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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 2nd Quarter of 2016.

The Markets

The first quarter was similar to the last few quarters characterized by high volatility. The stock market dropped in the first half followed by a recovery in the second half. Again returns varied considerably across the asset classes we invest in. U.S. large cap stocks gained 1.3% but small cap continued their underperformance with a 1.5% loss. Foreign developed market stocks lost 2.7%. The emerging markets reversed their several year underperformance with a gain of 5.9% for equities and a gain of 10% for emerging market local bonds.

Asset Class Returns- Ending 3/31/16	
Asset Class	**1st Quarter 2016**
US Large Cap Stock	1.3
US Small Cap Stock	-1.5
Foreign -Developed Mkts Stock	-2.7
Emerging Mkts Stock	5.9
US Intermediate-Term Bond	3.0
Emerging Markets Local Bond	10
High Yield Bond	2.1
Inflation-Protected Bond (TIPS)	4.5
Cash	0.09
US Real Estate	6.3
Natural Resource Stocks	2.9
Commodities	-0.5

Most fixed income markets did well in the quarter with the U.S. Intermediate-term bond market up 3.0% with help from the drop in treasury interest rates. This is noteworthy because, despite the Federal Reserve raising their benchmark rates late last year, the markets have rejected the idea that interest rates should rise. Slow economic growth here and around the world continues to keep rates down.

Changes to Our Portfolios

Here is a great quote from Benjamin Graham who is considered the grandfather of value investing and author of "The Intelligent Investor" in 1949. His quote below sums up our long-term value approach to investing better than anything I could say.

"price fluctuations have only one significant meaning for the true investor. They provide him with an opportunity to buy wisely when prices fall sharply and to sell wisely when they advance a great deal."

Fortunately the market has given us more opportunities to buy assets at good prices over the last year. In late January we added a new fund to the lineup which has lost about 50% of its value over the last couple of years previous to our purchase. Oppenheimer SteelPath MLP

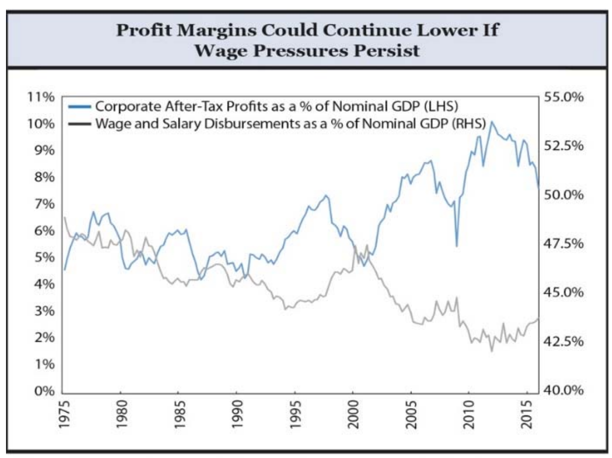
Income fund is an investment primarily in energy infrastructure such as pipelines, treatment plants and storage facilities. Many of these facilities are organized under Master Limited Partnerships (MLP) which earn pretty consistent income by charging fees to move, treat and store energy products. Their income is mostly insulated from price changes of the products as they simply charge a fee for moving, treating or storing. The market has been concerned about falling oil prices in the energy market and the impact this could have to the MLP firms. Most of these firms use debt to help fund their operations and expansion plans. Production cuts and difficulties accessing the capital markets could reduce their income and increase their costs.

We believe the markets have overreacted to the above concerns and bought the Oppenheimer fund which, partially due to the falling fund price, it currently yielding over 1% per month. Distributions are made monthly and you will see them under the transactions section of your monthly statements.

Another change we made to our portfolios is swapping out the PIMCO All Asset All Authority fund for the Wells Fargo Absolute Return Institutional fund. Both funds are similar in that they are a "go anywhere" fund that is free to invest in a wide range of asset classes that they feel offer the best risk-adjusted returns. In recent years PIMCO has been going thru a lot of upheaval with company founder Bill Gross leaving the firm. We simply feel more confident in the management of the Wells Fargo fund going forward. Understand that the fund is managed by GMO, not Wells Fargo. GMO is headed up by Jeremy Grantham and has two other co-managers for the fund. While this fund in only 3 years old they have been managing similar funds under the GMO name since 1996 and have a great track record.

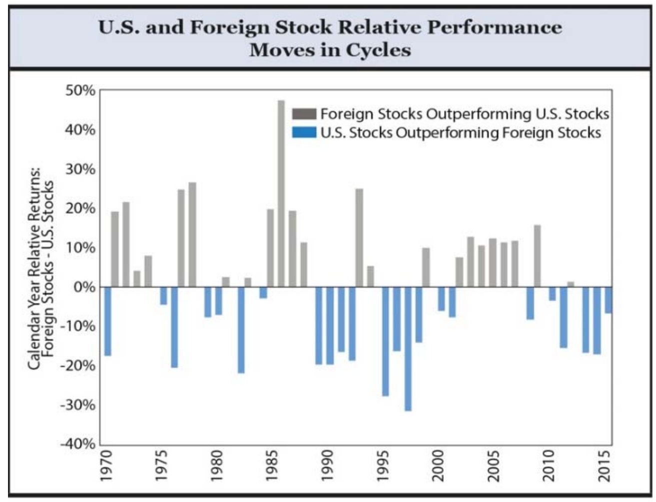
Our Outlook on Corporate Profits

We have talked a lot about the high level of corporate profits for some time and our view that they will come down to earth as some point. The chart shows profits as a percent of GDP. While profits have come down by this comparison the last few years from record highs close to 10%, they are still at about 8%, still much higher than the long-term average of 6%. With increasing costs for health insurance, regulatory compliance and increasing wage pressures, we believe they will continue to go down.



