Archer Investment Corporation

BALANCED INVESTMENT MANAGEMENT

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Archer 2013 Mid-Year Outlook:

The year is shaping up a bit as predicted. We have skyrocketed in the stock market for the first half of the year, only to see a mild correction in June in stocks. The stock market is not going to go straight up to the moon without a few setbacks. In fact since the Depression we average one correction of 10% or more each year. This correction we seem to be facing with a 7% downturn and now as of this writing it has bounced back to be a 4% correction is extremely mild. Much of the correction has come from the jaw-boning of the Fed discussing the end to Quantitative Easing or the reduction in the buying of Debt. Investors were skittish with this news even though we knew at some point it would happen. However, most of the returns this year were not driven by a flood of earnings increases but merely the fact the Fed has taken some of the risk off the table by being “the buyer” of the market even if someone else was selling.

Before we turn our attention to the rest of 2013, let’s discuss what our investments are supposed to do over time. We (including the portfolio managers) invest with the idea our investments we choose will continue to do their job over time and increase. Sometimes we look at our investments and think they are disappearing or shrinking and not doing their job. Growing up, I lived on 5 acres surrounded by thick woods that had a creek running through the back. The creek in the winter time was easily seen from the house and you could see deer and other animals (including our horse and pigs) visiting for a drink of water supplying them with the resources they needed. Once spring and summer came, the trees grew leaves and the vegetation thickened up so you could not see the creek. Occasionally there was a drought and you were sure the creek was not doing its job. However, even though you could not see the creek, the next rain came and went and the creek was doing its job over the years. I am confident to this day, 30 years later, it still is. This Fall and Winter the leaves will drop and once again, you will see the creek. Over the years and decades to come it will keep serving the wildlife and ecosystem.

Investments over time do the same thing. Even though sometimes it looks like a drought and the trees are thick, the investments are still there doing what they are supposed to do, grow.

Let's look at the bond market for a second as we have seen negative returns thus far in 2013 with a 2.33% drop in the AGG or Aggregate Bond Index. This has been promulgated by low interest rates over the years as well as the most recent Fed news of slowing the buying of Federal Debt. This may continue over the year and we could see a negative return in bonds this year as we discussed in the 2013 Outlook. Although if negative, we still expect the bonds we purchase to realize a positive return over time. We generally do not buy and sell bonds. We find bonds we like and hold them to maturity. So if a bond with a 5% coupon, (assuming we purchased it with an expected 5% return) each year drops in price (this means the yield will increase above 5%) we will hold that bond and ultimately receive our 5%.

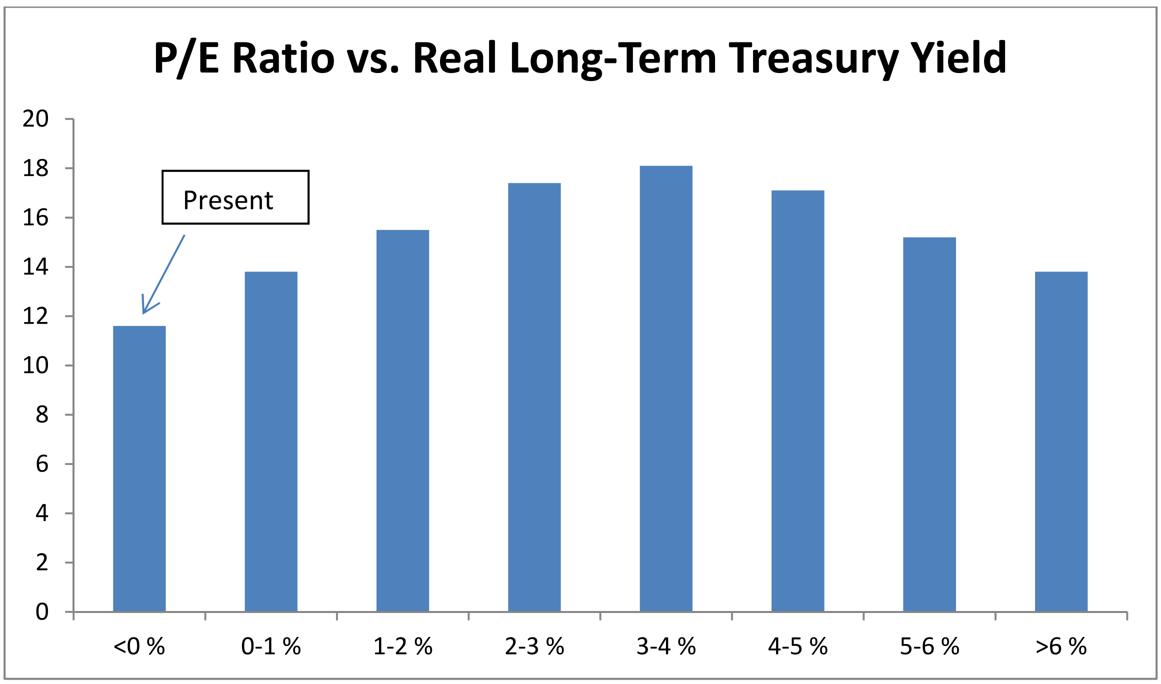
Let's turn our attention to the stock market. Although corporate profits have increased in the first and second quarter of 2013, they have slowed dramatically in the second quarter. We track the earnings of companies reporting earnings and the ratio of up/down earnings is at 1.16 as of early June. This is far below the average of 1.57. This is telling us the economy although improving is going to take some time as the economy hires more employees and the profits from those hires is more productive. (See 2013 outlook for discussion of hiring and corporate profitability). One area to support this theory is the hiring trend in the US albeit slow is improving on a 4 week moving average. The chart from Bloomberg below shows we are now at 2007 levels on US initial jobless claims.

What does this ultimately mean for the market since we have pushed beyond our targets for 2013? Do they stay the same or go up or down? We think they will rise. Although earnings were relatively flat for the second quarter, we think this bodes well for the Fed to continue its QE practices. Maybe not $85 billion, but the Fed will continue to buy which means continued increase in prices and profits. This is actually good for the stock markets. In addition as the employment picture improves and contributions from these additional employees start adding profits to corporations, earnings will escalate a bit and start moving closer to the $116-$118 on our graph below.

The end result is positive. I would reference you to the additional graph we included in the 2013 outlook. If the Real rates get between 1-2%, this would mean earnings, employment, and the Fed are all on target and we should see multiple expansion getting closer to 14.5x which would give us a 1696 target price on the S&P 500. I have highlighted this in the graph below.

PE/EPS	$105	$110	$115	$120	$125
12.5x	1313	1375	1438	1500	1563
13.0x	1365	1430	1495	1560	1625
13.5x	1418	1485	1553	1620	1688
14.0x	1470	1540	1610	1680	1750
14.5x	1523	1595	1668	1740	1813

The reason for the expansion in multiple can be seen on this graph. Yields will generally rise as the economy is doing better, thus there are less buyers of debt and more of equities.



Again, we believe the rise in interest rates in June is a bit overdone with all the selling, but remember, rates have been artificially low for quite a while and should not stay that low forever. The low rates have given corporations the ability to retool their business balance sheets and put more profits to the bottom line. This has and will translate into more hiring, more consumer spending, and (we can all hope but not hold our breath) more responsible Washington spending.

We will continue to keep you up to date on our posts at www.thearcherfunds.com. Remember to invest in a manner you are content with and focus on long-term investing. Although we speak about short-term gyrations in the market, it is difficult to trade the market with any kind of long-term accuracy.

Regards,

The Archer Team

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