From: Doug Ciocca
Sent: Monday, June 17, 2013 2:39 PM
Subject: Market Update - 6/17/2013 - Interesting Commentary from PIMCO

Good afternoon and I hope everyone had a great Father's Day weekend! I wanted to pass along an e-mail and an attachment that I received on Friday evening from our relationship manager with Pacific Investment Management Company, known more commonly as PIMCO. Our team has a tremendous amount of respect for PIMCO and find great value in the depth of their research and analysis.

The US stock market has been very strong for the first half of this year but such strength has not been shared across many other asset classes. Like PIMCO, we feel that this deserves as much concern as it does celebration. Additionally, we think that recent spate of volatility (as mentioned below) may be a by-product of some risk recalibration as move into the back half of the year. I think you will find the information below and attached helpful in considering the current market environment. I look forward to talking to you soon and to visiting with those that are able to attend our Open House on Thursday evening. dc

From: Tupper, Jonathon [mailto:Jonathon.Tupper@pimco.com]
Sent: Friday, June 14, 2013 6:00 PM

Hi Doug,

Over the past week I have been getting many questions about the recent market volatility and movements. I thought it would be helpful to quickly summarize PIMCO's thoughts and outline what our firm will be focusing on going forward. Attached you will find a recent piece from Bill Gross but first, a few key bullet points:

- Fixed income had its fourth worst monthly return in the last 20 years in May. We witnessed a selloff across all fixed income sectors because of: (1) uncertainty about the Federal Reserve tapering its $85 billion asset purchase program and the possibility of rising interest rates, (2) concerns about the effectiveness of Japanese quantitative easing lead to broader global interest rate volatility and (3) the re-pricing of inflation expectations as markets priced in slower global growth. Asset classes that were perceived to be the most illiquid and/or highly levered were hit hardest. In terms of fund flows, Morningstar month to date June data indicate redemptions out of high yield bonds, intermediate bonds, emerging markets, large value and large blend equities, and real estate. The asset classes with the most inflows were bank loans, nontraditional bonds, small and foreign large blend equities, long/short equities and short- and ultra-short fixed income.
- Most of the questions I received have been centered around Fed tapering. PIMCO believes that the impact of tapering is already well priced into the market. As you may know, the Fed is currently purchasing $85 billion ($40billion in agency MBS plus $45 billion Treasuries) in assets each month. What many investors do not realize is that the Fed is actually buying much more than this. For example, the Fed has been purchasing approximately $70 billion each month in agency MBS ($40 billion in monthly purchases plus the reinvestment of interest and principal prepayments from the MBS securities it currently owns). So it is possible we may see a modest reduction in Fed asset purchases this year. But we do not expect the Fed to completely remove the stimulus or to signal a dramatic increase in interest rates. The main reason is that the Fed has not achieved its quantitative employment and inflation targets. Additionally, the Fed has to play its cards very carefully here because it does not want to upset growth in the broader economy, dampen housing prices and housing affordability or inhibit consumer spending. Yes, interest rates may fluctuate over the short-term, but they should be fairly range bound. In fact we have seen rates moderate over the week (10y treasuries finished trading at 2.22% on Monday and are currently trading at 2.13% at the time of this writing).
- Going forward you should expect PIMCO to: (1) reduce risk and preserve capital, (2) emphasize liquidity and increase our dry powder (having the flexibility to pivot between a more defensive posture and prudently seek alpha will be critical in this environment), (3) allocate toward securities with higher credit quality - the higher the better, (4) avoid financial repression by allocating towards countries with relatively "clean" balance sheets and attractive yields such as the U.S., Brazil, Mexico and Australia, (4) avoid long durations.
- For the remainder of 2013, we expect returns for the core bond market of approximately 2%, translating to an annualized return of about 3%. At current levels, we believe duration is fair to cheaply priced. PIMCO continues to believe that a secular increase in interest rates is unlikely to occur in 2013.

If you have any questions about the broader markets or the positioning, performance and outlook for any of your PIMCO strategies, please call.   Please take advantage of our resources. I'd be glad to help. While there are certainly areas where investors should be defensive, there are others that are attractive and warrant prudently taking some risk. The past few weeks have been challenging, but we believe our portfolios are well positioned for future opportunities and to add alpha in both traditional and non-traditional sectors.

Thank you for your partnership and have a great weekend,

Jonathon.

Jonathon J. Tupper
Vice President
Global Wealth Management

PIMCO
840 Newport Center Drive
Newport Beach, CA 92660
D: +1 949.720.7851
TF: +1 800.842.3815
M: +1 760.520.5141
F: +1 949.720.8603
Jonathon.Tupper@pimco.com
www.pimco.com

Registered Representative
of PIMCO Investments LLC

KAVAR
CAPITAL PARTNERS

Douglas G. Ciocca
CEO & Partner
Kavar Capital Partners, LLC
11460 Tomahawk Creek Parkway
Suite 420
Leawood, KS 66211
913 428-3300 ph
913 481-8824 cell
www.kavarcapital.com

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