BRADYCO

Bradley F. Richardson

August 20, 2013

Results

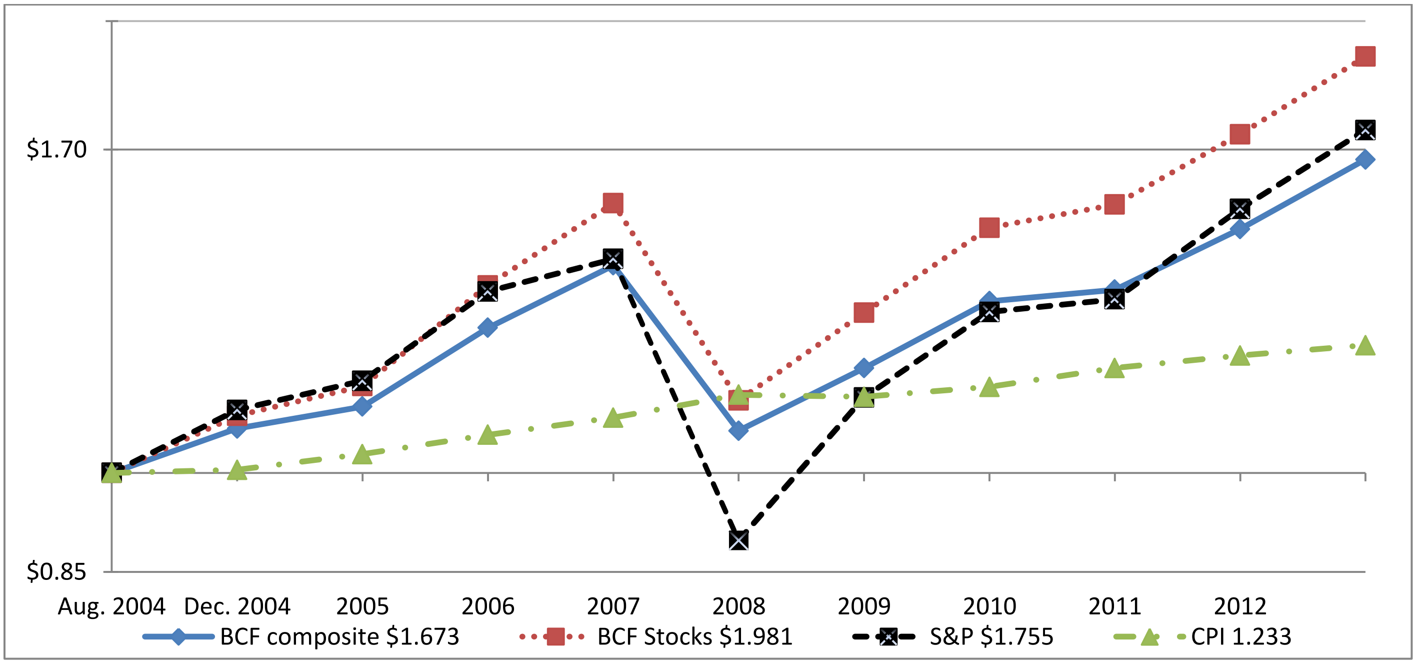
The Bradyco composite result for the first half of 2013 was a gain of 12.1%, net of expenses, while the S&P 500 index, including dividends, gained 13.8%.

The following table compares our results versus the S&P 500 index. Complete results are included at the end of this letter.

	2013 YTD	2012	2011	Last 2 yrs.	Last 3 yrs.	Last 5 yrs.	Since Inception
Bradyco composite	12.1%	10.5%	1.9%	10.1%	13.6%	5.3%	6.0%
Bradyco stocks	13.6%	12.2%	3.9%	12.0%	16.6%	7.0%	8.0%
S&P 500 (w/ DIV)	13.8%	16.0%	2.1%	12.8%	18.5%	7.0%	6.5%
CPI	1.7%	2.1%	3.2%	1.7%	2.3%	1.3%	2.4%

Returns are annualized; past performance is no guarantee of future results.

The following graph compares the performance of one dollar invested by Bradyco Financial since 7/31/04 to one dollar invested in the S&P 500 index.



