THE EAST END FINANCIAL GROUP

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Dear EEFG Client,

As I once again draft my annual "state of the agency" letter I find myself in the library in Woodstock, Vermont with my newspaper articles, notes I've made during the year and collections of economic data that I accumulate in a large brown folder for the magic moment that I begin to construct my thoughts, and for the 34th time, write my annual client letter.

I've found that sitting in a library allows me to go back to my days as a college student when my job was to think, an uncluttered thought process with no particular agenda. For the last few years I've tried to take the first week in January each year to come to our home in Vermont and do just that; work on business projects, marketing, budgets and, of course, this letter. So here we go again, for better or for worse, the 34th version of the senior Kosinski's take on the economy, markets and life in general.

Market Summary and the Economy

2013 proved to be the best year for equities since 1997 with the Dow up 26.5% and the S&P 500 posting a 29.6% gain.[1] In a portfolio fully invested in equities gains over 20% would be common. For a well-diversified portfolio, using the traditional mixtures of fixed income, metals, commodities and real estate, those gains proved to be in the 7% - 8% range.[2] The more bond exposure in your portfolio, the lower your returns for 2013.

Why would diversification hurt you? You've all heard me say a hundred times that when interest rates go up, bond values go down. The 10 year Treasury yield went from 1.6% to a high of 3% by year end. This increase in rates starting in May coupled with the Detroit effect in the municipal bond market produced losses in the municipal bond market of -3% to -5% on even the highest quality bonds and bond funds.

In the fall of 2012 we anticipated this change in the bond markets and began to shorten the duration of our bond portfolios and also shift out of bond funds into alternative investments such as Hilton Capital Management and Pimco All Asset All Authority. Hilton had a 10 year track record of averaging 8% returns with a 6% yield using alternative fixed income investments such as MLPs,

[1] Morningstar Advisory Services
[2] East End Financial Group Core Satellite Model Returns 12/31/13

preferred stocks and REITs. Depending on when Hilton was purchased in your account in 2013 the return on their portfolio was -3% to flat.[3]

Pimco All Asset All Authority, run by Ron Arnott, commonly referred to in our business as the “smartest guy in the room” returned -5.47% after averaging 8.38% for the last 10 years. In 2008 he lost -6.92% versus -38% for the S&P.[4]

The point is a simple one. Some of the finest fixed income money managers in the world lost money in 2013 and this bond exposure hurt portfolio performance in all accounts.

Why Own Bonds, Especially Municipal Bonds

In 2013 bonds suffered their worst decline in price since 1994.[5] Interest rates will probably continue to rise in 2014 potentially producing a decline in the market value of your bonds or bond funds. So why would you hold bonds in your account?

Bonds do two things in an account and neither is very exciting. First, they pay predictable income monthly or semi-annually, many times tax free. Secondly, they cushion the volatility of the portfolio during an equity sell off. The worst one year return for bonds was a -9%, the worst three year period showed a flat return. For equities those numbers are -38% for one year and -46% for three years.[6] Bonds will go down in price as interest rates rise but not by 40%.

I enjoy reading Jason Zweig in the weekend Wall Street Journal who had an interesting quote last year. “Many investors have been behaving as if the bloodbath between October 2007 and March of 2009, when the markets lost 50%, never existed**. More worrisome, investors are forgetting the agonizingly real fear they felt during the financial crisis.”**[7]

Luckily we don’t forget that fear. Many of you are at that point in life that you have made your money and your primary goal is to protect principal and make sure your money will provide the necessary income to maintain your lifestyle. Bonds, though boring and even in some years showing slight losses, will help you accomplish this.

Market Outlook

Coming off this year’s outstanding equity gains, you may expect to see some pull back. As the Federal Reserve begins to taper our bond buying program, interest rates may begin to rise. Hopefully we can begin to buy CDs again someday in our accounts.

We recently asked Pimco and Fidelity for their views on the markets for 2014 looking out over a ten year time period. Using a model of a 60% / 40% blend of equity to fixed income, Pimco is predicting a 4.5% annualized rate of return for 10 years. Fidelity’s projection is a bit higher at 5.5%.

The point is again a simple one. Manage your expectations. If the best research firms in the world have models showing 4.5% - 5.5%, use 5% as a target. Don’t fool yourselves. You’ll hear the chatter

[3] Hilton Capital Management 12/31/13 Performance History
[4] Pimco Performance Summary 12/31/13
[5] Morningstar Advisory Services
[6] Morningstar Advisory Services
[7] Weekend Wall Street Journal, The Intelligent Investor, Jason Zweig 3/15/13, 2/22/13

at the cocktail party about all the big gains people are getting. One thing I've learned in the 40+ years of doing this is that people that make money usually don't talk about it. A 5% return on average with low volatility and good tax efficiency in your non-retirement account can be a realistic and attainable goal.

