



Review of 2014

US large cap stocks as measured by the S&P 500 index increased 13.69% in 2014. International stocks as measured by the MSCI EAFE International Index dropped 4.90% and Emerging Market stocks as measured by the MSCI Emerging Markets index fell 2.19%. US REITs were the top performing asset class with returns of 30.43%, as measured by the FTSE NAREIT US Index; and commodities were the worst performing asset class with a loss of 17.01% as measured by the Bloomberg Commodity Index. Hedge funds struggled as well. The HFRI Equity Hedge Index, which tracks the performance of hedge funds investing in stocks, posted returns of 2.3% in 2014, its worst relative performance since 2011.

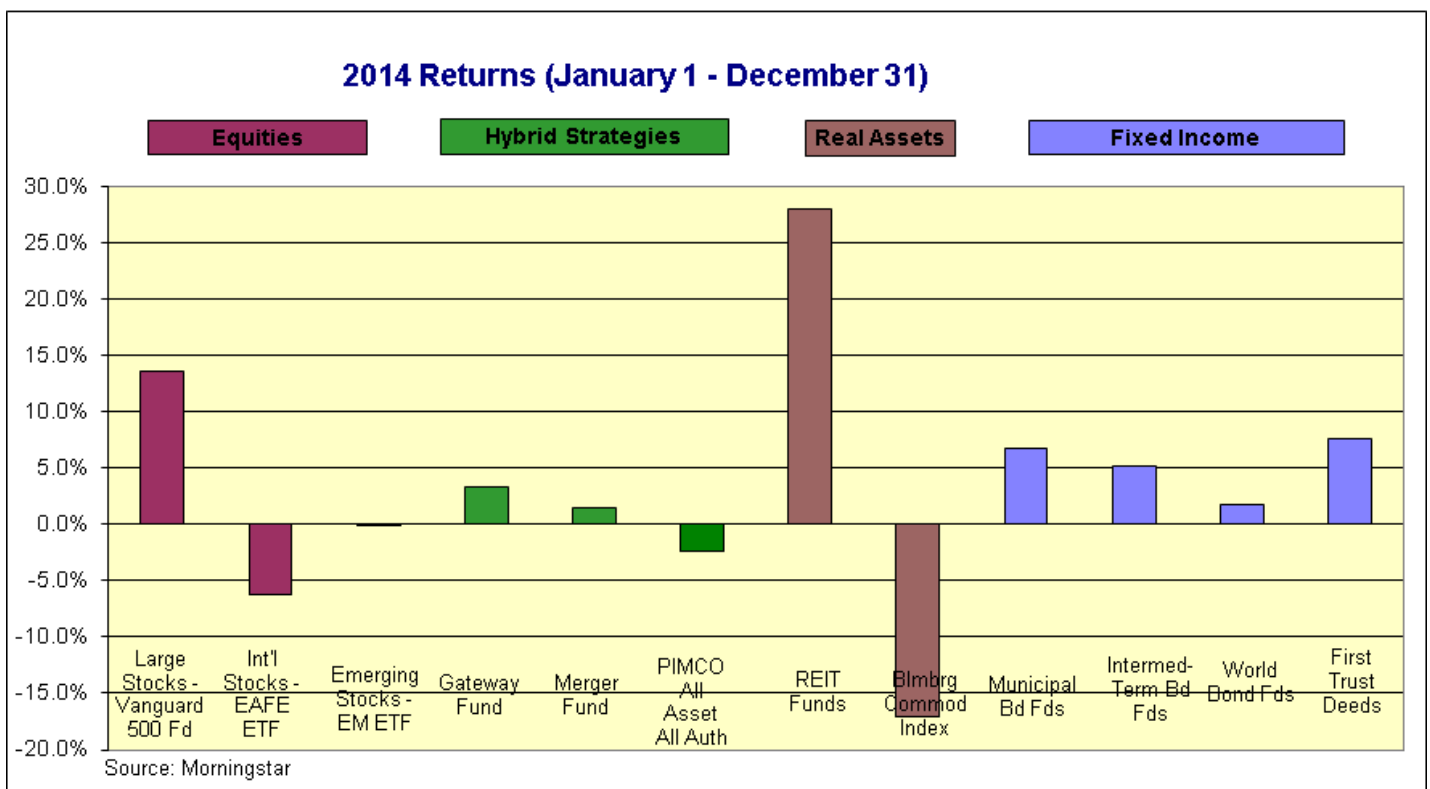
One of the biggest surprises in 2014 was interest rates falling rather than rising as most people had predicted. The 10 year treasury bond began the year at 3.04% and ended the year at 2.17%. This drop in interest rates propelled the Barclays US Aggregate Bond Index to a 5.97% return. If interest rates eventually do rise as most people expect them to, this 2014 increase in bond prices will reverse itself and bond prices will fall. Short term treasury bills and money market accounts continued to pay virtually 0%