Bradyco Financial
16 Sargent Street, Cambridge, MA 02140-2514
TEL (617) 945-1991 ■ FAX (617) 517-9197 ■ Brad@BradycoFinancial.com
www.BradycoFinancial.com

Commentary

The stock market – as represented by the S&P 500 index – had a strong 1st half in 2013 returning 13.8% (including dividends). During the same period, our stocks were up 13.6% while our composite – which includes cash – rose 12.1%. These compare with an inflation rate of 1.7%.

Our long-term track record remains strong. Since our inception, our stocks have grown by 8.0% per year, our composite by 6.0%, the S&P 500 index was up 6.5% and inflation grew at 2.4% per year.

Interest Rates and the Stock Market

Equity returns in 2013 have benefited from a strong tailwind caused by the interest rate policies of the Federal Reserve Bank. Since the Fed lowered interest rates to nearly zero in December 2008, the stock market has risen 17.1% compounded per year. As the Fed Reserve contemplates changing its policies, it is worthwhile to consider what effect an increase in interest rates will have on the stock market.

Let's start by reviewing how stock prices are determined. For an individual stock to increase in value, either the company's earnings must increase or the value that investors place on those earnings (the price-earnings ratio) must rise, or both. While earnings have grown since 2009, they have not increased as much as stock prices. Thus, the price-earnings ratio of the S&P 500 index is currently at its highest level in nearly 4 years. This tells us that investor optimism has played a major role in the stock market's strength in recent years.

With this framework in mind, we can look at the possible effects an increase in interest rates might have on a company's earnings. The chief issue for an individual company is how much they are exposed to debt. Those firms with high debt levels, especially debts that need to be refinanced during the next 3-5 years, are likely to suffer the most. Another factor is the condition of the economy when interest rates go up. The Fed has pledged to hold off increasing interest rates until the economy strengthens. Just how strong the economy is when rates change will have a significant impact upon earnings.

The second half of the equation is how investors value those earnings. As interest rates increase, investment alternatives to stocks, such as bank certificates of deposits and other short-term debt, may become more popular. By contrast, investments that lock investors into fixed payments for more than short periods such medium and long-term bonds are likely to be less desirable. For stocks, the key will be earnings growth.

With these different forces in play, when interest rates go up, stock prices may fluctuate significantly as investors try to sort out what their long-term impact will be. Public ruminations by various Fed Governors as to what the Fed *might* do in the future have been enough to create increased volatility in June and August.

Another potential cause of volatility this fall is the possibility that our political system in Washington will have trouble agreeing on a debt ceiling increase as well as spending bills to fund the US government. Our leaders could reach a "grand bargain" – affecting not only the debt ceiling, but also tax reform, entitlements, and defense spending – but that seems unlikely.

Regardless of the decisions by our elected officials, a major issue affecting our finances will be the Federal Reserve Bank's ability to successfully navigate a major change in its strategy. The Fed's current policies were designed to boost our economy and thereby reduce unemployment. Some of these policies involved using unprecedented techniques such as using the Fed's balance sheet to influence long-term interest rates. As our economy improves, the Fed will shift its focus from employment levels to inflation rates. This shift will require both the unwinding of the Fed's balance sheet as well as the more traditional practice of increasing interest rates. Whether the Fed can manage these complex processes without causing an inflationary spiral or a deep recession is an issue even Fed Governors cannot agree on. Our job will be to find companies that can prosper regardless of what the future brings.

What's Next?

Since February 28, 2009, which is approximately when the stock market had its bottom during the financial crisis, the S&P 500 index has returned 22.4% per year while inflation has averaged just 2% per year. Not surprisingly in light of these strong results, Bank of America's monthly investor survey indicates that investors are the most confident they have been since 2009. While it is human nature to feel optimistic when the stock market is strong (and scared when the stock market is weak), logic and experience suggest we would be wise to do just the opposite.

Housekeeping

I want to thank you for your patience, understanding, and cooperation during the recent transition from Fidelity to Schwab. The fact that we were required to make the move quickly created some special challenges. While this change was imposed upon us, I feel confident that it is going to work out well for all of us in the long run. Schwab is well known for its strong customer service, which should help me to better serve you going forward. Please let me know if you have any questions or comments on the transition to Schwab.

