NASDAQ	10.8%	24.9%
Russell 2000	10.2%	27.7%
International	10.9%	13.4%
Fixed Income	0.6%	-1.9%

Improving GDP growth has fueled the discussion over when the Federal Reserve will begin to taper the quantitative easing (QE) policy it has been providing through bond purchases. The stock rally over the last several years has occurred alongside QE and investors have feared what will happen when QE is reduced. The Fed has tried to assure investors that they will not do anything to cause the economy to falter and they will keep QE in place as long as it is needed. In September, the Fed decided not to begin tapering contrary to what many had expected. Many people believe that Fed Chairman Ben Bernanke will begin to taper before his term expires in January. The frontrunner to replace Bernanke, Janet Yellen, is also seen as dovish on monetary policy so a change in leadership will not likely result in a radical change in strategy.

Corporate profits continue to grow and reached a new high in the second quarter. Although they have not been growing as fast, third quarter comparisons should be favorable as last year's third quarter was weak. JPMorgan expects a 12% increase year-over-year for third quarter and 8% - 9% for all of 2013.

According to Warren Buffet, stocks are "fully valued" at current levels. Much of the gains in the stock market have been from expanding PEs in addition to earnings growth. Now, PE ratios are higher than they were on average over the past 5 years. However, they are still in line with their 10-year average and below the 15-year average. Even though they are not the bargain they have been, stock prices seem fairly valued and can continue to grow—most likely at a more modest pace. The growth will need to come from actual earnings growth rather than from PE expansion. JPMorgan expects S&P 500 earnings to grow around 6% next year.

Yields on the 10-year Treasury soared from 1.85% at the end of the first quarter to 2.48% at the end of second quarter. Now, the yield sits at 2.62% after peaking at

We value our relationship with you, and we are always available to meet with you in person or by phone. Please do not hesitate to call or email us with any questions that you may have.

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2.98% in early September. This quarter, the interest earned on bonds offset the decline in bond prices. Even though the yield on Treasury bonds increased during the quarter, the Barclays Aggregate Bond Index had a positive return of 0.7%. The year-to-date return for the index is still negative at -1.9%.

Even with potentially flat or slightly negative bond returns, an allocation to bonds is still appropriate to provide safety when stocks are more volatile. In the near-term, stocks may be more volatile during this time of uncertainty regarding the government shutdown, the reaching of the debt ceiling expected later in October, and the timing of the expected tapering by the Fed. Longer-term, these issues will be resolved and stocks may not be as volatile. Bond portfolios may add exposure to high yield, convertibles, and floating rate securities to help protect against further depreciation or as a yield enhancement. Likewise, investment in real assets like real estate, gold, and other commodities can also reduce portfolio volatility long term even if in the short term, these assets do not have high returns. We continue to believe diversification is a prudent strategy and can help reduce risk and smooth out total returns over the long term.

FINANCIAL PLANNING

Reminders for Year-End

Required minimum distributions from IRAs are due by December 31 for those age 70 1/2 or older. If you have not already received your RMD, we will be contacting you before year-end.

Many people like to gift appreciated stock to non-profit organizations. Year-end is an especially busy time to do this and Schwab may experience overwhelming requests. Please let us know if you would like to make a gift before year-end so that we can make sure it is processed.

Upcoming Changes for Nebraska's College Savings Plan

Nebraska has raised the maximum state tax deduction from $5,000 to $10,000 for contributions made to Nebraska's 529 College Savings Plan (NEST). The new limit applies to contributions made in 2014 and later.

E-delivery of Schwab Statements

If you would rather receive electronic copies of your confirmations and statements from Schwab, please let us know. It is easy to set up and we can help you. You can store an electronic copy on your computer or you can just access past Schwab statements for up to 10 years online. You will still continue to receive your paper copy of reports from Cambridge Advisors.

QUESTION: *What could happen if the government doesn't increase the debt ceiling?*

ANSWER: Much of the focus in Congress recently has been over the budget and government shutdown. Another issue is looming on the horizon that will also need to be addressed soon. With Congress at a stalemate, the US is projected to hit the debt ceiling in mid-October. The last time this fight occurred was in 2011. Then, the debt ceiling was raised at the last minute, causing the US debt to receive its first downgrade ever by a ratings agency. The compromises made then for raising the debt ceiling also resulted in the automatic budget cuts that went into effect this year.

The debt ceiling is an arbitrary limit set by Congress as to how much debt the US incur. No other major economy has a debt ceiling; when passing their budgets, it is implied that whatever borrowing is necessary is approved. Congress used to raise the debt ceiling when they passed the budget. More recently, they have used it as a negotiation tool to limit spending.

Rick Rieder, chief investment officer of fundamental fixed income at Blackrock, doesn't think the US will default on its debt. Nor does he think the US's credit will be downgraded again. If the US defaulted on its debt payments, the implications regarding money markets and international investors would be substantial. So much so, that Rieder believes Congress "would never take us down that path". BCA Research also puts the probability of default at only around 5%.

Each year, we are required to offer you the most recent version of our From ADV Part II which describes our business and how we work for our clients. When you first became a client, you received a copy. Each year in March, we send you a report of anything that has changed on our ADV Part II. If you would like to receive a complete copy, please give us a call. A copy of our Proxy Voting Policy is also available upon request.

CAMBRIDGE ADVISORS NEWS

Please help us welcome Anne Heibel to the Cambridge Advisors team. Anne is originally from Lincoln and is a student at Creighton University. She joins us as an intern and is helping us with special projects.

Serious about your future