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First National Bank

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“It’s important to prepare your portfolio for the potential decline in value.”

If the Bond Bubble Bursts

THE FED’S ROLE IN RISING RATES



The Federal Reserve’s practice of quantitative easing has created a monthly influx of tens of billions of dollars into the treasury and mortgage-backed securities market. Increased demand has in turn created a rate ceiling on the 10-year treasury, which drives mortgage rates.

If a plan to reduce quantitative easing is implemented, treasury and mortgage rates will likely increase. Even a 1% increase in the 10-year treasury rate could result in significantly increased mortgage payments and an eventual economic slowdown.

While many are alarmed by this possible scenario, any proposed plan to reduce quantitative easing would likely occur in a very controlled manner over an extended period of time. This slow and steady pace gives investors an opportunity to reevaluate their current fixed income holdings and make adjustments to mitigate the effects of potentially higher rates.

It’s likely that you’ve heard at least some reference to the “bond bubble” in recent months. In generic terms, a financial bubble results when an asset class moves to unsustainable heights. Eventually, you can expect a rapid and intense decline in this asset class, a decline that mimics the bursting of a bubble.

Unfortunately, investors rarely associate these swift downward spirals with the assumed safe haven of the bond market. For some time, the Federal Reserve’s efforts to stimulate economic activity have resulted in historically

low interest rates. By its very nature, this extended, low rate environment is unsustainable, making the reality of a bond bubble seem almost imminent.

As an investor facing a possible once-in-a-generation bond bubble environment, it’s important to prepare your portfolio for the potential decline in value when interest rates do begin to increase. If you’re wondering where to begin, the first piece of advice is, “Don’t panic.” Investors who make aggressive moves in uncertain times typically live to regret their actions. Balanced investment decisions factor in your need for return, as well as your tolerance for risk.

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The co-mingled nature of bond mutual funds can require a more in-depth analysis that considers the quality and duration of your existing bond holdings, as well as how they will respond in an increasing rate environment. For guidance tailored to your financial goals, we encourage you to consult the experienced financial advisors at F.N.B. Wealth Management. With the appropriate guidance, you’ll be better equipped to adjust your portfolio, perhaps by accepting less income now in favor of a structure that offers less risk exposure.

Regardless of your current holdings, now is the time to prepare for the likelihood that interest rates, for the first time in decades, will begin a prolonged period of rebound. Our experienced team of experts is on hand to help you evaluate your exposure and respond with prudent portfolio adjustments. *Call us today at 866-362-4603, and stay ahead of the bond bubble that could diminish the value of your existing portfolio.*



Hedging Against Rising Rates

As a growing company, your need for capital may be immediate or on the near horizon. If so, it is especially important that you consider how to best protect yourself against the potential of rising interest rates. First National Bank has solutions that will help you mitigate interest rate risk by locking in a long term fixed rate. One option is the Interest Rate Derivative (derivative), or swap. Since 2006, First National Bank has employed derivatives to satisfy hundreds of client needs.

If your company is considering an expansion, acquisition, recapitalization or the option to refinance existing debt, a derivative could be the right fit. Derivatives offer a number of attractive benefits, including the option to hedge your rate exposure on all or a portion of your loan. Additionally, a derivative provides a fixed rate over a longer term. This equates to a pre-determined payment each month, a payment that will not change over the life of the derivative.

While interest rates have risen in the recent past, they remain at historically low levels, making this an ideal time to act. Whether rates continue to inch upward or reflect a sharp incline, the result will be the same. By locking in now, you can mitigate interest rate risk. You can set that process in motion at any time by contacting a Commercial Banking Relationship Manager at First National Bank.



When market indications suggest that interest rates will rise, swap rates should begin to increase. The above graph illustrates how the 10-year swap rate has reacted to recent interest rate increases.

In today’s interest rate environment, there is limited downside to a derivative. As rates increase, you’ll continue to benefit from a fixed payment, and the derivative will begin to serve as a business asset. Given the derivative’s prepayment feature, you could also benefit from transferable value by selling the lower rate in a higher rate environment.

During this attractive low rate environment, the primary risk may simply be waiting too long to lock in a rate. Otherwise, once rates increase, your cost of borrowing will do the same.



While interest rate derivatives are generally suited to loans of \$1 million or more, a variety of factors should be considered. To determine if your business is a good candidate for a swap, call us at 866-362-4603. Our experts will help you identify the best solution to accomplish your financial goals.



F.N.B. Wealth Management products are not FDIC insured, not bank guaranteed, not a bank deposit, may lose value and are not insured by any federal government agency.