Executive Summary

- US Stocks & US REITs were the top performing asset classes in 2014.
- Globally diversified multi-asset class portfolio returns were disappointing in 2014 relative to US Stocks.
- Asset class outperformance trends normally reverse themselves over time.
- Selling out of an asset class due to a couple years of underperformance is unwise.
- The temptation to sell commodity positions after such poor performance should be resisted.
- Rebalancing a diversified portfolio on a periodic basis is often the most prudent strategy.
- Stock and bond returns could be lower than the historical averages over the next 7 – 10 years.
- We expect the First Trust Deed investment we use will continue providing solid, predictable returns.

interest in 2014. Generally, US bonds outperformed unhedged international bonds partly due to the strengthening of the US dollar.

When US large cap stocks (our home market) outperform international and emerging markets by such a wide



Best Performing Asset Class Highlighted in Yellow

Annual Returns*	1998	1999	2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
Large US Stock	28.7%	20.4%	-9.7%	-11.8%	-21.5%	28.2%	10.7%	4.9%	15.8%	5.1%	-36.7%	26.3%	15.0%	1.9%	16.0%	32.3%	13.5%
Mid US Stock	16.9%	15.3%	17.4%	-0.9%	-14.4%	35.1%	15.8%	12.5%	10.0%	7.1%	-36.3%	37.5%	26.3%	-2.2%	17.8%	33.1%	9.4%
Small Value US Stock	4.8%	3.3%	21.9%	13.7%	-14.2%	37.2%	23.6%	6.3%	19.2%	-6.9%	-32.3%	31.0%	25.1%	-4.2%	19.0%	36.5%	10.6%
Non-US Developed	19.6%	26.5%	-14.5%	-21.7%	-15.4%	39.7%	18.9%	13.3%	25.9%	9.9%	-41.0%	26.8%	8.2%	-12.3%	18.8%	21.4%	-6.2%
Non-US Emerging	-18.0%	61.8%	-27.4%	-2.7%	-7.3%	57.9%	26.3%	32.2%	29.2%	37.3%	-52.3%	75.3%	19.4%	-18.7%	19.2%	-4.9%	-0.1%
Real Estate	-16.2%	-4.0%	26.5%	12.5%	3.8%	35.8%	30.9%	11.6%	33.5%	-16.4%	-37.0%	30.1%	28.4%	8.6%	17.6%	2.3%	30.4%
Natural Resources	-14.6%	26.6%	15.2%	-16.0%	-14.4%	34.7%	24.7%	35.6%	16.2%	33.7%	-42.9%	37.1%	23.3%	-7.8%	2.0%	15.5%	-10.2%
Commodities	-28.0%	42.8%	24.4%	-8.7%	24.6%	25.8%	37.1%	30.9%	16.0%	31.5%	-31.7%	16.2%	11.9%	-2.6%	3.5%	-7.6%	-28.1%
US Bonds	8.6%	-0.9%	11.5%	8.3%	10.1%	4.0%	4.2%	2.3%	4.2%	6.8%	8.5%	3.7%	6.3%	7.9%	3.9%	-2.1%	1.4%
TIPS	3.7%	2.2%	13.0%	7.7%	16.3%	8.2%	8.3%	2.6%	0.2%	11.9%	-0.5%	8.9%	6.1%	13.3%	6.4%	-8.5%	-1.4%
Non-US Bonds	17.7%	-6.8%	-3.3%	-4.4%	21.3%	17.6%	11.5%	-9.2%	6.8%	10.4%	4.2%	5.4%	3.8%	4.0%	5.8%	-3.6%	-2.5%
Cash	5.3%	5.0%	6.3%	4.2%	1.7%	0.9%	1.1%	3.0%	4.9%	5.1%	2.8%	0.5%	0.1%	0.0%	0.0%	0.0%	0.0%

margin, it is easy to be disappointed by the returns of a more diversified portfolio that includes international and emerging market stocks. There is a temptation to sell the international and emerging market positions and invest more money into the recently higher performing US markets. This is rarely a good strategy to follow because these periods of outperformance and underperformance tend to reverse themselves. We call this the worst to first phenomena in investing.

