Five Lessons from the Three-Year Market Rally

…now a four-year market rally, but the lessons are still relevant. 1) The turning point is not always obvious. In hindsight, it seems like it should have been dead obvious that stocks were cheap four years ago. But, because of their inability to clearly identify market bottoms, investors may be better off sticking with a strategic asset-allocation plan. 2) Don't let past performance control your portfolio. To the extent that you can, let your strategic asset-allocation framework be a key driver of where you deploy new cash. 3) To help maximize participation, make a little room for the risky stuff. Even though higher-quality stocks tend to hold up better during downturns, the opposite tends to be true during recoveries. Investors may want to maintain exposure to both types of companies: high-quality, wide-moat dividend payers and economically sensitive small- and mid-caps. 4) But there are also chicken ways to play. You don't need to pile on the risk to generate robust gains in absolute terms. Investors who have shorter time horizons or are simply more comfortable with lower-risk stocks can reasonably allocate more toward such stocks without completely ceding their upside potential. 5) There will be bumps (and buying opportunities) along the way. The movement hasn't always been upward since the market bottomed. If your portfolio is light on stocks at the outset of a rally, periodic sell-offs may provide opportunities even at a later time.

Diversification and asset allocation do not eliminate the risk of investment losses. Stocks are not guaranteed and have been more volatile than other asset classes. Small stocks are more volatile than large stocks, are subject to significant price fluctuations and business risks, and are thinly traded. This should not be considered financial planning advice. Please consult a financial professional for advice specific to your individual circumstances.

Canandaigua National Bank & Trust

Monthly Market Commentary

The U.S. stock market dropped by 2.9% in August, heavily weighed down by news out of Syria. Though Syria produces no oil to speak of, there are fears that other Middle Eastern oil producers would be drawn into the conflict, and oil prices would soar.

Federal Reserve news: There are a lot of worries in anticipation of the Fed's September meeting, when tapering seems imminent. An increasing number of Fed governors seem to believe that there has been enough bond buying. Still, some governors continue to believe that the economy is in a fragile state and are more reluctant to make any changes without clear evidence of an accelerating economy. A small tapering might represent an acceptable compromise, unless the near-term economic indicators fall apart.

GDP: The second-quarter GDP estimate was revised sharply to show 2.5% growth, compared with the previous estimate of just 1.7%. Most categories were unchanged, except for the much-anticipated change in net exports, which accounted for almost the entire 0.8% revision in the GDP.

Employment: The economy added 169,000 jobs in August, with most of the growth coming from the retail trade and health-care sectors. However, the June and July numbers were revised downward by a combined total of 74,000 jobs. Based on the new numbers, only 148,000 new jobs were created on average during the past three months. The unemployment rate dropped to 7.3% from 7.4% in July.

Housing: Pending home sales fell 1.3% between June and July, while the year-over-year tally was up 6.7%, its lowest showing in 2013. Unfortunately, pending sales are tracking lower than existing-home sales data, which means that existing-home sales are likely to show slower growth rates in the months ahead. The data also seem to indicate that the big jump in July existing homes was a result of a rush to close mortgages faster (to beat rate increases), and not actual gains in the housing market. Home prices have risen sharply over the last 15 months; however, rising interest rates and declining affordability may keep a lid on prices, at least in the near future. Affordability has slipped from an index of 210 to 166, and that was before rates really started to increase this spring. Overall, the housing market appears to be slowing its growth rate.

Consumer spending: Consumption, which represents 70% of the U.S. economy, has been on a slow drift down during the past year. Given the limited growth in July actual data and lackluster shopping-center data so far in August, Morningstar economists estimate that consumption data will be hard-pressed to grow much faster than 1.5% in the third quarter overall, compared with increases of 2.3% in the first quarter and 1.8% in the second quarter. Given that consumption is the largest component of GDP, the data would seem to indicate a slowing in the overall GDP growth rate in the third quarter.

International: The European economy appeared to move out of recessionary territory in the second quarter as the 17-country eurozone experienced growth for the first time after an 18-month-long double-dip recession. The 2013 second-quarter annualized GDP growth rate of 1.1% was the first positive one since fall 2011. Germany, France, and the United Kingdom were the backbone of the recovery with annualized growth rates of 2.8%, 2.0%, and 2.4%, respectively. Employment data didn't show nearly as much improvement as GDP did, especially in France, but overall, the improved data should make Europe less of a headwind to world growth.

Morningstar economists are still optimistic about the long-term outlook for the U.S. economy, because of the potential of the housing, oil, aerospace, and auto industries. Manufacturing and the banking system also remain strong, and inflation appears under tight control. However, there is no denying that fiscal austerity and higher interest rates are taking at least a short-term toll.

