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Asset Management • Retirement, Tax and Estate Planning • Fee Only • No Commissions • Independent Advisor

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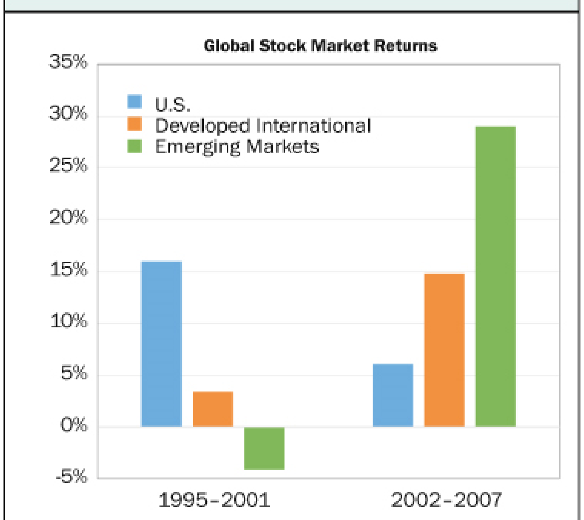
Here is our newsletter for the 1st Quarter of 2015.

The Markets

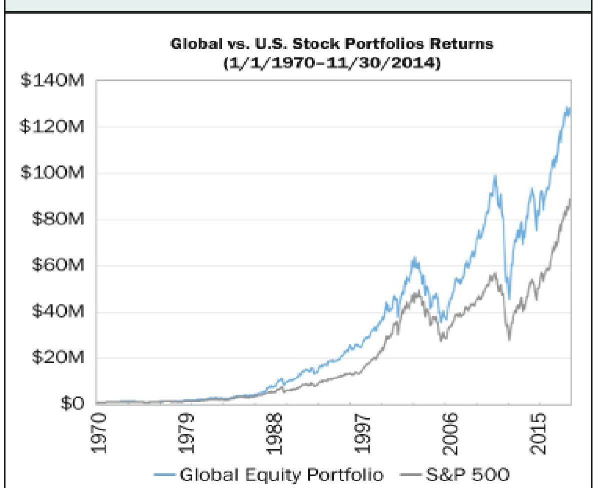
The 4th quarter saw the continuation of the trend that has occurred the last three years with U.S. equities outperforming foreign equities by a wide margin. While U.S. large-cap stocks were up almost 5%, developed foreign stocks were down 4.1% and emerging market stocks were down 3.6%. The U.S. total bond market was up 1.7%, the high-yield market was down 1.1% and world bonds were down 1.5%. The big news was in the commodity markets with the GSCI index down 29% for the quarter (and 33% for the year).

Our portfolios had small losses for the quarter (less than 2%) primarily due to our underweight to U.S. stocks and overweight to the foreign stock and bond markets. As the U.S. markets have outperformed other markets for the 4th time out of the last 5 years we are starting to hear more people question the benefit of investing around the world. Since markets move in cycles (see chart at left below) there will always be periods of several years when global diversification does not appear to work. In our view as long-term investors, the case for global investing is increasingly compelling. In 1970, U.S. GDP accounted for 47% of the world's total GDP. Today it is closer to 20%, while emerging markets now comprise roughly half the world's total output. Likewise, in terms of stock market capitalization, in 1970 the U.S. market comprised 66% of the world's total stock market value. By 2013 it had declined to roughly 49%, with emerging markets comprising 11%, and the remainder

Equity Markets Go Through Cycles and It Is Unwise to Extrapolate Recent Trends Far Into the Future



Despite the Recent Outperformance of U.S. Stocks the Case for Global Equity Exposure Remains a Compelling One

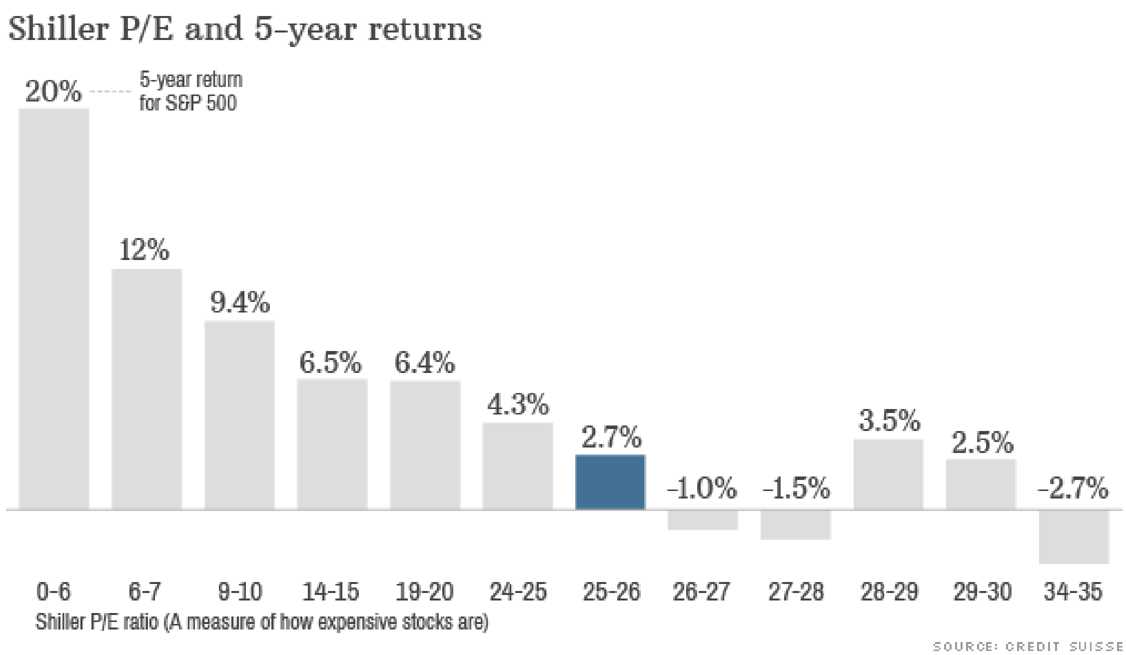


	Annualized Return	Standard Deviation	Starting Value	Ending Value
Global Equity Portfolio	11.4%	14.9%	$1M	$128,383,142
S&P 500	10.5%	15.4%	$1M	$88,750,665