See the table above which shows calendar year returns for various asset classes from 1998 to 2014. It's interesting to note how certain asset classes outperform for several years and then the trend reverses itself. An extreme example of this was the time period of 1/1/00 to 3/31/09. During this time the Vanguard Emerging Markets stock fund gained 45.56%, the Vanguard S&P 500 fund lost 36.14% and the Vanguard Total Bond Market fund gained 71.55%. Then from 4/1/09 to 11/31/14 the Vanguard Emerging Market stock fund increased 103.65, the Vanguard S&P 500 fund gained 192.07% and the Vanguard Total Bond Market fund gained 30.09%.

It is impossible to predict which area will be the next top performer. We believe that staying with a diversified portfolio and rebalancing on an ongoing basis helps to avoid the temptation to chase the most recent top performers.

Diversification Works But it Can Be Frustrating

The performance of a globally diversified multi-asset class portfolio will obviously underperform some of the component asset classes within it. This is because the overall performance is roughly equal to the weighted average performance of the underlying asset classes.

Such a portfolio is most dissatisfying when the top performing asset classes for the year are based in one's home country. Typically investors hear more news about how their home US markets are doing. If things are going well, investors tend to assume things are going well in other asset classes and markets – and that may not be the case as we have seen in 2014.

On the other hand, the most satisfying times for a globally diversified multi-asset class portfolio are when the markets in one's home country are performing poorly, and investors hear frequently how bad things are going. When

they find their overall performance is better, they are pleasantly surprised. This familiarity with home country performance can easily turn into a “home bias” which leads to investing errors.

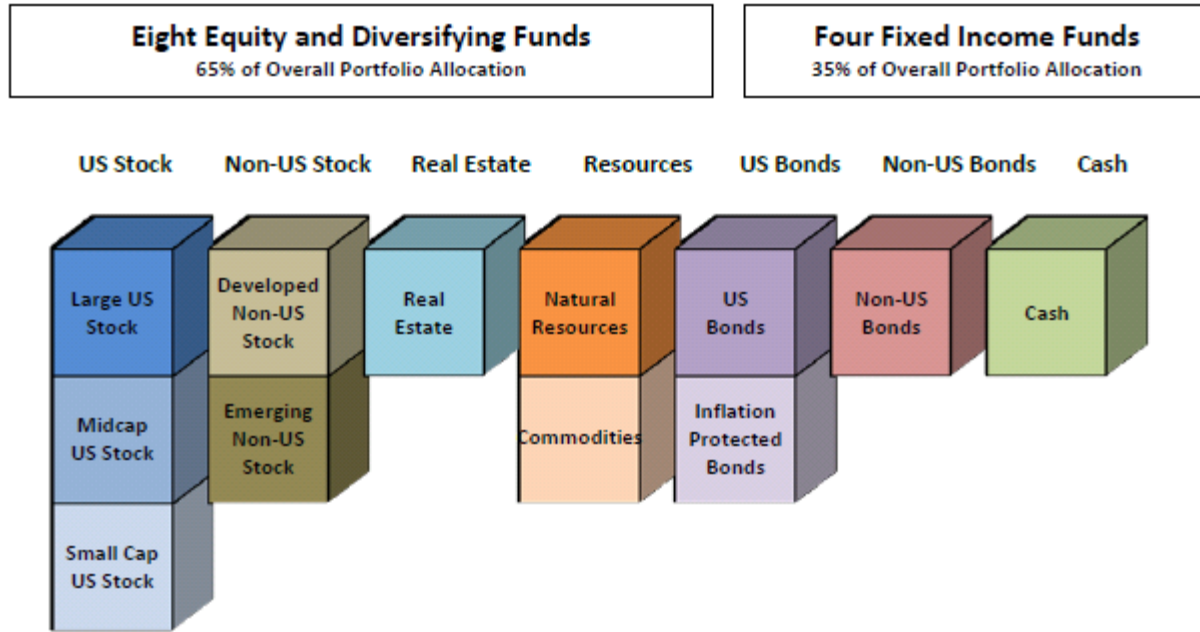
This same issue holds true for less risky portfolios which hold more conservative fixed income and hybrid investments that have more downside protection and less upside potential. When portfolios are designed to take less risk, they are most dissatisfying to investors when stock markets rise and they are most satisfying to investors when stock markets fall.

