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Thoughts and Comments

Winter 2013

As one year ends and another begins, I find myself thinking a lot about the changes I have witnessed since my time at college. This is most evident within the technological realm.

I saw my first computer in the early 1970s when I was a college student at Concordia College in Moorhead, MN. It was in a room that was bigger than my office, information was input via data cards, and it was basically a big adding machine. Events that happened after that were the recession and stock market decline of 1973-1974, Watergate, the end of the Vietnam War, the oil embargo, and the beginning of double digit inflation. It was a very difficult time with many challenges for individuals and the United States as a country.

I bought my first computer in the late 1980s. I bought that generation's version of a laptop, which would have been bigger and heavier than a medium sized travel suitcase. There was no Windows. It ran on DOS, programs were loaded via discs about the size of a small plate, and there was no internet. It was basically a fast calculator and advanced typewriter that could recall stored information. Events that happened at that time were the stock market crash of 1987, the first Gulf War, and the recession of 1991. People in general and investors in specific were worried about the future. Then came the bull market of the 1990s. Today, the stock market as measured by the S&P Index is almost 1,000% higher than it was in 1987.

In the late 1990s, we had desktop computers installed throughout our office that could communicate with each other and were connected to the internet. As the year 2000 approached, many were concerned about Y2K and how the collapse of computers would affect both our economy and our security. Y2K was a non-event, but the subsequent decade was very difficult with two economic and market declines including the Great Recession of 2008.

Even with all difficulties, the stock market as measured by the S&P is actually higher, though not by much, than it was at the beginning of 2000. Since the low on March 9th, 2009, the S&P Index has increased more than 100%. By this measure, the United States has recovered lost wealth. Though slowly, the economy has been growing since the beginning of 2009. Though I would be surprised to see a higher growth rate, I would be equally surprised to see the economy stop growing.

The computer I saw as a college student was, in a sense, the foundation of computers today. However, I doubt if very many people could have predicted the changes that technology has brought to our lives over the past 40 years. Today, we are connected through various forms of technology. In our office, we communicate via email, Skype, and phone. Recently, Morgan, Ryan, Courtney, and I were discussing our investment strategy and outlook. Morgan was in Minneapolis, Ryan was at his residence in West Fargo, Courtney was in Salem, and I was in a hotel in Bismarck. We could have all been in the office, but it is no longer necessary for us to be in one location. Technology has advanced and changed how we do things.

Though I have no plans to retire, it is obvious I have been around for more than a few years and this

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brings perspective to all current events. If I think of the world when I graduated from college and the world that exists today, it is very different. The global economy is different. Technology is different. Transportation is different. Energy is different. Agriculture is different. Employment is different. Manufacturing is different. Health care is different. Education is different. Housing is different. Demographics are different. Different is not bad, but it can be scary. Today, I believe there is often a feeling of pessimism that in my estimation is not warranted. We have gone through a very difficult time period. Challenges exist and will continue to exist. However, it is important to remember (and this is the purpose of my short little walk through history) that every time period has difficulties and challenges, but every time period also has opportunities.

This past summer I bicycled over the Grand Coulee Dam which was built in 1937. It is still the largest concrete structure in the United States and provides power for millions of people. I also bought coffee at a Starbucks in Singapore. Both were inspiring to me. One reason is for what we have done and can do in the future, and the other as an example of the global economy and the opportunities that it presents.

I have often said the investment world of the 1980s and 1990s is, in my estimation, gone and unlikely to return. That is not necessarily bad, just different. I believe we are in a new investment world which is more global, diverse, and though not more volatile, it is also unlikely less. There are challenges, but also new investment options and strategies that are increasingly available to investors. Our allocation models are designed to take advantage of this new investment world as well as manage both risk and reward.

As a firm, our goal remains the same: To help you reach and maintain your financial goals and objectives today and tomorrow.

Congratulations Stephanie!
We are very excited to announce Stephanie's promotion to Client Relations Coordinator. Stephanie has been with our firm since 2006. Many of you have met Stephanie or talked to her on the phone. Stephanie has many roles – most importantly, she processes all the paperwork that comes through our office. Going forward, if you have a question regarding paperwork you have received, need your online access password reset, or need to update personal information such as your address or phone number, feel free to talk to Stephanie.

