SPECTRUM[SM]

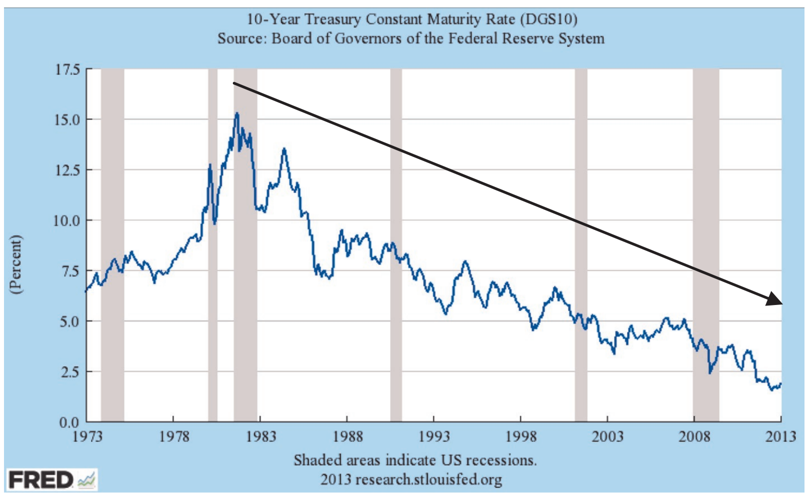
INVESTMENT ADVISORS

PIMCO Due-Diligence Conference

Newport Beach, California
February 25-27, 2013

James F. Marshall
President

Since the last quarter I had the opportunity to attend a due-diligence conference at PIMCO in Newport Beach, California sponsored by LPL. PIMCO, which was founded in 1977 by **Bill Gross** is now one of the largest bond managers in the world with over $2 trillion in assets. Our group found Bill to be very friendly and engaging, someone you'd love to have as a neighbor. **Bill Gross**, Managing Director and Co-CIO of PIMCO is 68 years old, originally from Ohio and truly loves what he does. Proof of his passion is in how he spends his days. At 68 years old, he starts each day on the PIMCO trading floor at 5 a.m. and doesn't leave until 5:30 p.m., five days a week. Bill explained that he used to start his day at 7:30 a.m. until PIMCO went global with its investing.



H.15 (519) selected interest rates. (2013, April 08). Source: http://www.federalreserve.gov/releases/h15/current/h15.pdf

As busy as he is, Bill still found time to spend 45 minutes with our group on his trading floor discussing the markets. The PIMCO trading floor is very compact with over 100 portfolio managers, traders and analysts working side-by-side in very open 6-foot wide cubes. The traders also work 12 hour days starting at 5 a.m. as Bill does. Bill's open 10x10 foot cube adjoins **Mohamed El-Erian**'s matching cube in the middle of the trading floor, each with seven computer screens on their desks. Bill believes in an open office floor plan with very few walls and compact spacing so each analyst can not only email and text one another but also simply stand up and speak to each other face-to-face. A concept which embraces communication.

The trading floor includes 12 large television monitors around the room. Three of the television screens are turned to CNBC. One of the reasons for CNBC is that Bill Gross has his own CNBC studio in his office building. Should there be a major economic news event, CNBC can instantly schedule a last minute interview with either **Bill Gross** or **Mohamed El-Erian**. Mohamed is CEO and Co-CIO of PIMCO and a former portfolio manager of the Harvard Endowment Fund.

Bill Gross's theory on bond investing is "**seven fat years, followed by seven lean years**", with the final fat year in this cycle being 2012. As Bill Gross would concur, bonds have benefited from a bull market that has lasted over 32 years. Interest rates peaked on December 11, 1980 when the 13-week U.S. Treasury bill paid 17.14% per annum. Today this same instrument pays only 0.07%. The longevity, consistency and magnitude of the collapse in interest rates have been unprecedented in the 200 plus year history of our nation, according to Rob Brown, Chief Investment Strategist at United Capital Financial Advisers.

As the chart on the back indicates, PIMCO sees debt limits rising substantially in developed economies including the United States, Japan, Europe and the United Kingdom. For example, the gross government debt to GDP ratio in the United States is 107, with Japan at 237, while emerging economies like China are at 22, Mexico, 43 and Brazil, 64. Developed economies are also facing an older population base with the percentage of U.S. citizens above the age of 65 at 14%, Japan at 24%, Germany at 21%, with emerging economies like China at 9%, and Mexico and Brazil at 7%.

Rising debt limits along with the aging populations in developed economies of the world, will result in slower growth than in previous decades. Emerging economies of the world, with less debt and younger demographics, are in a stronger position for future growth, which makes their bond markets and stock markets more attractive for the long term.

For now, Bill Gross calls the U.S. market, "**the world's cleanest, dirty shirt**". He states, however, that "our nation must begin to close the gap on spending, which includes Medicare and Medicaid liabilities, before the turn of the next decade. If we don't, our nations debt to GDP ratio will continue to rise, forcing the Fed to print more money to pay for the deficiency, followed by inflation and the eventual decline of our dollar." He also states that, "**if we continue to close our eyes to existing deficits and entitlement liabilities, we will resemble Greece by 2020"** (*Investment News*, 10/15/12).

As a bond management company, PIMCO's emphasis at the due-diligence conference was to diversify more than ever, not only positions in the equity markets but also in the bond markets. This includes inflation protected securities, global bonds (including emerging market bonds) and corporate bonds (including high-yield and convertibles). PIMCO's offerings have been expanding beyond just pure bonds which includes REITs, commodities and tactical asset allocation funds. PIMCO is bearish on long-term treasury bonds. What we learned from this conference is to not only focus on diversifying your stock positions, but also your bond positions, with multiple bond choices. **Multiple choices in the bond category, would be prudent in today's market.**

The New Normal comes to Emerging Markets (EM):
Growth is slowing but EM has stronger initial conditions than Developing Markets (DM)

2012	Developed economies										Emerging economies			
Country (percent of 2012 GDP except as noted)	United States	Japan	United Kingdom	Germany	France	Spain	Italy	Portugal	Ireland	Greece	China	Mexico	Brazil	Russia
Government gross debt	107	237	89	83	90	91	126	119	118	171	22	43	64	11
Expected 2013 GDP growth	2.1	1.2	1.1	0.9	0.4	-1.3	-0.7	-1.0	1.4	-4.0	8.2	3.5	4.0	3.8
Primary budget balance	-8.7	-10.0	-8.2	-0.4	-4.7	-7.0	-2.7	-5.0	-8.3	-7.5	-1.3	-2.4	-2.1	0.5
Unemployment (% population)	8.2	4.5	8.1	5.2	10.1	24.9	10.6	15.5	14.8	23.8	4.1	4.8	6	6
Population over 65 years old (% population)	14	24	17	21	17	17	21	18	12	19	9	7	7	13
Monetary Policy Flexibility	Yes	Yes	Yes	No	No	No	No	No	No	No	Yes	Yes	Yes	Yes
Gross Domestic Product per capita ($)	49,802	46,896	38,591	41,168	40,690	28,976	32,522	19,768	44,781	22,757	6,094	10,123	12,340	13,765

Though risks remain most acute in the eurozone peripherals, many "core" developed countries face debt and deficit headwinds while emerging economies must meet the challenges of a middle income transition

As of 31 December 2012
SOURCE: IMF World Economic Outlook October 2012, Bloomberg, Haver