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Thoughts and Comments

Summer 2013

I have decided to retire … from bicycle tours. I will keep riding for exercise and enjoyment, but I think I have done my last tour. I made the decision last June biking over a mountain pass east of Seattle in a driving cold rain after spending the previous night sleeping in a rain pelted tent. It was a beautiful climb to the top, but somewhere along the way, between the rain coming down, water on the road running underneath my tires, and the continual cold, I decided I had done everything I needed to do on a bicycle.

So, I decided to take up golf. The last time I golfed was in high school, so essentially I am starting from scratch. I have taken a few lessons and have played a total of ten times so far and my game is a game of wonder. Every time I hit the ball, I wonder where it is going, or in some cases if I will even hit it. But, I enjoy it and since Kim picked up golf a few years ago, it's something we can do together. This brings me to the point of my article – keeping score. A purist counts every stroke including penalty shots and there are no mulligans. However, even in the short time I have played, I have seen a range of personal interpretations, generally around the concept "I am here to have fun and not going to worry about every detail." My favorite method of keeping score so far is a friend who only keeps track of lost and found golf balls. At the end of the round, if he has more golf balls than he started with, it has been a good day.

With investing or portfolio management, we also keep score, but in a different fashion. We use benchmarks and the benchmarks change depending on the objectives and holdings of the investment. We have different benchmarks for our different allocation models. For our core model, the RFPS Global Spectrum, the benchmark is 50% All Country World Index (ACWI) and 50% Barclays Capital US Aggregate Bond Index. The All Country World Index represents 85% of the global stock market. The Barclays Capital US Aggregate Bond Index is an unmanaged index of investment-grade, fixed-rate debt issues with maturities of at least one year. (Note: It is not possible to invest directly in an index.)

We are occasionally asked why we do not use the S&P Index as a benchmark and there are a couple reasons:

- First and foremost, we are not trying to match the stock market. In our Global Spectrum Model we are seeking to obtain a real return (a return in excess of inflation) with reduced market risk or volatility.
- Second, we are global investors and the S&P is limited to US stocks. The ACWI includes stocks represented in the S&P Index in addition to global stocks.

Benchmarks are an important means for portfolio managers to measure their performance against a specific standard over an extended period of time. It is also helpful for investors to assess if the portfolio manager is reaching the portfolio's objectives, again over an extended period of time. Given that, we continue to believe diversity and ongoing asset allocation are the keys to obtaining a competitive return while managing risk. In evaluating a specific asset class, we look for long-term value with managed risk. Now or in the future, if you have questions on any of our models, be sure to contact Ryan, Courtney, or me.

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An Update from Ryan

Backdoor Roth IRA

For those people who do not qualify for a deductible or Roth IRA due to income limitations, there may be a way to backdoor into a Roth IRA. In the most simple example, an individual can still make a non-deductible contribution to an IRA and then convert this IRA to a Roth IRA at no tax cost. Poof … you have now snuck money into a Roth IRA when you are not directly eligible for one.

But, there is a catch. This strategy will not work well if you have a significant amount of money in Traditional IRAs at the time of conversion. The IRS requires that upon conversion of the non-deductible IRA dollars, the amount that qualifies as a tax-free conversion is only the amount of the non-deductible IRA that is proportional to the total amount you have in all IRAs.

Therefore, a backdoor Roth IRA conversion is a great strategy, but only if the value of your Traditional IRAs is less than or equal to the value of your nondeductible IRA contributions. Please let us know if you feel this strategy may be a fit for you.

Long-Term Care Insurance for the Young

We suggest all clients look into obtaining long-term care insurance. Up until a few years ago we generally suggested clients consider this coverage when they are between the ages of 50 – 60. Since 2009 North Dakota offers a tax credit of up to $250 per person for qualifying policies. This credit has caused us to recommend much younger clients consider this type of insurance.