Once again Jason Zweig has produced an article for the Wall Street Journal that focuses on the frustration of investors that bailed out of the market in 2008 and never got back in. Many of these investors want back in now, with the equity markets near all-time highs. "While markets are efficient, many investors are hopelessly inefficient." How true![8]

Vanguard has produced a chart that shows that over the last 10 years a 100% equity portfolio versus a 50% / 50% and 30% / 70% blend of equity to fixed income has gotten you to the same place financially. The point is a simple one; your money should be managed with a goal in mind, not performance. If you need to earn 4.5% on your portfolio at age 65 to insure your money will last for your lifetime, construct your portfolio for this target rate of return.

You pay a financial planner to protect you from yourself. Some clients clamor for more equities at market highs; two years ago it was gold. Our fee is earned by demonstrating that a well thought out diversified portfolio with low risk (beta) will allow you to reach your financial goals. You pay us to tell you things you don't want to hear and to take the emotion out of investing.

Staff Updates. The Service Model.

Another thing you've heard me say a dozen times is that we have nothing unique to offer in your portfolio. We have the same investments on our shelf as Merrill Lynch or UBS. The only thing that differentiates us from the competition is our service model. Annmarie Zilnicki who is now in her 30th year with me, heads up the finest service team I've seen. You need a check, Annmarie gets it to you. You need to get your 401(K) deposits transferred electronically, she does it. You need contract information on a life insurance policy you didn't purchase from us, she gets the information for you.

Her team, made up of Margret Loper, Mary LaFemina, Chrissie Curtis and Liz Niles, are absolutely the best. Remember, no 800 numbers. The answering machine goes on at 5 PM not 9 AM. You call and you get an intelligent human being that will be courteous and assist you in any way possible.

Debbie Zaita and Colleen Gogos continue to provide pension administration services to our 401(K) and pension clients. Debbie has been affiliated with us for 14 years and to my knowledge offers the only in-house qualified retirement plan administration in eastern long island.

Colin Moors is now in his 5th year with us providing research, portfolio design, and managing all trading activities for the firm. If you call and can't reach your advisor, Colin is available to answer any question relating to your account.

Meredith Diamond and Ernie Vorpahl, both certified financial planners (CFP) spend time between the East Hampton and Riverhead offices. Many of you work with them so you know how conscientious and informative they are. They have been invaluable members of the EEFG team.

[8] Weekend Wall Street Journal, The Intelligent Investor, Jason Zweig 3/15/13, 2/22/13

And finally there are my sons, Jack and Joe. Jack begins his 5th year and Joe is now in year 9. Both have now taken over many of the accounts that I brought on years ago and have grown to the level that they can handle any financial planning situation. Because of their growth as financial planners and more importantly, men with integrity, I feel comfortable turning the day to day operation of the company over to them in the near future.

Giving Something Back

Helping others and giving back to the community has taken a lead role with us.

Our foundation for brain cancer research, the Gwen L. Kosinski Foundation, has now raised over $500,000 in 11 years. My daughter, Jaime, recently flew to Los Angeles to meet with Dr. Keith Black, the top neurosurgeon in the world and present him with a check for $25,000 for his research. We just concluded a $150,000 grant at Memorial Sloan Kettering for a brain tumor research project. Many of you have helped to support us with this foundation over the years and I can't begin to thank you enough.

The last week in April, I will again escort disabled veterans from the Capitol Building in Washington to the battlefield at Gettysburg – "140 miles of hell as I call it". Last year 500 of us assisted 200 veterans and the ride generated over $400,000 for various wounded warrior projects.

Annmarie is chairman of the Rotary's scholarship committee. Joe is a mentor for career day at Westhampton Beach high school. We sponsor and support countless Little League, Biddy Basketball and Robotics Teams – it goes on and on. You have an obligation to give back, and our company and its employees have a firm commitment to community involvement.

A Reflection on Life

This year's office Christmas party provided me with the opportunity to reflect on my 34 years at the East End Financial Group. When I started the company my daughter, Jaime, was 3 and Joseph was under a year old. At this year's party the staff brought their spouse and children. Nadine and Coral came with Colin, Juliette was with Mary and Ian, Meredith brought the spirited Owen and, of course, Jack brought Dana and beautiful Olivia. Kirsten brought "my boys" JJ and Liam to meet Joseph. All the children were under the age of 4; Santa brought gifts for all. It brought me back to when I was 29 years old with two young children, an understanding and supportive wife and a dream to build an independent financial services company. I looked at the group and that was me 34 years ago. I have been incredibly lucky to have succeeded in my goal to build a first class financial services company, but more importantly, to have had the opportunity to keep our business in the family for at least another generation and to become friends with our clients over these many years.

As I lay the foundation to pass the responsibility of managing this wonderful business to Annmarie and my sons, I look forward to new dreams and goals; doing some part time teaching, possibly working on a PhD, becoming a hospice volunteer, spending time with Cindy in our new house in Mattituck and longer stays in Vermont, and most importantly, spending more time with my grandchildren as they turn in to real people in the blink of an eye.

Life goes very quickly, especially as you get older. Nobody guarantees you tomorrow. Thank you for your friendship and your years of loyalty to our company.

Best regards,
John J. Kosinski
John J. Kosinski, CLU, ChFC, MSFS
President