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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 2017.

The Markets

The 4th quarter of 2016 saw a continuation of big divergences across asset classes with U.S. stocks and commodities doing well but foreign stocks (developed and emerging) losing ground. The big news was the big spike in interest rates which resulted in losses in the bond markets with US intermediate-term bonds loosing 3.0%.

Asset Class Returns- Ending 12/30/16			
Asset Class	**4th Qtr 2016**	**One Year**	**3 YR-Annual**
US Large Cap Stock	3.8	12.2	8.9
US Small Cap Stock	8.8	21.6	6.9
Foreign -Developed Mkts Stock	-0.8	1.4	-2.0
Emerging Mkts Stock	-3.8	12.2	-1.9
US Intermediate-Term Bond	-3.0	2.4	2.9
Emerging Markets Local Bond	-5.1	12.1	-3.5
High Yield Bond	1.6	14.4	2.4
Inflation-Protected Bond (TIPS)	-2.4	4.7	2.1
Cash	0.2	0.5	0.2
US Real Estate	-3.0	8.6	13.2
Natural Resource Stocks	4.1	30.2	-3.6
Commodities	5.2	18.6	-14.9

2016 was a good year for most asset classes, the most notable exception being foreign-developed stocks (although still gaining 1.4%). Emerging market equities had a turnaround after performing poorly over the previous five years. For the year our portfolios had mid to upper-single digit returns.

How Does the Election Impact Us?

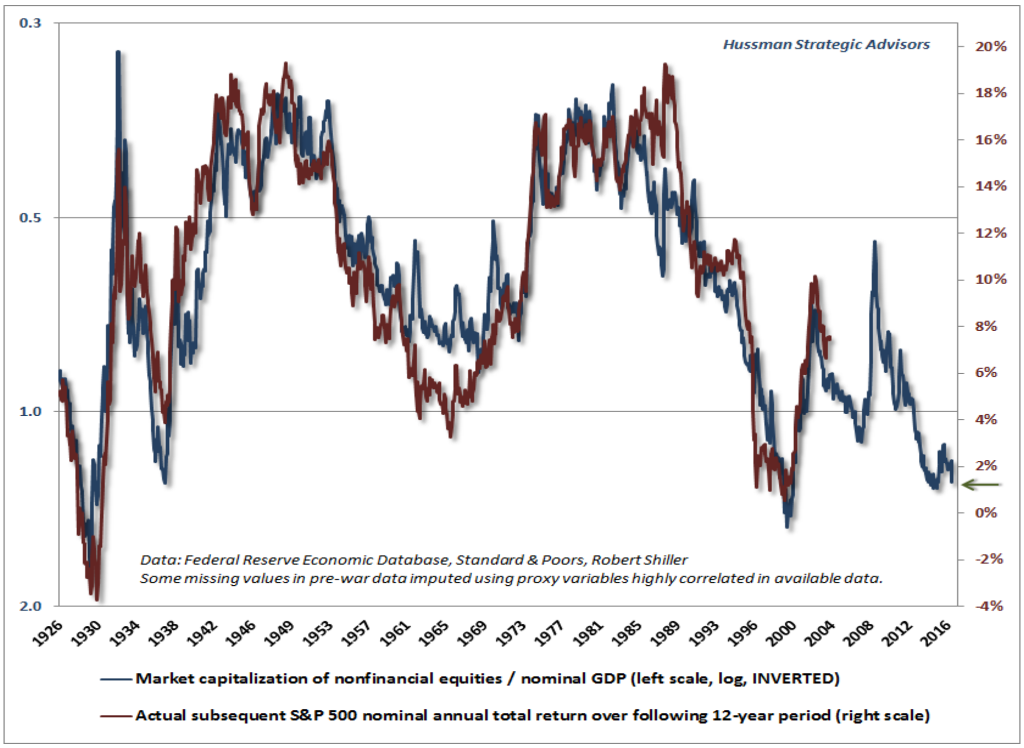
Many of my clients are concerned about the election and the impact on the markets and elsewhere. Many thought if Trump won the markets would tank. That hasn't happened, so far at least. Most market watchers see the U.S. stock market's big move up as anticipating more business friendly policies such as less regulation and lower business taxes.