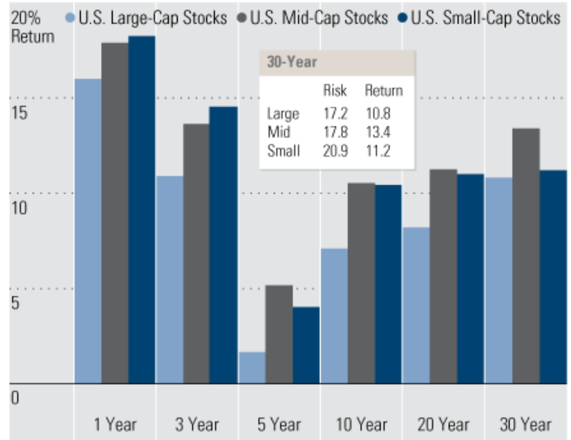
A Quick Look at Mid-Cap Stocks

Investors often hear about large- and small-cap stocks, but what about mid-caps? A quick look at large-, mid-, and small-cap stock performance over various time periods shows that investors may want to consider U.S. mid-cap stocks for their portfolio.

Mid-cap stocks offered the highest compound annual returns in four out of the six time periods analyzed, and were relatively close (in terms of return) with small stocks in two other time periods. In terms of risk, the data shows that mid-cap stocks had a 30-year annualized risk of 17.8%, which was lower than the 20.9% risk of small stocks and only slightly higher than the 17.2% risk of large stocks.

Talk to your financial advisor to see if there is potentially a place for mid-cap stocks in your portfolio allocation.

Annualized Stock Performance as of December 2012

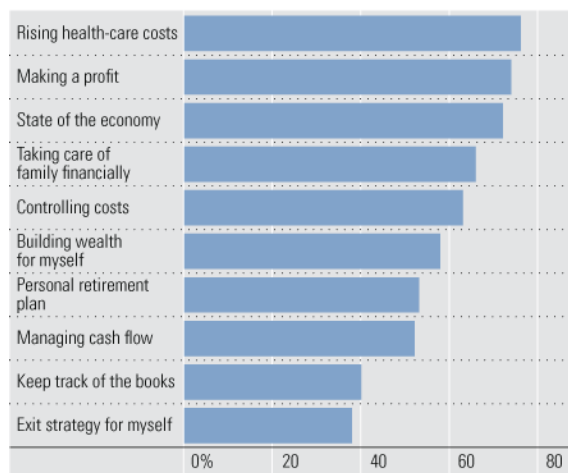


Past performance is no guarantee of future results. This is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Diversification does not eliminate the risk of experiencing investment losses. U.S. large stocks are represented by the Standard and Poor's 500®, which is an unmanaged group of securities and considered to be representative of the U.S. stock market in general, U.S. mid-cap stocks by the S&P MidCap 400®, and U.S. small stocks by the Ibbotson® Small Company Stock Index. Returns and principal invested in stocks are not guaranteed. Furthermore, small stocks are more volatile than large stocks and are subject to significant price fluctuations, business risks, and are thinly traded. Risk and return are measured by standard deviation and compound annual return, respectively. Standard deviation measures the fluctuation of returns around the arithmetic average return of the investment. The higher the standard deviation, the greater the variability (and thus risk) of the investment returns.

The Needs of Small Business Owners

Small business owners typically desire more than just retirement planning and wealth accumulation advice (both for personal and for family) from their financial advisors. According to a 2011 survey by Securian Financial Group, top concerns include cost controls (including health care), profitability, cash flow management, bookkeeping, as well as exit strategy or succession planning. While several small business owners have the knowledge to tackle most of these issues themselves, many would like outside help as well, recognizing the benefits of having an advisor assist with business strategies. Ideally, a holistic approach that extends beyond just investment and insurance products is needed to cater to the specific needs of small business owners. And given the current economic uncertainty, enlisting the services of an experienced professional may help significantly.

Top Concerns of Small Business Owners



Source: "Small but mighty: Growing opportunities for financial advisors and small business owners," Securian Financial Group, Inc., 2011.

How Are Variable Annuities Different When Held in a Qualified Account?

There are some basic differences when a VA is held inside a qualified account, meaning an IRA (traditional or Roth) or employer plan.

Contract Titling Difference: A non-qualified contract can be held by two owners or a trust, whereas a VA held in a qualified account must have an individual owner who is also named as the annuitant. (Note that on the Lifetime GMWB, joint spousal coverage can be achieved on an individual retirement account.)

