Financial Alternatives Inc

integrated wealth management

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Year to Date 2014

As you can see from the graph below, investment returns were positive across the board for all asset classes. US, developed international, and emerging international stocks all showed meaningful and relatively similar gains. This is unlike last year when US stocks dramatically outperformed international stocks.

Bonds may have provided the biggest surprise so far in 2014 by posting solid gains as bond yields on the 10 year treasury fell from 3.04% to 2.53%. Longer-term bonds, lower rated bonds and emerging market bonds posted even greater returns.

REITs and commodities which performed poorly in 2013 have done well so far in 2014, providing us with yet another example of asset classes that rebounded strongly after a year or more of underperformance.

The first trust deed investment continues to provide clients monthly distributions at an annualized rate of roughly 7.5%.

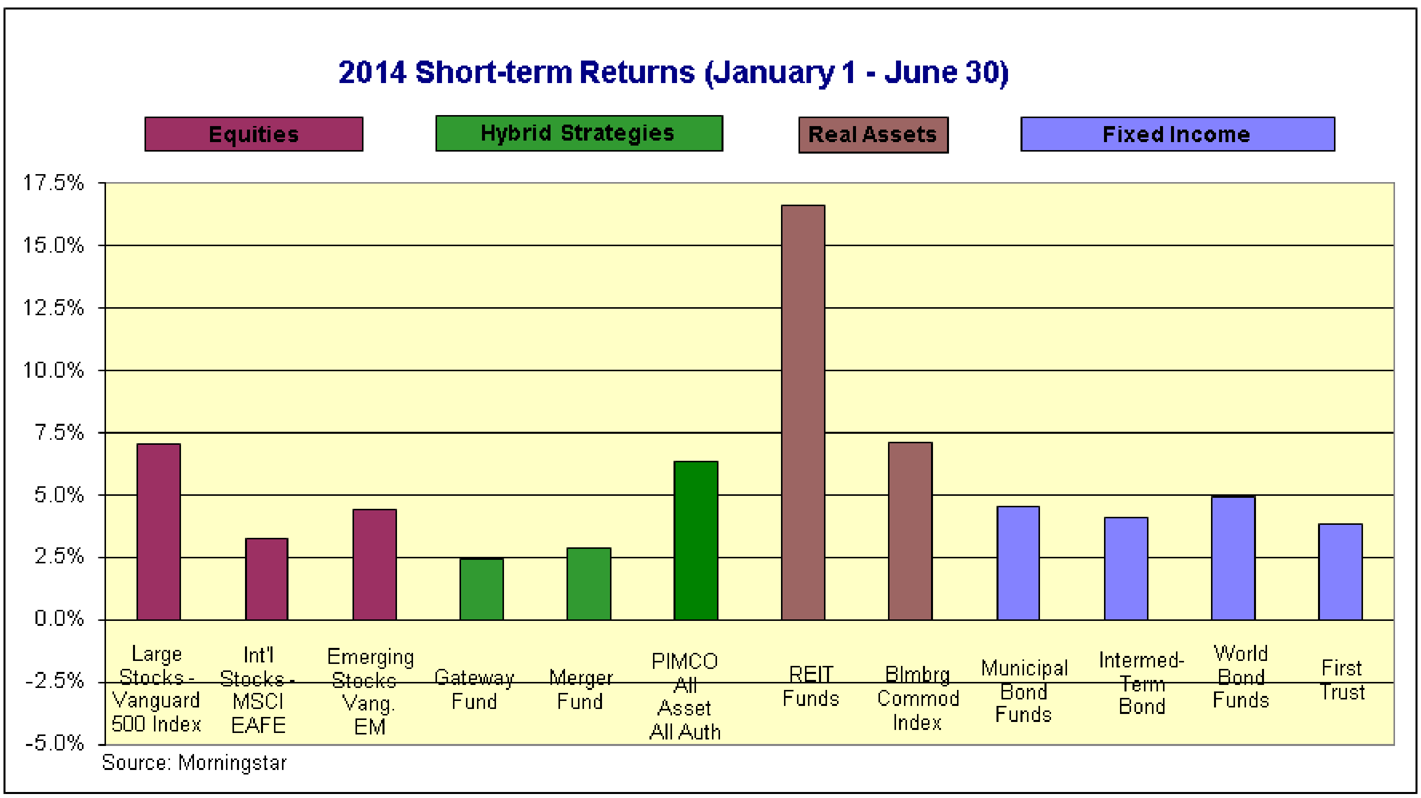
Executive Summary

- Investment returns were positive across the board for all major asset classes in the first half of 2014.
- Don't expect returns to be this consistent going forward.
- The difficulty of successful investing is often times more emotional than intellectual.
- Learning to expect market corrections will help you become a better investor.
- "Far more money has been lost by investors trying to anticipate corrections than has been lost in all corrections combined." – Peter Lynch
- Disciplined rebalancing can keep you from selling stocks in bear markets and overweighting stocks in bull markets.

