SETTING SAIL
THIRD QUARTER 2015

IT'S ALL GREEK TO ME, OR "IT'S LIKE IT'S DÉJÀ VU ALL OVER AGAIN."

[July 13th: We completed the following article on Thursday, July 9th, not expecting that the Greece/Euro crisis would resolve as quickly as it did (although we never doubted that it would resolve). Rather than rewrite the article (or come up with a new topic) we elected to leave it as is. Hopefully this sequence of events will help us all remember not to panic the next time one of these blown-out-of-all-proportion-non-crises occurs.]

With apologies to the famous Yogi Berra, it does look like we've seen all this before: about 4 years ago, the last time that Greece found itself in trouble with its Eurozone neighbors. As then, the financial world is in turmoil and, as then, it will pass once everyone comes to their senses. While no one knows how this will play out (see our accompanying article "Soothsayer . . . .") here are a few observations that may be comforting:

- It is possible that a compromise will still be worked out between Greece and its lenders. While Eurozone financial leaders have legitimate concerns about Greece's willingness to fix its problems, they are likely still open to some kind of intermediate-term fix.
- The Greece economy is only 2% of the entire Eurozone economy. That makes it less than 1% of the world economy. Its GDP is about the size of Connecticut. If it disappeared from the world economy (which isn't what I'm espousing by any means) it would be a mere bump.
- As in 2011, world markets will drop (as they have) and they will recover (as always have in the past).

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In 2011, the value of world stocks, (as evidenced by the Vanguard Total World Stock ETF (VT)) dropped about 22% from April to September 2011. VT recovered to its April 2011 value by December 2012). From then, it has had a total return of just over 33% (about 12% annualized). Not great, but not too shabby either.

- The Eurozone is in much better condition to absorb losses from Greece's holdings than it was back in 2011. At that time, most of Greece's debt was owed to privately-owned banks, while this time the debt is owed to the more resilient International Monetary Fund (IMF), European Central Bank (ECB), European Union (EU) and other such financial bailout vehicles. The concern in 2011 was that Greece's problems would spread to other countries, which is highly unlikely today.
- Most mutual fund managers have been avoiding Greece's debt and equity securities. For example, the Vanguard Total International Stock ETF (VXUS) has about 0.06% invested in Greece. Only one of the funds that we follow has any significant Greece holdings. That fund, the Artisan International Small Company Fund (ARTJX) has slightly over 1.5% in Greece holdings. Even with this allocation, however, its total return for the year-to-date through July 2, 2015 was over 12%, compared with the foreign stock fund category average of about 2.5%. The foreign bond fund we follow (Templeton Global Bond) has nothing in Greece bonds.

Greece's leaders must correct some of its fundamental fiscal deficiencies. Almost 90% of Greece's 2010 income taxes remain uncollected. Its state-supported pension system is at verge of collapse: there are only four workers for every three retirees receiving state-supported pensions. One way or another, Greece will go through some tough years.

On a Personal Note . . .

From Joe and Nola:

We recommend a visit to South Africa (where we spent four glorious weeks at the invitation of our four exceptional grandchildren and their parents, Joseph and Heather.) If you do, here are some suggestions:

- While in South Africa, you must take time to go to Victoria Falls, just an hour or so north (by plane). Although getting through customs was a hassle, it was worth it. The Falls are simply indescribable. Be sure to visit The Victoria Falls Hotel (on the Zimbabwe side). Built in 1904, the "Vic" still carries a Colonial charm. We ate a light supper on the Terrace, with a view across beautiful lawns of the Victoria Falls bridge and the spray of the falls. Very romantic (even with four exceptional grandchildren).
- While in Cape Town (also an destination we'd recommend) we took a tour to the Cape Point Peninsula. At the end of the peninsula we had a great lunch at the Two Oceans Restaurant (Atlantic on one side, Indian on the other). Local Rock Lobster and Hake (a local popular fish) were both great.
- Throughout South Africa there are some local chains worth visiting when you're in a hurry and not looking for upscale dining. **KFC** is very popular in Africa, and it is just as "finger-lickin' good" as it is here. **Nando's**, a local chicken chain, grills it's chicken using a local pepper sauce (peri-peri peppers). Spicy chicken, very good service. **Spur Steak Ranch** is a full-service chain, kind of like Denny's here, but less expensive, better food, and very friendly service.
- We tried only a few of the "local" delicacies: *crocodile* tasted like overcooked tuna, *ostrich* was basically hard to classify. We did not try *mopane worms*, which the locals all said were delicious (and nutritious, as well). *Pap*, a staple, is a thick corn porridge, somewhat like grits only slightly better. We ate it a lot. That and potatoes (usually French fries) were the starch at most meals. Pap was best with gravy, with the most prominent being a tomato-based gravy that was tasty (but not spicy enough.)

