MONONGAHELA CAPITAL MANAGEMENT

PERCEPTIONS

2nd Quarter, June 30, 2013	6/30//2013	% Change 2nd Quarter	% Change Year
Dow Jones Industrials	14,909.60	2.92 % *	15.20 % *
S & P 500	1,606.28	2.91 % *	13.82 % *
Russell 2000	977.48	3.08 % *	15.86 % *
BC Aggregate BD Index		-2.32 %	-2.44 %
10 YR Treasury Yield	2.48 %		
30 YR Treasury Yield	3.50 %		

* ***Includes reinvested dividends***

The Importance of Inflection Points

The 150th anniversary of the Battle of Gettysburg provides an opportunity for quiet reflection on one of the seminal events in American history. Up until the Battle at Gettysburg, neither the North nor the South was able to establish dominance in the conflict. Gettysburg marked the first major defeat suffered by General Robert E. Lee, the brilliant leader of the Confederate troops. The loss repelled Lee's invasion of the North, inflicting severe casualties on the Confederate forces of the Army of Northern Virginia. After Gettysburg, Lee attempted no more strategic offensives and the North, with its superior industrial advantage, ground out the War until the South surrendered at Appomattox on April 9, 1865. The Union victory at Gettysburg was clearly an inflection point in not only the Civil War, but in the larger course of American History.

While the blood was flowing on the American continent, the European bond market was making an assessment of the likelihood of Confederate victory. K.Oosterlinck and M. D. Weidenmier reviewed the relationship between the Battle of Gettysburg and the European market for Confederate War Bonds.

> *"European investors gave Johnny Reb about a 42 percent chance of winning the war in early 1863 prior to the battle of Gettysburg. ... However, news of the severity of costly Confederate defeats at Gettysburg/Vicksburg led to a sell-off in rebel bonds and the probability of a Southern victory fell to about 15 percent by the end of 1863."*
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> Oosterlinck and Weidenmier, *Did Johnny Reb have a Fighting Chance? A Probabilistic Assessment from European Financial Markets*, Lund University School of Economics and Management.

Even in 1863, the bond market reacted to global events and assessed military victory or defeat as a measure of financial opportunity. Like the Battle of Gettysburg, the recent rise in interest rates appears to be an inflection point for the markets and the economy. The accompanying table highlights the dramatic rise in interest rates since the beginning of the year. Note that the yield on the benchmark 10 Year Treasury has risen over 43% since January 2013. With the rise in bond yields comes a corresponding drop in bond prices. This was clearly evident to any investor with exposure to the bond market.

Date	3 Mo Libor	6 Mo Libor	1yr Bill	5yr Tnote	10yr Tnote	20yr Tbond	30yr Tbond
Jun-13	0.280	0.420	0.15	1.41	2.52	3.22	3.52
May-13	0.270	0.420	0.14	1.05	2.13	2.92	3.27
Apr-13	0.280	0.430	0.11	0.68	1.66	2.44	2.83
Mar-13	0.280	0.450	0.14	0.77	1.86	2.71	3.10
Feb-13	0.290	0.460	0.17	0.77	1.86	2.71	3.10
Jan-13	0.300	0.480	0.15	0.88	2.04	2.83	3.21
Dec-12	0.310	0.508	0.16	0.72	1.76	2.54	2.95
Dec-11	0.581	0.808	0.12	0.83	1.89	2.57	2.89
Dec-10	0.303	0.456	0.29	2.01	3.30	4.13	4.34
Dec-09	0.251	0.430	0.47	2.69	3.85	4.58	4.63

Wall Street is littered with the bodies of fixed income short sellers who have repeatedly tried to call the top over the past few years. While calling long term tops and bottoms is a dangerous occupation, recognizing inflection points is critical for setting long term strategies. There is enough evidence and data accumulating to indicate that if the 31 year old bull market in bonds is not over, the long term upside is minimal.

When Ben Bernanke began to discuss a possible exit strategy of tapering the Fed's bond purchases, the bond and equity market promptly began to tank. After a brief "taper tantrum" by the markets, the Fed Governors changed tunes and talked about a long term commitment to easy money, thus calming the equities market; the bond market remained suspicious.

The credit markets need to return to a natural order, without massive central bankers' support and interventions. The markets are slowly beginning to adjust, whether the Fed is on board or not. The BC Aggregate Bond Index was down 2.32% in the 2nd quarter and is now down 2.44% year to date. The BC Aggregate Index has not had a negative annual return since 1999; it is well on its way to a negative return in 2013. Bill Gross (whom we respect as an excellent fixed income manager) has recorded a 3.2% decline year to date in his PIMCO Total Return Fund. The market is beginning to send out notice that there is risk associated with fixed income return. We have been analyzing, trading, and managing funds for 34 plus years, and adapting to long term structural changes is paramount to successful long term returns.

Our position is that while the bond market will have short term rallies into economic or global weakness, we are at an inflection point in the fixed income markets. We are suggesting that the

long term interest rate trends are changing and we are more than likely entering a long cycle of rising interest rates. The structural change is so significant that we will begin to change the composition of your equity portfolio (more on that next quarter) and will continue with very short duration on the fixed income side.

In periods of transition, we respect risk inherent in change but also understand opportunities when inflection points have been reached.