A Wonderful Six Months

If returns were this good and this consistent every six months, investing would quickly become an easy, very relaxed and pleasant experience for everyone. But as much as we would like this to become the case, the chances of this happening are remote indeed.

Investing can be a challenge, but in many cases the difficulty is more emotional than intellectual. Once the intellectually hard work of defining your objectives and risk tolerance, and designing an appropriate portfolio has



been completed, the more difficult emotional work of sticking with your plan through the good times and the bad begins.

Becoming more educated about market volatility and preparing for feelings of fear, greed, and regret will help keep you on track.

Expect Market Corrections

In a recent Wall Street Journal article Jason Zweig wrote, "As of this Friday (6/13/14) the S&P 500 has gone 980 days without a 10% decline the fifth-longest such stretch on record."

His statement implies that a 10% correction may be right around the corner. We have no argument with that. But we would also add that a 10% correction is always right around the corner. In fact from 1900 to 2010 according to the Capital Research and Management Company 10% corrections have occurred on average once per year.

Famed mutual fund manager Peter Lynch notably said, "far more money has been lost by investors trying to anticipate corrections than has been lost in all corrections combined."

Should You Be Concerned?

No, we don't think you should worry. Make no mistake about it; a 10% correction is coming. In fact many, many more 10% corrections are coming in our investment lifetimes. Because of this fact, it is best to become more educated about this reality and the possible effect to your portfolio, and decide beforehand not to sell any of your stock holdings during such a correction.

There will always be well-reasoned arguments about why the market has topped out (or bottomed out for that matter). However, believing in the media pundits who are constantly espousing short-term forecasts and predictions causes investors to be more emotional about their investment decisions than they otherwise might be. This rarely leads to sound choices.

Warren Buffet said it best in his 1992 Berkshire Hathaway Letter to Shareholders, "We've long felt that the only value of stock forecasters is to make fortune tellers look good. Even now, Charlie (Munger) and I continue to believe that short-term market forecasts are poison and should be kept locked up in a safe place, away from children and also from grown-ups who behave in the market like children."

The Benefits of Disciplined Rebalancing

When you try to time the stock market to avoid losses in your portfolio, you will likely end up with inferior returns over the long-term. You may get lucky for a while, but most people will fail with this strategy.

Having a well diversified portfolio and regularly moving back to your target asset allocation can help you avoid making emotionally charged mistakes. Instead of trying to anticipate the market implications of news, you can use your own needs and portfolio as a trigger for when to rebalance. If your portfolio has drifted away from your target allocation, it may be time to sell the overweight positions and buy the underweight ones.

This disciplined rebalancing will keep you from selling stocks at the low point of a bear market and it will also keep you from overweighting stocks during the peak of a bull market. Rebalancing will not keep your portfolio from experiencing periodic losses in years of poor returns. Such periodic losses are unavoidable in portfolios that contain a significant allocation to stocks or other volatile asset classes.

It is perfectly fine to take an interest in global events and other news, but base your investment strategy on a long-term disciplined approach. This will help immunize you from both the market pundits with their forecasts and the inevitable market corrections and volatility to come.

Summary

Returns have been strong for the first half of 2014. However, don't expect the rest of the year to be as smooth as the first half. Be prepared for stock market corrections at any time - even though we have not experienced a significant correction for quite some time.

And most importantly, find a way to control your emotions and rebalance your portfolio on a regular basis.

Thank You for Your Referrals

Once again we want to thank you for your referrals. Our business was built through word of mouth and we sincerely appreciate it when you mention us to your friends and relatives.

Most of you have been clients for many years, and we are grateful for the trust you have put in us over the years. Don't hesitate to call if you have any questions or anything on your mind that you would like to discuss. We hope you are enjoying your summer.

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