SETTING SAIL
FIRST QUARTER 2015

PREDICTIONS FOR 2015

We thought that might get your attention. So do the editors at Money and Kiplinger's magazines. Their covers for the January 2014 issues read "Where to Invest in 2014: 8 Stocks to buy Now…and 5 to Sell" and "Investor's Guide 2014: Your Best Moves Now," respectively.

There's nothing like predictions of the future that will sell magazines. That's probably why their January covers look pretty much the same every year. Of course, everyone is interested in the future, but investors always seem to be suckers for predictions.

Let's review some of the events from 2014 that **temporarily** affected markets.

- The biggest attention-grabbing story was the spread of Ebola in Africa and handful of cases here in the US.
- The mid-term elections went decidedly to the Republicans who will hold a majority in both the House and the Senate in 2015.
- The terrorist group ISIS wreaked havoc in Iraq and Syria.

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- ***Disciplined investing, and***
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- There were race riots in Ferguson, MO and around the country.
- Oil prices fell in half; US economic growth sped up while the unemployment rate continued to drop.

How many of these events were predicted by the experts a year ago? Perhaps someone predicted the election results, but most of the other events simply were not, and could not be predicted. Most news events are surprises, which by definition can't be known in advance. That's what makes them interesting.

Long-term, prudent investors aren't caught up in the short-term vicissitudes in the market because they are confident in where it is going in the long-term. They know that the market goes up permanently and down temporarily and trying to predict what comes next is a waste of time. This outlook, and a well-diversified portfolio designed to meet long-term income needs, allows these investors to simply enjoy the ride. It really can be fun as long as you believe it will work out in the end. *--ASC*

Did He Really Mean to Say This?

While flipping through radio stations recently, I chanced upon a famous financial advisor (I'll call him ATVM, "America's Trusted Voice on Money") in the midst of sharing his wisdom with an unsuspecting caller.

The caller (I'll call him John) and his wife owned a duplex, renting half and living in the other half. John was relocating for a short period of time (2 to 3 years) and would then return to his current city, and he wanted advice.

I wish I could have recorded ATVM's response, but it was along these lines:

- *Of course, you'll want to sell the duplex.*
- *Find a good realtor in the new area and ask him how home prices have been trending.*
- *If they've been up 10% to 20% annually for the past few years, then look for a house and buy it.* John would be assured (yes, I believe ATVM really said, "assured") that he would make money on the new residence in a few years.
- *If home prices had only increased 3 to 5, don't buy, because after commissions, etc. you likely won't make enough to make it worthwhile.*

On a personal note . . .

The Semi-Annual Meeting of the National Association of Financial Advisors (NAPFA) took Nola and me to Charlotte, NC, a beautiful city that we could consider for a second home. We enjoyed walking around the attractive downtown, with lots of parks and, of course, many great restaurants, which we enjoyed. The most memorable were:

- **Roosters' Wood-fired Grill**. One of those places we knew nothing about and just dropped in for lunch. Highly recommend.
- **King's Kitchen**, owned by Jim Noble, who also owns Roosters', is "Where the Hungry Feed the Hungry". Operated as a nonprofit, King's Kitchen provides job-training opportunities with the profits supporting the homeless and other charities.
- **Aria Tuscan Grille** provides a broad range of Italian-inspired dishes in a dressy (but not too dressy) setting.
- **Mert's Heart & Soul** is one of Charlotte's most memorable restaurants, providing solid Southern cooking served with just enough 'sass to keep you laughing without offending! Whatever you order, you just gotta have the cornbread!

A visit to our exceptional grandchildren in Fort Collins (Emily, Rachel and Grant) gave me the opportunity to instruct Emily as to what a true BBQ restaurant should be like when we went to Serious **Texas Bar-B-Q** in nearby Loveland. I had to explain to her that this couldn't be real Texas BBQ because it had pork ribs instead of beef ribs (thank goodness!) and it was shiny and new. However, the ribs were heavenly, as were the sausage, brisket and pulled pork; tender with just the right amount of smoke flavor. AND they provided the traditional slices of white bread to build your sandwiches with.

Long-time friends Gene and Debbie Taylor introduced us to **Café Tuscano** in Pocatello. This is a place we would have never tried on our own (we probably couldn't have found it on our own!) Its part of a gas station just off the freeway, but the atmosphere and the food were top rate. Their Crawfish Bisque is worth a stop all by itself.

Well, bless your heart, ATVM, I'm sure you meant well. Nevertheless,

- Why sell the duplex? What about the current cash flow, the potential cash flow if he rented both halves, the tax implications of selling (there would likely be gains on the half he was renting), or anything else. Maybe the duplex will keep paying for itself while John is gone and build equity. It would also give him a known place to return to.

- What relevance do past years of 10-20% appreciation have on future home prices? Residential real estate typically averages about a 3% long-term annual appreciation (about the same as inflation). As we experienced not that long ago, sometimes a few years of that high appreciation results in years of price collapses.
- Anyone who plans to be in an area for only 2 or 3 years should usually plan on renting. While it is possible buying can make them money, the risks are too great that a loss in value can entirely wipe out a family's net worth (as we saw all over the country the last time we saw a real estate price "correction".) Avoid the risk and rent!

It is possible (although remotely so) that ATVM's advice to John was appropriate because there was information that ATVM had about John that ATVM didn't share with the listening audience. Nevertheless, in the absence of such information, listeners following his advice could make a big mistake.

I hope John got a second opinion!