MAKING WISE MORTGAGE DECISIONS

Given the potential of rising interest rates, the best mortgage strategy depends on your particular circumstances, your current cash flow and whether you are more interested in a manageable monthly payment or the lowest interest rate possible.

If your goal is to increase cash flow, an adjustable rate mortgage (ARM) could offer an attractive solution. Should rates continue to increase, the difference between a 30-year fixed loan and an ARM will also increase, so it may not be wise to commit to a long term fixed rate. While rates remain at a relatively low level, an ARM would allow you to lock in an affordable rate for a lesser number of years. This could be especially appealing if you plan to sell your home within the next 10 years.

If selling your home is a more immediate consideration, now could be the right time. Housing inventories in many markets remain on the low side, and interest rates have not sufficiently rebounded to a level that would discourage buyers. All in all, it’s a seller’s market.



Call us today at 866-362-4603 for help with your mortgage questions.

Maintaining Your Portfolio Discipline

Investors today are facing somewhat of a conundrum when it comes to effective asset allocation. Stock, bond and cash investments all present their own particular challenges in today’s environment. While the outlook may appear dismal, the best course of action is to avoid knee-jerk reactions, and maintain your portfolio discipline.

Because stock values as a whole have nearly doubled since 2009, the assumption could be made that the market can no longer sustain this upward climb. The urge to pull out of stocks, however, is complicated by a rising rate environment. If rates continue to rise, bond values will decrease and returns will diminish. Given this two-pronged challenge, you may consider more heavily weighting your portfolio in favor of cash assets. Reverting to cash, however, almost guarantees a drain on your long term financial plan, since the current return on cash barely registers above zero.

So, where can you turn in this challenging environment? First, consult a professional Financial Advisor. With more than \$4.5 billion in assets under management, the experts at F.N.B. Wealth Management have the experience to help you adjust to changing circumstances without abandoning your long term investment objectives.



While stocks have doubled in recent years, remember that those increases represent a recovery that has just recently reached pre-recession levels. Additionally, indications of economic growth support the idea that stocks may actually continue to increase in value. The same principle applies to the bond side of your portfolio. While bonds may eventually begin to yield a flatter return, they will continue to offer balance in terms of overall risk exposure.

In conclusion, your primary consideration should always be to maintain your portfolio structure and discipline. Pulling out of one asset class or another would likely be detrimental to the soundness of your portfolio. Instead of overreacting to changing circumstances, talk to a Financial Advisor at F.N.B. Wealth Management. We will help you identify reasonable adjustments that won’t disrupt your portfolio structure. *Call us today at 866-362-4603, and let’s discuss ways to help you effectively maintain your portfolio discipline in this challenging environment.*

Relieving the Burden of Fiduciary Risk

In a mobile workforce environment, a 401(k) Plan is a near necessity to attract and retain the best talent in the market. Unfortunately, the heavy demands of plan administration and compliance prevent many employers from recognizing the feasibility of offering a 401(k) Plan.

Fiduciary risk is one of the heaviest employer burdens associated with a 401(k) Plan. Increased regulation is impacting every aspect of investment management, and retirement plans are not exempt. The drain on company resources can be too great for many employers. In addition to compliance with ever-changing regulations, the plan sponsor must also ensure that the plan structure and investment options remain in the best interest of employees. In an environment of rising interest rates, asset review and adjustments to mitigate risk become an even higher priority, particularly in the fixed income segment.

Unlike many providers, F.N.B. Wealth Management offers comprehensive trust services that enable us to lift the burden of fiduciary risk from your shoulders. By absorbing the role of the fiduciary for your company’s 401(k) Plan, our specialized retirement experts will oversee every aspect of compliance, staying ahead of new regulation and preparing you for its impact well ahead of time. We can also fulfill your comprehensive plan management needs, including investment monitoring, transactions, website access and recordkeeping.



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As a community-based financial institution, we have the flexibility to customize our service delivery to your company’s unique needs. Whether you need comprehensive plan management or select services to supplement your existing resources, F.N.B. Wealth Management is equipped to serve you. Plus, as your needs change, we’ll adapt with you. You’ll never have to worry about outgrowing your plan administrator.

If you have a retirement plan in place, we can manage the transfer of that plan, including all aspects of conversion. Most importantly, we can alleviate the drain on your company’s resources and the burden of fiduciary risk, so you can focus on your core business.

Our experts are also available to educate your employees about the importance of saving for retirement, as well as the specifics of the plan’s structure, related fees, investment options and more.

F.N.B. Wealth Management’s certified retirement plan specialists have more than 100 years of collective industry experience

and currently manage nearly \$1 billion in retirement plan assets. *Contact us today at 866-362-4603 to discuss retirement offerings that make sense for you.*

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