Source: Bureau of Economic Analysis. Data as of 12/31/2015.

U.S. Versus Foreign Stocks

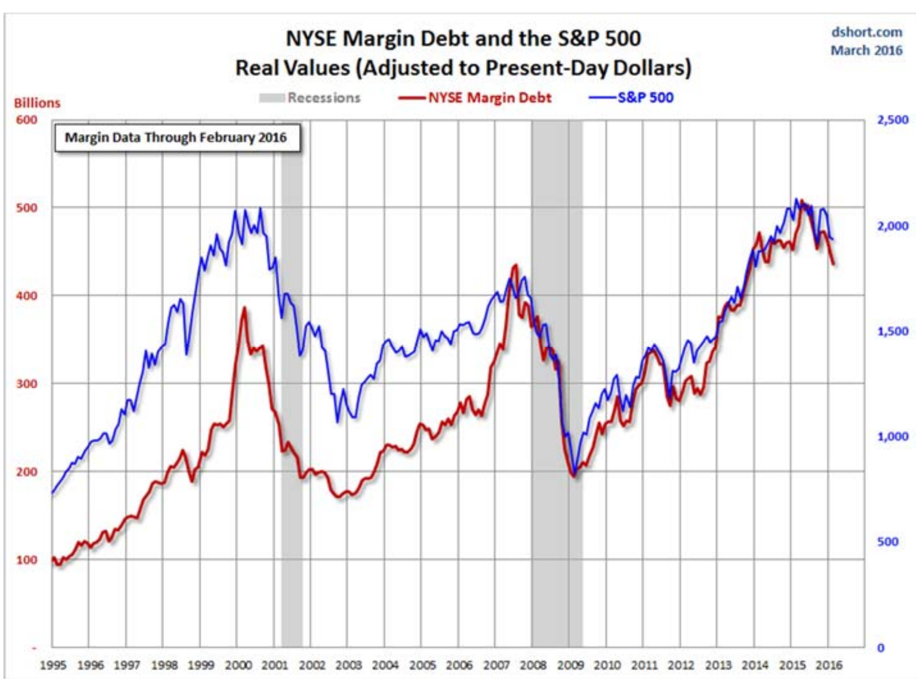


Source: Morningstar. Data as of 2/29/2016. Foreign stock returns tracked using the MSCI World ex USA Index from 1970 to 1987 and the MSCI ACWI ex USA Index from 1988 onward.

One of the important themes of our investment process is to recognize and take advantage of swings in investor behavior that produces value differences between asset classes. Readers of this newsletter know about our view that, over the next several years (5 or more) U.S. stocks are likely to deliver underwhelming returns (low single digit), while developed international and emerging-market stocks are poised to produce much higher returns. This has been a headwind to our portfolio performance as the current cycle of U.S. stock outperformance versus foreign stocks now ranks as the longest streak since the inception of the international stock index in 1970.

Why the Boom and Bust Cycles

Ever wonder why the stock market over the last 20 years has gone thru three big boom and two bust cycles? This chart illustrates how individuals and institutions using debt to buy stocks has been one of the drivers. The blue line is the S&P 500 average and the red line is the amount of debt used just on the NYSE stock exchange to buy stocks on margin. Notice how the stock market and margin debt both have dropped considerably within one year of a recession indicated by the gray bands.



Funding College
My last couple of newsletters have detailed some of the services we provide to our clients concerning how to reduce the cost of and help pay for college for your kids and/or grandkids. One very costly and risky way to fund college is to borrow the money and that is what many parents have been doing increasingly so over the last 8 years. Outstanding Federal student loan debt has gone from $116 Billion at end of 2007 to $946 Billion today. That is a rise of over 800%. We don't have a data source for private loans for college, but the New York Federal Reserve estimates total student loan debt to be in the neighborhood of $1.2 Trillion.

There are many ways to avoid (or at least minimizing) using debt to pay for college, many more options if you plan ahead when the kids are young. Only a comprehensive financial plan that considers your complete picture including funding of your retirement and other goals can put your kids onto a path free from debt and you with a secure retirement.

DoL Issues Fiduciary Rules for Advisors
Last week the Department of Labor (DoL) issued final rules that have been in the making since the Frank-Dodd Financial Regulatory Reform Act was passed in 2010. While the rules are a step in the right direction by providing some protections for investors the devil is in the details. Here is my own take is this. The rules require brokers and other advisors to act in the best interest of the client as a fiduciary. However is does not eliminate any of the practices that create conflicts of interest such as commissions, revenue sharing and other hidden, conflicted compensation. It also still leaves the door open to everything from controversial illiquid products like non-traded REITs, high-commission products like some variable and equity-indexed annuities, and companies that implement their own proprietary products as the "recommendation" at the end of every financial plan. It commits to a general fiduciary standard but leaves it up to the investor to prove that the fiduciary standard set has been breached, and to do so in court.

The important thing to know here is this advisor has always been and will always be a fiduciary with all my clients all the time. Thanks for reading and let me know if you or someone you know could use a financial advisor always on their side.

Sincerely,

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Registered Investment Advisor
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