From Alan and Amber:

- After a full year in Idaho after living on the East coast, I can comfortably say it has been the best year of the last decade as far as Mexican food goes. We have taken it upon ourselves to find the best Mexican food in Idaho Falls. At the risk of offending readers who share a dissenting opinion, I proudly endorse **Jalisco's Mexican Restaurant** as our favorite. They pack more flavor and spices into their dishes than anyone else in town. I highly recommend the Burrito Chipotle which features their original Chipotle sauce.

Our Thoughts on Dimensional Funds

We began using funds from Dimensional Funds Advisors (DFA) a little less than two years ago, following a many-year "check-each-other-out" period. Overall, we've been satisfied with the change, particularly as we've learned more about their operations. DFA bases its investment strategies on research by Nobel laureate Eugene Farma of the University of Chicago and Kenneth French of Dartmouth College. Farma and French (who are now part of DFA's advisory board) identified characteristics of stock investments that, over the long run, enhanced returns relative to the total market. The original research indicated that smaller companies tended to outperform larger companies, and value companies tended to outperform growth companies. DFA learned from their subsequent research that the stock performance of profitable companies tended to outperform unprofitable companies.

While these concepts aren't unique to DFA (for most of our history, Spinnaker has tried to overweight value companies and small companies in client portfolios) DFA developed a trading approach that stayed true to these concepts, while minimizing taxes and reducing costs. Although DFA is often called a passive or even index firm, we view them as more of an enhanced-passive firm. Their intent is to incorporate the best characteristics of both active- and passive-management strategies.

DFA limits access to its funds to investors working through advisory firms. This benefits investors since advisors are much more likely to hold fast to an investment strategy during bear markets. This, in turn, means that fund investors aren't penalized when funds sell off positions to cover withdrawals during declining markets. In addition, this lowers trading costs and allows fund traders to manage tax implications better.

Our involvement with DFA has helped us make better decisions on how we utilize non-DFA funds. Since we started using DFA, we have seen our average fund management costs drop significantly—they now are typically between 0.5% and 0.6% of assets, another real benefit to our clients. Currently about 40% of the US stock portfolios and 34% of the total portfolios we manage are held in DFA funds. We are still learning how to best implement these tools in our portfolio strategies, and anticipate that these percentages may increase over time.

Soothsayer: A Person who Claims to See the Future

One of my favorite movie musicals is "A Funny Thing Happened on the Way to the Forum" starring Zero Mostel, Phil Silvers, Buster Keaton, and in his musical debut, young Michael Crawford, (who went on to originate the role of the Phantom in Andrew Lloyd Weber's famous "The Phantom of the Opera"). One of the many roles that Zero Mostel plays in the show is that of a "soothsayer". His brief interaction as a soothsayer with Buster Keaton's character includes the following bit of dialogue:

> Zero: I say! You are in need of a soothsayer.
>
> Buster: How did you know?
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> Zero: I'd be a fine soothsayer if I didn't.

So, you ask, what does this have to do with Spinnaker Financial Advisors?

It's simple: **We are not soothsayers**! We don't know the future of the investment markets or of anything else, for that matter. If that was what you were expecting from a financial advisor, you're going to be very disappointed.