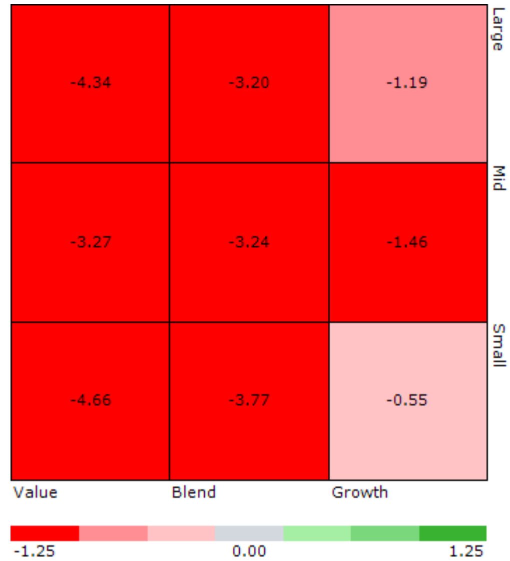
Product Differences: Often, a VA contract or benefit held in a qualified account has a different issue age. For example, one lifetime income rider must be purchased by age 77 when held in a qualified account, versus age 80 in a non-qualified account. In a few cases, fees and expenses are different. One variable annuity contract charges an extra 20 basis points when held in a qualified account. One carrier waives the annual account fee for qualified accounts with a minimum balance of $20,000. In one case, the VA product itself was designed exclusively as a qualified contract. For one carrier, an owner of a qualified contract has the option to terminate a living benefit, whereas non-qualified contracts cannot terminate a benefit once elected. Select carriers increase the withdrawal percentage to equal the RMD. Other living benefits treat RMDs favorably.

Tax Treatment—Different IRS limits on contributions: Non-qualified VAs do not have IRS restrictions on annual contributions, while qualified VAs are limited by the $5,000 annual contribution ceiling. 1) RMD requirements: Qualified VAs need to start required minimum withdrawals at age 70 ½ (except if the VA is held in a Roth IRA). Non-qualified contracts do not have RMD requirements. 2) RMD calculation is different: When calculating the RMD, the carrier factors in the present value of any enhanced death benefit and living benefit. As a result, RMDs can seriously erode account value. 3) Treatment of annuity payments: There is no exclusion ratio on payouts from a qualified VA, since no taxes have been paid on any of the investment principal. So 100% of the withdrawals are taxed as ordinary income. 4) Acceptance of rollovers: Proceeds from a qualified plan rollover are eligible to be rolled over directly to a qualified VA without taxation. Conversely, qualified plan rollovers cannot be placed in a non-qualified VA contract without taxes being owed.

Advisor Tips: When a variable annuity is held in a qualified account, name the owner and the annuitant as the same person. Once the owner passes away, the death benefit will pay to the primary beneficiary. When a living benefit is held inside a qualified account, an RMD may erode the account value quicker unless the rider is "RMD friendly," meaning an RMD above the allowable withdrawal percentage is not considered an excess withdrawal. Be aware of how an RMD affects the benefit base, especially when using a GMIB rider, most of which have no special treatment of RMD withdrawals. Look for "RMD friendly" living benefits.

The examples presented herein are for informational purposes only. They are not representative of any specific annuity and do not constitute investment advice. Annuities are suitable for long-term investing, particularly retirement savings. Withdrawal of earnings will be subject to ordinary income tax and, if taken prior to age 59½, may be subject to a 10% federal tax penalty. Investing in a variable annuity within a tax-deferred account will provide no additional tax savings and, therefore, should be considered only for other benefits that may be provided by the annuity or associated riders. Additional fees apply for living-benefit options. Investment restrictions may also apply for all living-benefit options. Violating the terms and conditions of the annuity contract may void guarantees. Read your prospectus carefully for all the fees and expenses that may apply to your variable annuity contract. It is also recommended that you consult with a financial advisor and tax advisor before purchasing an annuity.

Monthly Market Barometer



1 Month, ending August 31, 2013. The U.S. Market returned -2.87% (YTD 16.73%).

The Morningstar Market Barometer provides a visualization of the performance of various stock market indexes. The color scale (red for losses and green for gains) allows you to assess which areas of the market performed strongly and which areas showed weakness for the time period analyzed. The nine-square grid represents stocks classified by size (vertical axis) and style (horizontal axis). There are three investment styles for each size category: small, mid and large. Two of the three style categories are “value” and “growth” while the central column represents the core style (neither value nor growth characteristics dominate). Large-caps account for the top 70% of the capitalization; mid-caps represent the next 20%; and small-caps represent the balance.