When you have lost money in a correction and are very fearful of further losses, you need to work hard to resist selling poorly performing asset classes to stop the pain of loss. Conversely, if you are feeling strong regret due to underperforming a rapidly rising asset class (such as US stocks), you need to work hard to resist selling your underperforming asset classes (such as international stocks and commodities) and investing this money into the high performing asset classes.

Returns for a Globally Diversified Portfolio in 2014

Returns for globally diversified multi-asset class portfolios were low in 2014. We periodically refer to GMO (a Boston based investment manager) for their asset allocation insights and their 7-year return forecasts. GMO also manages two globally diversified asset allocation funds. Although GMO has a solid performance track record, in 2014, their Benchmark Free Allocation Fund (GBMFX) had a return of 1.21% and their Global Asset Allocation Fund (GBMBX) had a return of 1.31%.

Another globally diversified multi-asset portfolio that we have tracked for years is the 7Twelve Portfolio created by Craig Israelsen, a university finance professor who taught at BYU and now teaches at Utah Valley University. We use this portfolio as an example because of the readily available return data Israelsen provides on it. As you can see from the graph on page 3, the portfolio consists of 7 Broad Asset Categories and 12 different funds with 8.33% of the portfolio invested into each of the 12 funds. The result is a balanced portfolio with roughly 65% invested in eight equity funds and 35% invested in four fixed income



funds.

The 2014 return for this portfolio was 1.38% and reflects its allocation to international, emerging markets, natural resources and commodities. In spite of this portfolio's poor relative performance to the S&P 500, in 2014, it's interesting to note that it has outperformed the S&P 500 in ten of the last fifteen 3-Year rolling periods.

The five 3-Year periods where the S&P 500 outperformed the 7Twelve portfolio ended in years 2000, 2011, 2012, 2013 and 2014. The year 2000 marked the end of the massive tech stock boom of the late 1990's, and years 2011 - 2014 followed a strong bull market in US stocks after the 2008 financial crisis. It is unlikely that this recent stretch of S&P 500 outperformance will continue indefinitely.

The consensus view currently is that the outlook for US stock returns is good. Oftentimes, when everybody agrees that the outlook is good for a particular market, such optimism is already priced into these markets and they are more expensive. The reverse is also often true. Markets that have performed poorly and are unloved are often priced cheaper, and may end up providing higher future returns once a trend begins to reverse itself.

Renowned mutual fund manager John Templeton expressed this best in the following quote, "People are always asking me where the outlook is good, but that's the wrong question. The right question is: Where is the outlook most miserable? The obvious application of this concept in practice is to avoid following the crowd."

If an investor owned this 7Twelve portfolio, they would be following the crowd if they sold the underperforming assets and bought more of the top performing assets. On the other hand if they simply rebalanced the portfolio back to the initial equal weight of 8.33% in each of the twelve investments, this would cause them to trim the top performing

asset classes while prices are higher (sell high) and add to the lower performing assets classes when prices are lower (buy low) which is the opposite of following the crowd.

As stated earlier, we use this 7Twelve portfolio just for illustrative purposes. Although our own clients' portfolios contain many of the same asset classes, they differ markedly. For example, we do not have a dedicated allocation to natural resources and we have a lower allocation to commodities, and emerging markets. We also typically have a lower allocation to cash, inflation protected bonds, regular bonds and equities. In place of these assets we may use a First Trust Deed investment and an allocation to reduced risk hybrid investments which provide more downside protection.

Longer Term Valuations

As you can see from the GMO 7-Year return forecast graph at the top of page 4, international and emerging market stocks are projected to have higher returns over the next 7 year period than US stocks. Also note that in general, longer term returns for most asset classes are projected to be lower than their historical averages.