From 1970 to 1987, global equity portfolio is 60% S&P 500 and 40% MSCI EAFE. From 1988 onward, portfolio is 60% S&P 500, 20% MSCI EAFE, and 20% MSCI Emerging Markets. Source: Morningstar.

in developed international markets. In summary, businesses around the globe are launching, innovating, producing, and growing, and their stocks will do so as well.

The other factor is the clear overvaluation of the U.S. stock market in absolute terms and relative to foreign markets. The Shiller PE Ratio as of the January 5th market close was 26.5. The ratio has been higher, but only about 5% of the time. The chart below shows the annualized returns of the U.S. stock market at different ranges of starting Shiller P/Es. The 1% loss shown for the current range means a total cumulative loss of 5% over 5 years. (Note: positive values from 28 to 30 were all during the Tech bubble).



Another measure of the U.S. stock market valuation is shown on the last page. The Q ratio was developed by Nobel Laureate James Tobin and is calculated using a measure of the replacement cost of all U.S. companies. The current Q Ratio is 68% above the historical mean. This puts the ratio higher than any time except during the 2000 Tech Bubble. The following quote is from one of our fund managers, John Hussman: "Those who follow a historically-informed, value-conscious, and risk-managed investment discipline should be among the most optimistic investors in the financial markets. It's just that this optimism is about future return opportunities, rather than present ones".

Ingredients for a Happy Retirement

A lot of my time helping clients is spent on helping them get to, and thrive in their retirement. It is easy to get wrapped up in the numbers and fret over simply how big a nest egg you need. I mentioned a new book "You Can Retire Sooner Than You Think" by Wes Moss in my newsletter last quarter but want to detail the findings from his surveys highlighted by Mandi Woodruff on Yahoo Finance. His main point is to detail all the factors that affect our happiness. So here are 7 major factors that his survey identifies based upon answers received from over 1,200 retirees and soon to be retirees.

1. Retirees' happiness hit a wall once they reach $500,000 in savings. Happiness skyrocketed for those who saved $500,000 vs. those who saved only $100,000. A similar plateau occurs for those who spend over $4,500 per month.
2. Happy retirees fill their time with 3 or 4 core pursuits. On average, happy retirees participated in almost twice as many core pursuits than their unhappy counterparts (3.6 vs. 1.9).
3. Happy retirees pay off their mortgage early. I mentioned this last quarter. Unfortunately the trend here has been bad as the percentage of retirees who have a mortgage has gone from 22% to 30% from 2001 to 2011 and the average loan balance has gone up 82%.
4. Happy retirees have at least 2 to 3 sources of income in retirement (Social Security, pension, investment, real estate and part-time work). Unhappy retirees have between 1 and 2 income streams.
5. Happy retirees are "masters of the middle" in that they live off of $53,000 a year, which is close to the average national household income. Happy retirees shopping tastes were modest. "They aren't super, uber frugal, but they aren't shopping at thrift stores either".
6. Happy retirees spend at least 5 hours a year planning for retirement. Nearly half of unhappy retirees said they weren't satisfied with how much thought they put into retirement.
7. Happy retirees are more likely to be married. 76% of happy retirees were married vs. less than half for unhappy retirees. This agrees well with other surveys about happiness of married and single people. This also agrees well with my own experience (but your results could vary).

IRA Makes Significant Changes to Retirement Plan Rollover Rules

As usual every year there are lots of changes to the tax laws that keep us tax planners and CPAs busy. One notable change has clarified the rules for how one can rollover pre-tax and after-tax funds from a company retirement plan. In the past I have recommended against making after-tax contributions to a retirement plan but now we have a new ballgame. Now there are clear rules where one can convert after-tax funds from a retirement plan into a Roth IRA tax free.

The first step is to see if your company retirement plan allows participants to contribute after-tax funds. If they do, you may be able to increase your total contributions to the plan. For 2015 the combined salary deferral limit for pre-tax and Roth salary deferrals to a 401(k) or similar plan is $18,000 ($24k if you are at least 50 years old). However, the overall limit for total annual additions is much higher at $53,000 ($59k if 50). This higher overall limit includes company matches and your after-tax contributions.

So why would you contribute more to your company retirement plan vs. a taxable or other account? The main reason is the ability to convert this after-tax money into a Roth IRA when you distribute it in your retirement. There is even a possibility for someone under 59 ½ to contribute after-tax and convert to a Roth every year tax and penalty free as some plans allow participants to withdraw your after-tax funds annually.

Please don't try to do this yourself as there are still many rules to follow concerning how the distributions are handled. There is also a new rule which limits the number of rollovers you can do to no more than one every 365 days. Any rollovers done within 365 days of another rollover will be taxable. So please give me a call to discuss the details.

Sincerely,

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