What we are, however, is much more valuable. In a recent article by DFA's Vice President, Jim Parker, he identified **Seven Roles of an Advisor**: Expert, Independent Voice, Listener, Teacher, Architect, Coach, and Guardian. You can find Jim's complete article on our website at http://www.spinnakerfinancial.com/additional-reading**.**

As Jim points out, these roles vary over time, depending on what our clients need. Many times, they come to us for our expertise, but find that our greatest value might be our independence—giving them advice that isn't biased by commission-based compensation. When the markets are going crazy, perhaps our most valuable role will be in coaching them to stay with their plan and helping them guard their assets.

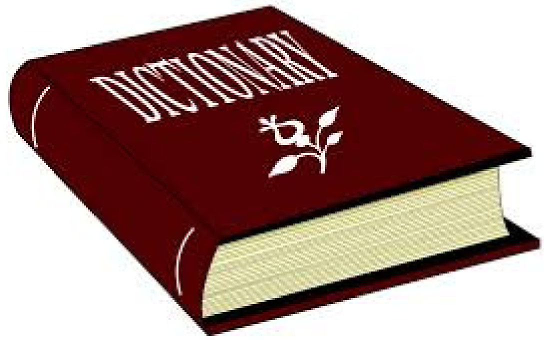
We're many things to our clients, all of which are extremely valuable. However, a soothsayer isn't one of them.

JUST CALL IT WHATEVER YOU WANT….

I get a kick out of some of the terms that the wirehouses and insurance/annuity firms come up with to promote their products. Here are some of the ones that can be most confusing to investors:

Fee-Based Advisor: Used primarily by non-RIAs (Registered Investment Advisors) who are trying to look like one. "Fee-Based" usually means a portion of the broker's compensation is based on fees, but the investor usually doesn't pay those fees; the broker receives a fee from a fund or some other company. "Fee" in this case is just another clever term for "Commission". They're still not fiduciaries.

Fixed-Index Annuity: I came across this one only recently. It's the new label for what used to be called an "Equity-Indexed Annuity" (EIA). EIAs were to provide annual income based on a stated floor (normally around 2%), and then a return tied (sometimes nebulously so) to some kind of index. As investors (and the financial press) came to understand that the caps, fees, limits, indexing-methods, and a whole raft of other provisions in the annuity contract made them of dubious value, producers started marketing the same product as a "Fixed-Index Annuity" and trumpeting the base guaranteed rate with the opportunity for some kind of equity participation. That may sound like a great deal to inexperienced investors. It isn't.



High-Yield Funds: This phrase has been around for a while, and is even used by that bastion of investor-friendliness, Vanguard Funds. High-Yield investments pay a higher interest rate primarily because the underlying bonds in the portfolio are very low value. The current values have dropped enough that the interest (assuming it is still being paid) is above-the normal market rate for high-quality bonds. Hence, "High-Yield". Sounds a lot better than "Junk Bonds", which is what these investments used to be called (and really are). While these do pay high interest rates, most investors have no idea of the huge additional risk they are taking. These funds can be decimated during an economic crunch. For example, during 2007, the average High Yield fund dropped about 30%-- less than stocks, but not what most investors expect from a bond fund. These should only be used cautiously.

Emerging Markets: Used to describe investment markets in countries that have yet to emerge into full-blown market-based economies. One of the interesting things about these countries is that they never seem to emerge, making "emerging" somewhat of a misnomer. Better descriptions for most of these might be "Unemerged Market Funds" and "Third-World Funds", both of which aren't very attractive titles. (My desire to avoid visiting or investing in countries that have guards with very visible automatic weapons at airports--often to keep people in—has kept me out of most of these funds.) While there is a place in a portfolio for these holdings, they are riskier than they sound.

> Don't let anyone tell you Greece is sticking up for its "dignity" by fighting "austerity." The current Greek government is sticking up for socialism by fighting reality.
>
> *-Brian S. Wesbury (1958-) American economist and financial writer*