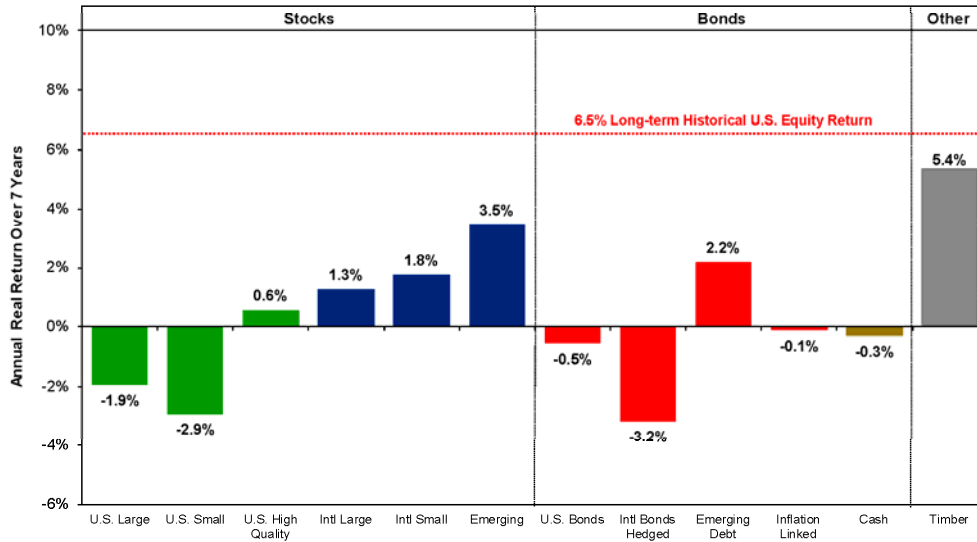
Compare this current GMO forecast to the 10/31/08 forecast just below it. In October of 2008, markets had fallen significantly and forecasted returns were much higher. When markets fall, expected future returns rise. When markets rise, expected future returns fall.

The Shiller CAPE on page 5 also suggests that US Stocks are currently in the more expensive range. The current CAPE is greater than 90% of measurements since 1926.

Critics of the Shiller CAPE ratio such as Jeremy Siegel say that the Shiller PE methodology overstates the PE of stocks currently because the S&P 500 earnings data over the last 15 - 20 years, particularly in recessions, have been much different than prior to that, primarily due to the change in accounting conventions and the forced write-downs of

GMO 7-Year Asset Class Real Return Forecasts*

As of November 30, 2014



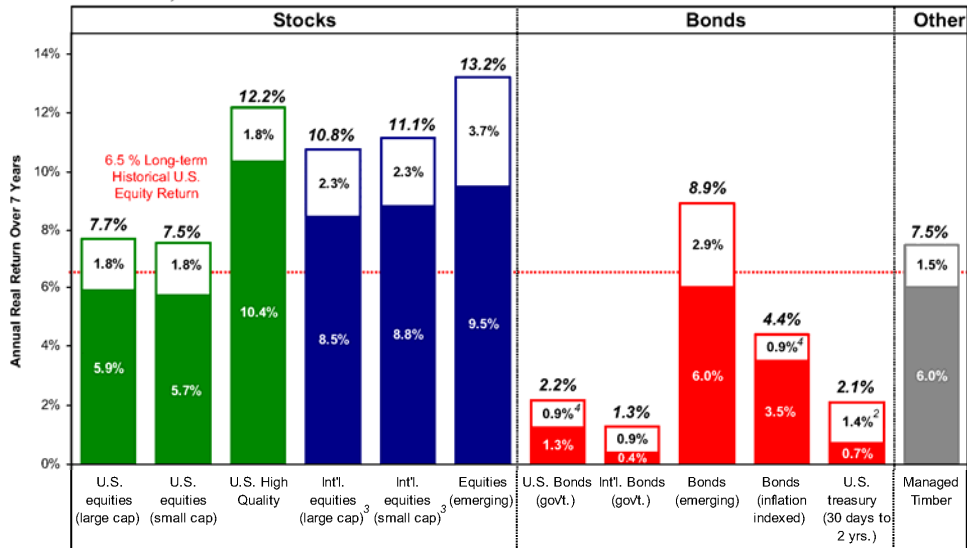
*The chart represents real return forecasts for several asset classes and not for any GMO fund or strategy. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Forward-looking statements speak only as of the date they are made, and GMO assumes no duty to and does not undertake to update forward-looking statements. Forward-looking statements are subject to numerous assumptions, risks, and uncertainties, which change over time. Actual results may differ materially from those anticipated in forward-looking statements. U.S. inflation is assumed to mean revert to long-term inflation of 2.2% over 15 years. Source: GMO