We are grateful for her hard work throughout the years. She has been an integral part of our firm and we look forward to supporting her continued professional growth.

When Will I Receive My 1099-B?
If you have an after tax account, you will receive your 1099-B (Proceeds from Broker and Barter Exchange Transactions) in early March. Unlike W-2s, Pershing, the custodian on your accounts, is not required to mail 1099s by January 31, 2013, but rather by March 1, 2013. If you have any questions once you receive your 1099-B, please contact our office.

An Update on Recent Tax Changes from Ryan
Just when I thought the crazy news media couldn't get much worse during the pre-election coverage, literally the day after the election they moved right into the 'fiscal cliff' talk. Needless to say, I can't wait for a day when there is no fiscal cliff to hear about. Unfortunately, that day is not here yet. We are in for two or three more months of hangover fiscal cliff and debt ceiling media coverage.

The passage of fiscal cliff legislation at the final hour does avoid the worst consequences of nothing being done, but it only delayed for two months the beginning of significant across-the-board spending cuts. There are still several legislative questions which will affect both tax law and economic growth into the future:

- How much (if any) will Congress raise the debt ceiling, projected to be reached in 2 or 3 months?
    - Did they do enough on raising taxes on the wealthy, or were the increases too modest to counter the country's rising debt?
    - Is a government shutdown possible?
- Will legislators specifically target the unemployment issue in the US?

But the biggest item left unresolved was $110 billion in automatic spending cuts set for this year. Until something is done, come March 1st, cuts are set to sweep through nearly all federal agencies, with the majority coming from the military.

The result of what was passed essentially resulted in the majority of tax cuts that were set to expire at the end of 2012 are now extended and certain rules that expired in 2011 were reinstated:

- The top marginal tax rate will again be 39.6%. Along with qualified dividends and capital gains rates on the wealthy rising to 20%. Only those people with incomes of over $400,000 meet this definition.
- The current federal estate tax exemption remains the same at just over $5 million per person, with rates on those affected rising 5%, up to 40%.
- For the majority of Americans, the biggest impact of the bill will come from the expiration of the two-year 2% payroll tax holiday. All wages up to $113,700 will now be taxed 2% more than the last two years.
- Upper-income households ($250,000 and above) will also lose some tax credits and deductions, but parents under those limits will continue to get the $1,000 child tax credit and $2,500 credit for college tuition.
- Perhaps the most welcome 'fix' was the permanent change to the alternative minimum tax. An estimated 28 million more families would have been subject to this tax had Congress not acted, to the tune of an average of $3,000 more per family.

As always, we will continue to monitor and keep our clients informed on the fiscal cliff and related issues. More importantly, we will factor our analysis of the situation into our ongoing management of client portfolios, looking to manage risk and take advantage of any opportunities that arise.

Recalibrating Your Finances for 2013 from Courtney

In the week between Christmas and New Year's, I moved to a new place in Portland, OR. As I prepared to move, I took four carloads of stuff to Goodwill and the Salvation Army picked up some of my larger items that were not going to make the move. During the packing process, I was taken aback by all the stuff I had accumulated in my adult life. Some of it I use on a regular basis – clothes, shoes, dishes – and I do love to be surrounded by books. But, some of it was unnecessary – perhaps I had needed it or used it a few years ago but that was no longer the case. As I started the unpacking process, I continued purging and evaluating what I truly did need. As I settle into my new place, I have decided to impose strict rules on new purchases – namely, do I need this item and will I use it on a regular basis? If the answer is no, then I will skip it.

It was fitting that I moved during a time of a year that is associated with reflection and resolutions. I began to ponder what other changes I could make in 2013. I think the start of a new year is a great opportunity to reflect on what is working in our lives and what needs some tweaking. Many people will agree that we can always make tweaks to our financial lives. As I transition into a new year, I start by reviewing and updating my budget separating it into projected income, fixed costs, taxes, and discretionary spending. I look to see where I can pare back my expenses so that I can add to my savings.

Once I have projected my income and expenses for the year, I take a look at the bigger picture – how much am I saving for retirement and my other long term financial goals? For our retired clients, the opposite question can be asked – what is my current rate of withdrawal of my retirement nest egg? We suggest an annual rate of withdrawal of 5% or less. Withdrawing less from your retirement funds increases the probability of meeting your retirement goals over the long term.