You may have wondered, why now? Fidelity has not answered this question, so I can only speculate. The major reason, I believe, is the recent interest rate environment, which I have written about above. Essentially, this phenomenon has caused firms who offer money market funds, including both Fidelity and Schwab, to lose money running these funds because the amount of income generated by the money market fund investments is not sufficient to cover the funds' operation expenses. Fidelity and Schwab have reacted to this situation differently. Fidelity made a short-term focused decision to cut its roster of investment advisors who presumably were not profitable for Fidelity, in part due to interest rates. Schwab has chosen a longer-term view. Schwab believes that taking on investment advisors who may not be profitable for Schwab today will be good business for Schwab in the long-term as interest rates normalize and the profitability of these investment advisors increases. We applaud Schwab's long-term thinking and are happy to join the Schwab family.

Thank you for your confidence.

Brad

All Assets	Bradyco Composite (all)	Growth Composite*	Growth & Income Composite*	S&P 500 Index	CPI
08/04 – 12/04	7.5%	7.3%	8.0%	10.9%	0.5%
2005	3.7%	3.5%	4.4%	4.9%	2.6%
2006	13.8%	14.3%	12.8%	15.8%	3.2%
2007	10.8%	12.7%	6.0%	5.5%	2.9%
2008	-23.8%	-25.5%	-18.6%	-37.0%	3.8%
2009	10.8%	11.2%	9.7%	26.5%	-0.4%
2010	11.6%	10.7%	15.1%	15.1%	1.6%
2011	1.9%	2.3%	0.4%	2.1%	3.2%
2012	10.5%	10.4%	10.9%	16.0%	2.1%
01/13 to 06/13	12.1%	12.1%	12.1%	13.8%	1.7%
08/04 – 06/13	6.0%	5.9%	6.3%	6.5%	2.4%

All returns over 12 months are annualized and net of all expenses including investment management fees and trading expenses. All composite returns are asset-weighted monthly and include cash. All calculations use prices provided by Fidelity Investments and Charles Schwab & Co. Non-discretionary accounts and accounts with 100% cash are not included. Index returns reflect the reinvestment of dividends.

Stocks only	Bradyco Composite (all)	Growth Composite*	Growth & Income Composite*	S&P 500 Index	CPI
08/04 – 12/04	9.8%	8.4%	16.6%	10.9%	0.5%
2005	5.0%	3.5%	10.8%	4.9%	2.6%
2006	18.0%	17.3%	19.8%	15.8%	3.2%
2007	14.5%	16.5%	7.9%	5.5%	2.9%
2008	-27.7%	-29.0%	-22.7%	-37.0%	3.8%
2009	15.5%	15.6%	15.0%	26.5%	-0.4%
2010	15.0%	13.8%	19.7%	15.1%	1.6%
2011	3.9%	4.5%	1.7%	2.1%	3.2%
2012	12.2%	12.2%	12.5%	16.0%	2.1%
01/01 – 06/13	13.6%	13.6%	13.8%	13.8%	1.7%
08/04 –06/13	8.0%	7.5%	9.9%	6.5%	2.4%

All returns over 12 months are annualized and do NOT include investment management fees. All returns are asset-weighted monthly and do not include any non-stock investments including equity mutual funds. All calculations use prices provided by Fidelity Investments and Charles Schwab & Co. Non-discretionary accounts and accounts with 100% cash are not included. Index returns reflect the reinvestment of dividends.

* See note on page 5

Note on Growth and Growth & Income composites

* When I started Bradyco Financial, I created two composites – Growth and Growth & Income – to represent the two strategies that I was following. The former emphasized long-term growth while the latter focused on income with long-term growth. In recent years, I have come to realize that for our purposes, there is no meaningful distinction between the two strategies. The results for the first six months of 2013 bear out this claim as the Growth, Growth & Income, and the all Portfolio composites returned 12.1%. Thus, starting with the next newsletter, I plan to eliminate these two composites – Growth and Growth & Income – and only present the all portfolio "Bradyco composite."