GMO
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GMO 7-Year Asset Class Return Forecasts*

As of October 31, 2008



Estimated Range of 7-Year Annualized Returns

±6.5 ±7.0 ±6.0 ±6.5 ±7.0 ±10.5 ±4.0 ±4.0 ±8.5 ±1.5 ±1.5 ±5.5

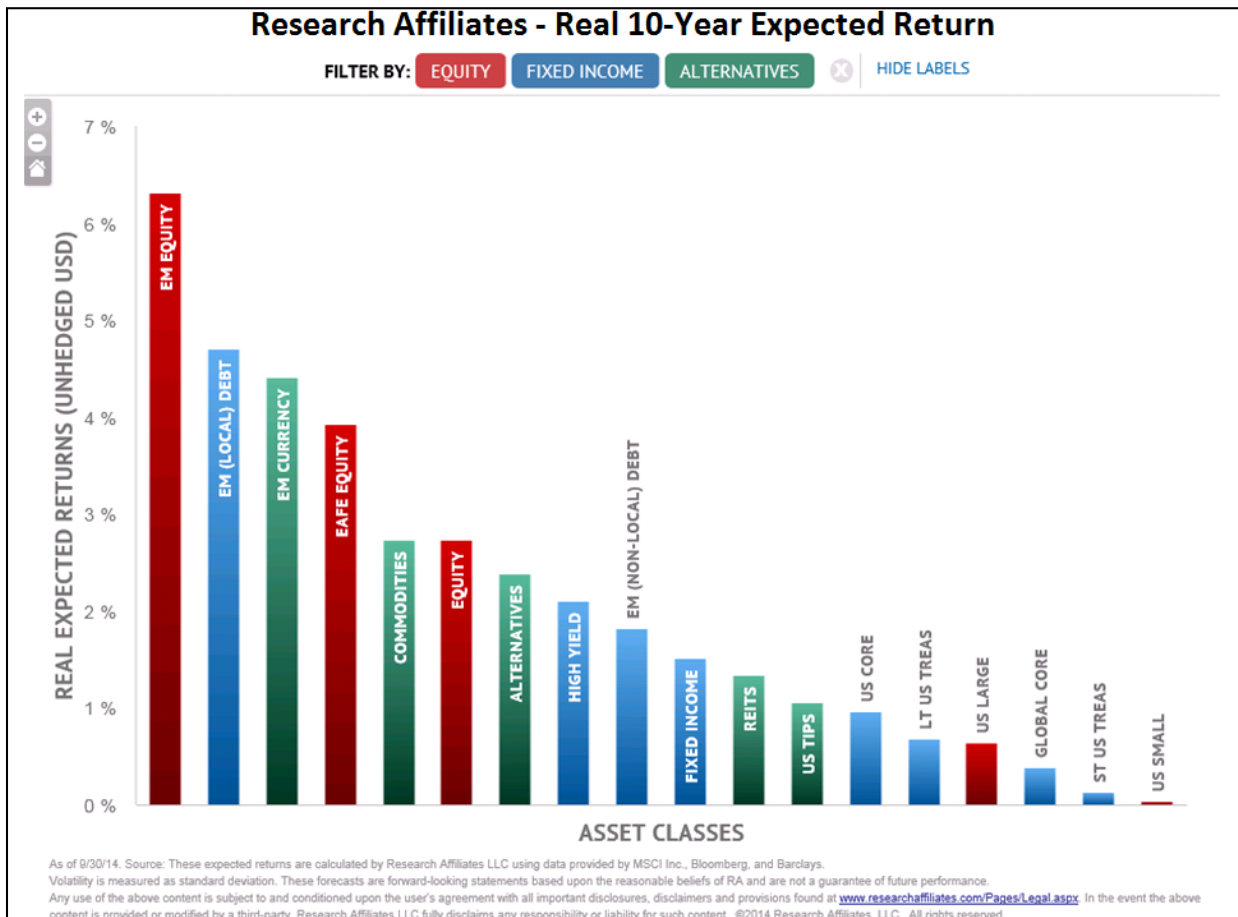
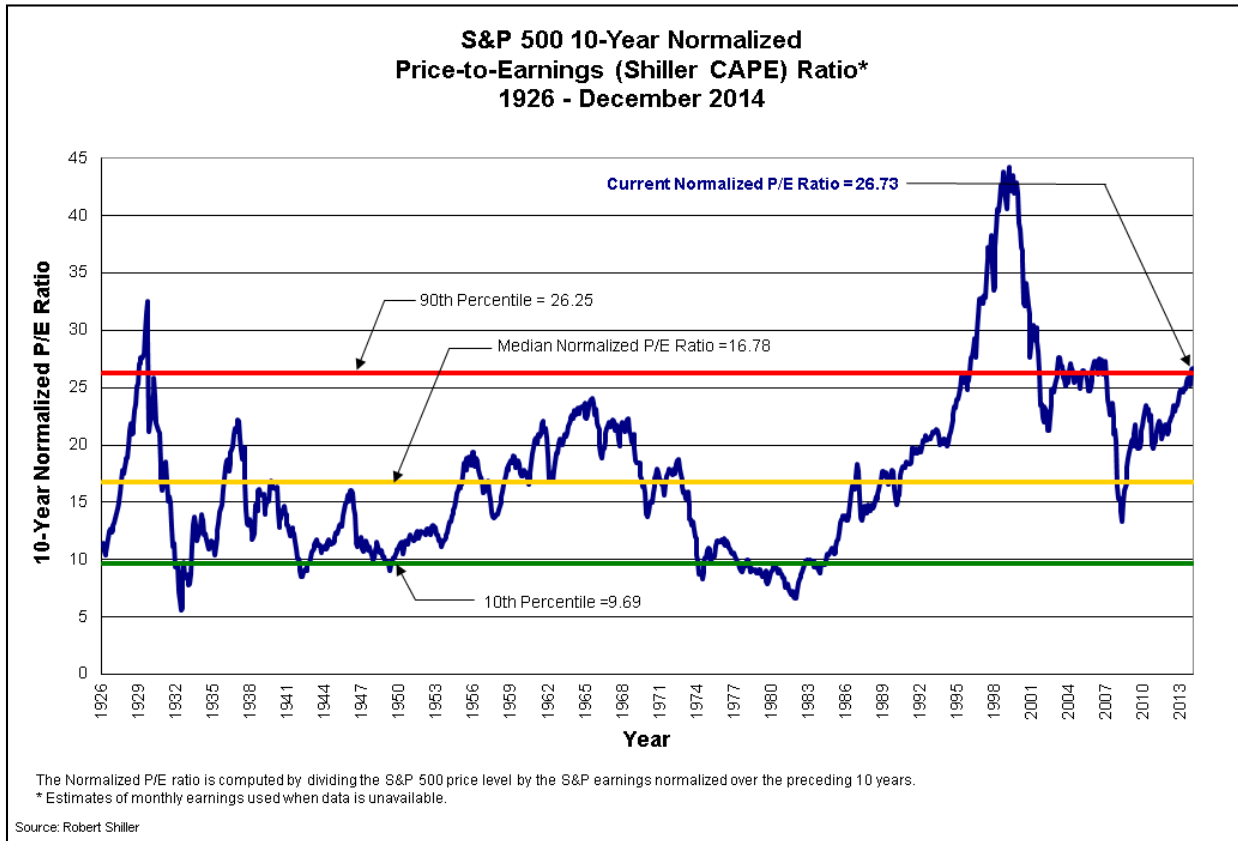
*The chart represents real return forecasts¹ for several asset classes and an estimate of value expected to be added from active management. These forecasts are forward-looking statements based upon the reasonable beliefs of GMO and are not a guarantee of future performance. Actual results may differ materially from the forecasts above.

GMO
Investment

¹ Long-term inflation assumption: 2.5% per year.
² Alpha transported from management of global equities.

³ Return forecasts for international equities are ex-Japan.
⁴ Alpha transported from management of global bonds.

Source: GMO 1



assets. If Siegel is right, the market may not be as overvalued as the Shiller CAPE ratio suggests.

The Research Affiliates valuation graph at the bottom of page 5 shows similar results and forecasts as the GMO 7-Year Forecasts (www.researchaffiliates.com/asset-allocation).