THE VALUE OF TAXABLE ACCOUNTS

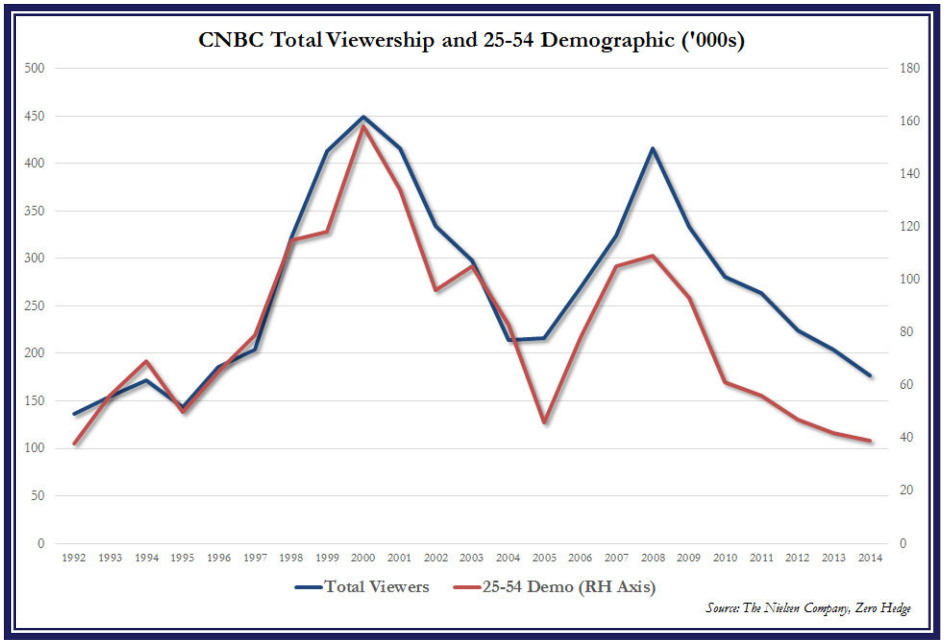
Back in the dim and dark past when I practiced as a "real CPA" (as opposed to my status as a "recovering CPA"), I recall clients engaging in herculean efforts (perhaps with a little of the profession's encouragement) to defer income from taxation through aggressive use of retirement plans. This resulted in 401(k) and defined benefit plans that could be manipulated to provide huge pre-tax contributions. However, after over 25 years of involvement with long-term financial planning (and particularly over 15 years in long-term wealth management) I've become increasingly aware of the danger investors can be in if they focus solely on pre-tax investments (qualified retirement plans, IRAs, etc.) and ignore the unique values of long-term after-tax investing. These benefits include the following:

- Flexibility. You can invest in essentially anything. Investments like artwork or coins and active real estate are essentially off-limits for pre-tax accounts.
- Low-Tax Compounding. By using mutual funds and ETFs, you can defer much of the growth in the value in the investment until you sell it. Most investors can pay very little tax relative to the increasing value of their portfolio, and then time when those gains will be recognized (also at low rates).
- Control over taxes. If essentially all of your investments are in pre-tax investments, whatever you take out is going to be taxed (at high ordinary-income tax rates, to boot). However, you can decide what after-tax investments you sell and thereby control the taxes you pay. Moreover, you're not required to make minimum taxable distributions in your retirement years.
- Time use of tax losses. Taxable investment accounts allow you to sell loss positions and get the current benefit of the loss. Similar losses in deferred-tax accounts are just locked up in the account until liquidation.
- Charitable contributions. The unrealized gains of most after-tax investments essentially "disappear" when they are used for qualified charitable contributions.

- Estate benefits. Amounts in qualified accounts are taxed to your heirs as ordinary income. Amounts in after-tax accounts generally receive a "step up in basis" resulting in little, if any tax, to your heirs after your death.--*JRC*

2014: Good For Markets, Bad For CNBC

As we look back on the financial markets in 2014, a few themes come into focus. The biggest movement was oil, which roughly halved in price over the last six months of the year. US large-company stocks had a slightly above average year, while US small-company, international, and emerging markets stocks didn't perform as well. The long overdue 10% pullback, or correction, in US large-company stocks never came. The S&P 500 made several new highs as the index worked its way up over the course of the year with limited volatility. In other words, it was a productive but terribly boring year to follow the markets.



For most investors, boring but productive is a good thing. We would take it any year it comes. **But not if you are the cable network CNBC**, who makes a living from exciting events and wasteful advice. The kings of hype and hysteria, fear and greed, and "change the channel at your own financial peril" couldn't scare up many viewers (pun intended). Their overall viewership was the lowest since 1997, just a few years after the network was launched.

Given their history, they know as well as anyone that viewership spikes in years of great volatility, whether it be in the flying high late 90s to 2000 or in the painful great recession years of 2007-2010. **This situation creates an interesting conflict of interest: CNBC is a network that is part news, part analysis and part prognostication. It reaches its goals by making any event seem bigger than it really is and in the process convincing the masses to abandon their long-term plan to achieve their goals.**

Maybe it will just go away.--*ASC*

The free market's the best mechanism ever devised to put resources to their most efficient and productive use. . . . The government isn't particularly good at that. But the market isn't so good at making sure that the wealth that's produced is being distributed fairly or wisely. Some of that wealth has to be plowed back into education, so that the next generation has a fair chance, and to maintain our infrastructure, and provide some sort of safety net for those who lose out in a market economy.

Warren Buffett, US Investor and Philanthropist