Here is my take. Nobody knows what is going to happen and trying to guess is a fool's errand. <u>The election outcome does not impact our investment philosophy.</u> We don't try to predict future events, instead we simply look at current values in the markets and try to invest where the value is. We invest in a diversified portfolio of 12 or more asset classes all over the world and adjust the asset weightings when an asset gets cheap or expensive.

So while you may be very happy or unhappy with the outcome (or don't care) we will stay with our long-term value investment approach. I encourage you to focus on the things you can control like making sure your own financial house is in order. I'm here to help in that regard.

Update on U.S. Equity Market Valuation

Here is the latest from John Hussman. U.S. stocks are projected to return less than 2% annually over the next 10-12 years (the blue line), pretty close to the analysis from GMA we presented in our last newsletter. Foreign developed and emerging markets are priced to have higher returns thus we continue to emphasize them in our portfolios. PE ratios for the emerging markets look especially attractive with the CAPE at less than 50% of the U.S. markets.



Update on Our Index Funds-Smart Beta

We have been using several index funds along with our actively managed funds for many years. In our October 2013 newsletter we detailed our use of an alternative way to use index funds. Rob Arnott with Research Affiliates developed the Research Affiliates Fundamental Index (RAFI) and helped bring to market a series of mutual funds and ETFs which track his indexes starting in 2006. His strategy uses a weighting structure that uses four fundamental measures of size: five-year averages of sales, cash flow and dividends plus current book value. You may notice earnings are not part of the equation. Current earnings are what drive stock prices up and down with Wall Street's focus on the short term and, not surprisingly, they can be highly volatile. Earnings are also more easily manipulated using creative accounting than book value, cash flow and sales.

The large-cap U.S. RAFI Index Fund (symbol PRF) has been in existence for over 10 years now and here is how it has performed compared to two popular traditional market capitalization index funds from Vanguard and I-Shares. Figures are since 12-31-2005.

	Vanguard -VFINX	i-Shares- IVV	RAFI- PRF
Total annual return	7.60%	7.70%	8.59%
Expense ratio	0.16%	0.07%	0.39%

The RAFI fund has the highest return by almost 1% despite the fact it has the highest expense ratio. It seems logical when picking index funds, to simply pick the fund with the lowest expense ratio. This illustrates that it is not always the case. RAFI has more recently developed other funds for small-cap, foreign stocks and bonds. We have been following those for several years and may add them to the line-up in the future.

Challenges in the Long-term Care Insurance Market.
I attended a call with John Ryan recently who is one of the insurance brokers we work with. The second largest LTC insurance provider, Hartford is getting out of the business, although they will continue to honor existing policies. The largest insurer, Genworth is in talks to be purchased by a Chinese firm, prompting concerns for all. The LTC business has been hit hard by low interest rates the last few years, as the premiums they pay are primarily invested in the bond markets. As a result of this and smaller lapse rates, most policies have seen big premium increases in recent years. There are some new combination life/LTC insurance policies are becoming more interesting. Let me know if you want more information.

Pacific West Income II Fund Open
I and a few of my clients invested in a private real estate investment about four years ago. They have a new fund that just opened and would be a good investment for the long-term investor wanting to invest beyond the public markets. You have to be an accredited investor ($1 MM net worth not counting your home) and the minimum investment is $100,000. Your investment will be pooled with other investor's funds to purchase mostly small commercial shopping malls. Think the small strip malls around your local Walmart and Home Depot with coffee shops, doctor offices, restaurants, health clubs, etc. The investment should yield 7-8% per year and the holding period is 10 years. Let me know if you are interested.

Sincerely,

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