It is critical to understand that valuation research tells us nothing about what will happen in the short term. But it can shed light on whether the markets are fairly valued, expensive, or on the cheaper side relative to their historical averages. The most important take away from this research is that investors should prepare for the possibility of lower than historical average returns for the foreseeable future.

In a recent research piece, Vanguard Investments also arrived at the conclusion that investors should expect lower returns over the next decade - due to the current market environment of extremely low interest rates and relatively high US stock prices.

Commodities

In the year 2000, when the tech bubble began to burst and the S&P 500 fell almost 10%, commodity returns were up over 20%. Once again in 2002 when the S&P 500 fell over 20%, commodities gained over 20%. These types of non-correlated returns to equities are why many sophisticated investors keep a small allocation to commodities in their portfolios. We typically allocate about 5% of our clients' portfolios to commodities. Commodities will not always zig when stocks zag as 2008 proved - they fell over 30% along with almost every other equity-like asset class.

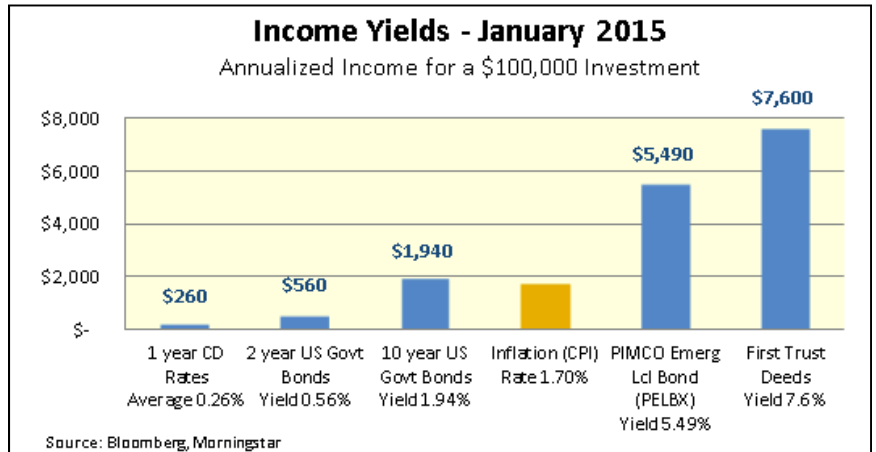
Commodities dropped significantly in 2014 with oil prices leading the way. The knee jerk reaction for many is to flee commodities even though they are cheaper than they have been in many years. We advise against this for obvious reasons.

Hybrid Investments

Hybrid investment returns can be disappointing in bull markets. Their relative performance should prove much better during times of market weakness. Due to the lower expected returns for equities (stocks) as well as the risk of lower bond prices if interest rates rise, we still feel it is prudent to maintain an allocation to Hybrid investments. They should provide greater downside protection relative to stocks; also, they may perform better than bonds in a rising interest rate environment.

Bonds & First Trust Deeds

As mentioned earlier, declining interest rates were one of the year's big surprises, and this boosted the Barclays Aggregate Bond index to a 5.97% return for 2014. Longer term bonds and muni bonds had even higher returns. This



interest rate decline could continue, but at some point interest rates will likely rise and cause bond prices to fall. Because of this risk, we prefer to have a portion of our clients' fixed income allocations in a First Trust Deed investment when applicable. This investment continues to perform well and paid out just over 7.5% in 2014.

Local currency emerging market bonds were hurt by the rising dollar as well as other challenges in some emerging markets. Their prices have fallen in dollar terms and now they have yields significantly higher than US bonds. We will continue to maintain a small fixed income position in emerging markets for most clients.

Summary

US stocks and US REITs were the top performing asset classes in 2014. Globally diversified multi-asset portfolios had disappointing returns in comparison, but this is not unusual historically speaking. Investors should resist the temptation to chase the best performing assets since a trend of yearly outperformance for an asset class will typically reverse itself.

Past performance is no guarantee of future results. All content in this newsletter is intended as general information, not specific advice. Performance data listed is for illustrative purposes only. Portfolios are personalized and often consider many variables, including investment objectives, age, time horizon, risk tolerance, and tax variables. Information contained herein has been obtained from sources believed reliable, but not guaranteed.

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