Anyone under the age of 35 living in ND should look into this coverage. It is possible someone this age or younger and in good health could qualify for coverage that would be almost or completely subsidized by the $250 credit. We have one 32-year-old couple who obtained this coverage and their combined premium was less than the credit, making this coverage 'free' for them. Minnesota also has a credit for this type of insurance, but it is capped at $100 per person.

Please let us know if you want more information on this topic. We would be happy to put you in touch with a long-term care insurance specialist.

Retirement Planning Update from Courtney

Recently, the National Institute on Retirement Security (NIRS) published research titled "The Retirement Savings Crisis: Is It Worse than We Think?" The study used data from the Federal Reserve's Survey of Consumer Finances and projected the US retirement savings deficit to be between $6.8 and $14.0 trillion.[1] In addition, they found that for working-age households, age 25 to 64, the median retirement account balance is $3,000.[2] For those households near retirement, the median retirement account balance is $12,000.[3] Much of the research about retirement account balances uses a sample of only households with retirement accounts. However, 45 percent of working-age households do not have retirement account assets; therefore, the median retirement account balance is much lower than previous research has led people to believe because many people are without any retirement assets.[4] As of 2011, 48 percent of private sector employees did not have access to a workplace retirement plan.[5] This research shows that for many Americans, their retirement situation is bleak and the burden rests squarely on them to provide for themselves now and in the future.

The above could be used to launch someone into a malaise that begins with "I'll never be able to retire." However, I think this research should be used to encourage us to think of ways to provide for our futures

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[1] Nari Rhee, "The Retirement Savings Crisis: Is It Worse than We Think?" National Institute on Retirement Security, June 2013.

[2] Ibid.

[3] Ibid

[4] Ibid.

[5] Ibid.

even if the road is a bit rougher. For our clients who find themselves in a job where there is not an employer plan, let us know so we can discuss other retirement savings options including Traditional IRAs, Roth IRAs, and after tax investment accounts. Conversely, if you have an employer-based retirement account but need help understanding it and selecting investments, please let us know so we can review the account with you.

As we have mentioned in previous Thoughts and Comments, beginning an investment strategy at a young age can be an important part of building a retirement portfolio. We have been fortunate to work with clients who then send their children to us. Many of them have just started working or been in the workforce for a few years but have had limited access to employer based retirement plans. When we meet with them, we discuss their different savings options and start mapping out a budget to meet their immediate- and long-term goals. By starting young and providing them with a base of financial knowledge, our younger generations likely will be better prepared as they navigate the financial aspects of adulthood. In addition, when building a portfolio, the rate of saving often matters more than the rate of return. Focusing on saving can create good habits throughout adulthood.

Since employer-based retirement plans do have benefits such as higher contribution limits for 401(k) accounts, we offer options for small businesses that strive to be cost efficient. In addition to helping employees get started on planning for their retirement, the plans can be used as a job benefit when seeking new talent.

I started off this section with NIRS's research not to depress you but to acknowledge some of the difficulties we face. Given the last several years of economic volatility, we are learning that we must be strategic about how we save and prioritize around planning for our future as well as providing for our current needs. For better or worse, we have to adapt to what is available to us and recognize that the burden ultimately rests on us to prepare for our retirement futures. Fortunately, we are here to work with you to build a plan that is tailored to meet your goals.

Investment Update from Morgan

Thus far, 2013 has proven to be a year of contrasts. Or maybe *contrast …* 2013 has proven to be a year of (one) contrast. Developed market securities (USA, Japan, & Europe) are performing quite well, while nearly everything else in the financial world is suffering in terms of performance. A few examples of the bifurcation of performance throughout the 1st half of 2013 (using ETFs as proxies for the asset class):