This moment of financial reflection reminds me that ultimately, I am responsible for my financial future by controlling my spending, keeping sufficient cash reserves, and saving for my future cash needs. As you look at your financial picture, please contact us. In addition to our wealth management services, we can help you review your budget and refine your financial goals so that you can start off 2013 on the right financial foot.

Investment Update from Morgan

There are countless reasons why the holiday season is quite dear to me. Most importantly, I have the opportunity to spend time with my family (outside of work no less) to catch-up, get outside, and mostly, to eat (no lying - Momma Ranstrom's baking went straight to the love handles this year!). However, it seems that every year I get more and more excited for something else the holiday season offers me: a chance to read whatever I like for as long as I like. This year I knocked off a few books on investing that had been stuck on the waiting list for too long. I know, we financial analysts are a riveting bunch. However, though Ryan may disagree with me, I find some much needed comfort in the fact that we still have accountants beat in the excitement arena.

This year, one of the books I read was Howard Marks' *The Most Important Thing: Uncommon Sense for the Thoughtful Investor* and it offered much to chew on (though in stark contrast to multiple loaves of pumpkin bread, this did not go straight to my hips). Marks is the founder of Oaktree Capital, a highly successful investment manager that specializes in distressed debt investing, and his quarterly commentaries are a must-read for many in the investment field. The book is an attempt to nail down the most important thing for an investor. However, Marks ended up with twenty chapters on twenty different topics – each, in its own way, the most important facet of successful investing.

Though the entire book is fantastic, I found the chapter on "Understanding Risk" to be most thought-provoking. The chapter begins with the following quote from Elroy Dimson: "Risk means more things can happen than will happen."[1] This is a very broad definition of risk, but I like it because it is inconvenient and messy – much like the notion of risk itself. Inherent within the statement is that risk is difficult to quantify or nail down in specifics. It is common in investing to use volatility or standard deviation as an absolute measure of risk. However, as 2008 proved, the 0.5% of negative possibilities that are left over after a 99% confidence interval can really pack a punch. Certainly, risk is not as simple as a statistic.

Additionally, that which does occur does not, in retrospect, define the risks that were present. A behavioral psychologist might call this *outcome bias,* or seeing the process through the lens of the outcome. For example, a high return on a Portfolio does not necessarily justify the means by which that return was achieved. To give credence, there is a whole host of former technology fund managers who were superstars in the late 90s but most likely had to seek alternative employment after 2002 (probably as derivatives traders). Indeed, one could say the exact same about a poor return – that is, a poor return does not necessarily mean the investment process was lacking or even that the investment itself was poor. Marks elaborates:

> The point is that even after an investment has been closed out, it's impossible to tell how much risk it entailed. Certainly the fact that an investment worked doesn't mean it wasn't risky, and vice versa. With regard to a successful investment, where do you look to learn whether the favorable outcome was inescapable or just one of a hundred possibilities (many of them unpleasant)? And ditto for the loser: how do we ascertain whether it was a reasonable but ill-fated venture, or just a wildstab that deserved to be punished?[2]

It is not my intent to be dismissive or to endeavor upon some misguided proposition of investment anarchy; rather, I want to assure you that we think about risk every day – though given the above, 'assure' might not be a word you would consider most apt. However, in a world that anxiously grasps for certainty, I offer you none. It is not mine to give and, like the cure-all elixirs of yore, convenient statistics often find themselves lacking in the face of reality. What I can say is that we will never think about the investments we make or your financial future 'simply.' The future is by its very nature unknowable and it is most certainly wise to acknowledge that which you do not know. It is for this reason that we continue to invest in a sustainable *investment process* as the only stability we might find in the face of an uncertain future.

To close, 'risk' is often used as the counterpart of 'reward,' but rather than the elegant simplicity with which it is often conveyed, risk is a mucky thing. To that end, we are showing up at the start of another year with our muck boots strapped tightly to our feet. These are muddy waters, but I, for one, cannot wait and it is an absolute honor to be a steward of your capital.

[1] Marks, Howard, *The Most Important Thing: Uncommon Sense for the Thoughtful Investor* (New York : Columbia University Press, 2011).

[2] Ibid.