- SPDR S&P 500: 13.74%[6]
- iShares MSCI ACWI: 5.31% [7]
    - The MSCI ACWI (All Country World Index) is a proxy for the global stock market. (Note: You cannot invest directly in an index.)
- iShares MSCI Emerging Markets: -12.07%[8]
- iShares JPMorgan USD Emerging Market Bonds: -9.21%[9]
- iShares Core Total US Bond Market: -2.54%[10]
- iShares Barclays US 20+ Year Treasury Bond: -7.85%[11]
- iShares Gold Trust: -26.35%[12]
- Apple stock: -24.42%[13]

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[6] "SPDR S&P 500 (SPY) Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

[7] "iShares MSCI ACWI Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

[8] "iShares MSCI Emerging Markets (EEM) Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

[9] "iShares JPMorgan USD Emerg Markets Bond (EMB) Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

[10] "iShares Core Total US Bond Market ETF (AGG) Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

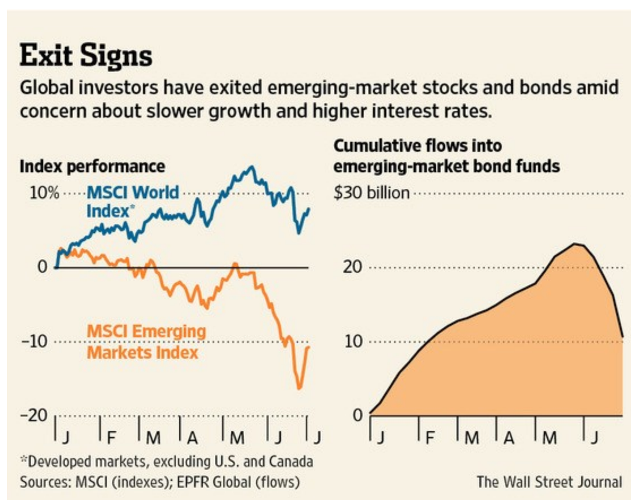
[11] "iShares Barclays 20+ Year Treas Bond (TLT) Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

[12] "iShares Gold Trust (IAU) Total Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

[13] "AAPL Apple Inc Stock Performance of Total and Trailing Returns," Morningstar, accessed July 4, 2013, http://performance.morningstar.com.

What is most interesting to us is that of the asset classes noted, US stocks have by far been the most hated. Fund managers, analysts, pundits, and journalists seem to have been in consensus that emerging market stocks and bonds, US bonds, Apple stock, and gold are the places to be while US stocks (ex-Apple) are to be avoided. However, performance year-to-date challenges that theory to its core.

In the Spring 2013 *Thoughts & Comments,* I wrote about investor fund flows and how they chase performance. In other words, investors usually chase the puck instead of skating to where it's going to be (to borrow a Gretzky-ism). As I noted, investors had been piling into emerging stocks and bonds, US bonds, and gold, while ignoring developed market stocks. Going forward, we expect this trend to reverse. In other words, as performance lags in these highly-touted asset classes, we believe investors (retail and institutional alike) will pull out their money in droves and hopefully find the US and Europe on a map in the meantime. The following chart from the July 2nd Wall Street Journal shows how this is already happening.



Source: Alex Frangos and Patrick McGroarty, "Emerging Markets Hit by Converging Forces," *The Wall Street Journal*, July 2, 2013.

The inherent problem with widely held asset classes is that at some point there is no one left to buy. Additionally, the supply-side seeks to catch up with demand. Over the past decade, steel companies have been working their nubbins to the bone trying to catch up with Chinese demand. However, just as all that capacity was coming online, China's economic growth slowed down a bit and steel companies were left with a lot of steel, a lot of debt, and a dearth of orders. The same thing could be said about real estate prior to the Great Recession. At some point, there were simply too many houses for the amount of buyers. Strangely enough, that simple recurring attribute of economic cycles is probably more to blame for the financial crisis than any one bank.

As we move into the second half of the year, we continue to favor developed market equities and alternative strategies over emerging markets and traditional bond funds. It is our view that economic data points to the fact that the US, European, and Japanese economies are stronger than many presume and we are invested as such.