Clear Financial Group

YOUR FINANCIAL FUTURE

Your Guide to Life Planning

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Bond Market Perspectives |Week of October 5, 2015

KEY TAKEAWAYS

- A low-return environment persists for bond investors.
- Even after a third quarter bounce back, the Barclays Aggregate Bond Index is up just over 1% year to date.
- Lingering U.S. economic uncertainty may provide near-term support for high-quality bond prices.

FOURTH QUARTER BOND OUTLOOK

Third quarter bond market trends may continue to start the fourth quarter. A weaker than expected September jobs report and a soft reading on the Institute for Supply Management (ISM) manufacturing Purchasing Managers' Index (PMI) for September raised questions about the strength of the domestic economy and pushed back expectations of a Federal Reserve (Fed) rate hike. The signal from these two top-tier indicators is caution, which may continue to be supportive of high-quality bonds.

High-quality bonds may hold recent gains, or even extend them until more economic data clarify the pace of economic growth. Proof will likely be required as to whether ISM and jobs data are reflective of an economic slowdown (or worse) or simply month-to-month volatility that often accompanies economic data releases. This may take a month or longer as investors await confirmation via the monthly employment report for October, which will not be released until early November.

The cautionary tone was a microcosm of the entire third quarter and reflected in bond performance. The mix of bond returns flip-flopped during the third quarter compared with the second quarter of 2015. Treasury strength helped high-quality bonds rebound from a weak first half of 2015, while high-yield bonds and more economically sensitive sectors such as emerging markets debt and bank loans also lagged over the third quarter [Figure 1]. Lower oil prices, China fears, and domestic economic concerns weighed on more economically sensitive sectors.

1 HIGH-QUALITY BONDS REBOUNDED FROM A WEAK FIRST HALF DURING Q3

Bond Market Performance, Ranked by Year-to-Date Returns

Sector	Q3 2015	YTD
Preferred Securities	2.1%	3.9%
Municipal High-Yield	1.1%	1.8%
U.S. Treasuries	1.8%	1.8%
Municipal Bonds	1.7%	1.8%
Mortgage-Backed Securities	1.3%	1.6%
Bank Loans	-1.5%	1.4%
Barclays Aggregate	1.2%	1.1%
Foreign Bonds (Hedged)	2.0%	1.0%
Investment-Grade Corporates	0.8%	-0.1%
Emerging Markets Debt	-2.0%	-0.3%
TIPS	1.3%	-0.8%
High-Yield Bonds	-4.9%	-2.5%
Foreign Bonds (Unhedged)	1.7%	-4.2%

Source: LPL Research, Barclays Capital, JP Morgan, Citigroup 09/30/15

The indexes mentioned are unmanaged and you cannot invest into directly. The returns do not reflect fees, sales charges, or expenses. The results don't reflect any particular investment. Past performance is no guarantee of future results.

Asset class returns are represented by the returns of indexes and are not ranked on an annual total return basis. It is not possible to invest directly in an index so these are not actual results an investor would achieve.

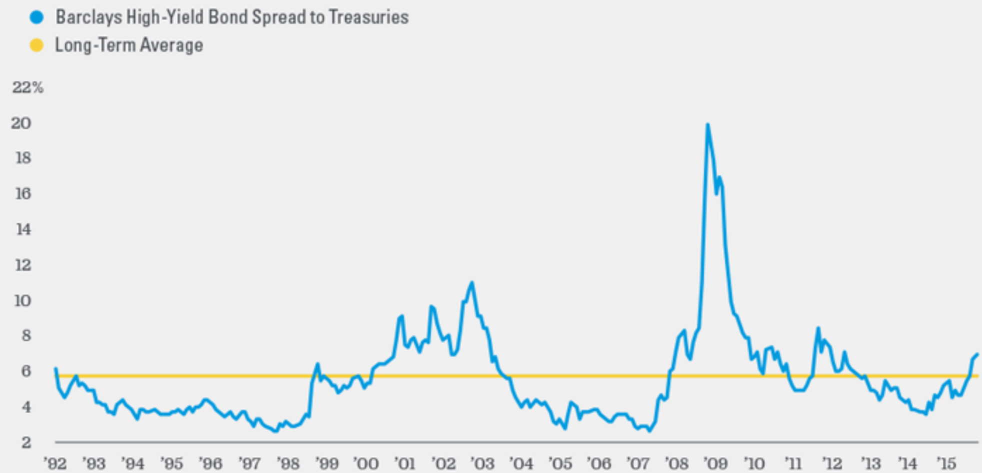
Asset Class Indexes: Foreign Bonds (hedged) – Citigroup Non-U.S. World Government Bond Index Hedged for Currency; Treasury – Barclays U.S. Treasury Index; Mortgage-Backed Securities – Barclays U.S. MBS Index; Investment-Grade Corporate – Barclays U.S. Corporate Bond Index; Municipal – Barclays Municipal Bond Index; Municipal High-Yield – Barclays Municipal High-Yield Index; Bank Loans – Barclays U.S. High-Yield Loan Index; High-Yield – Barclays U.S. Corporate High-Yield Index; Emerging Markets Debt – JP Morgan Emerging Markets Global Index; Foreign Bonds (unhedged) – Citigroup Non-U.S. World Government Bond Index (unhedged)

Although the mix of bond returns changed, the low-return environment facing investors is unlikely to change as we begin the fourth quarter of 2015. Even with the rebound in high-quality bond prices, the total return of the broad Barclays Aggregate Bond Index stands at just over 1% year to date through the end the third quarter. Treasury strength pushed the 10-year Treasury yield down to just below 2% at the end of last week, but sub-2% 10-year yields have not been sustained for any meaningful period of time since 2012 and 2013 [Figure 2]. The 2% yield barrier caused investors to reconsider expensive valuations in the past and confronts investors again.

A cloud of economic uncertainty may remain supportive of high-quality bonds, but an additional catalyst is likely needed for Treasury prices to rise further or yields to fall further. Treasury strength last week (September 28 - October 2, 2015), where yields fell by 0.13% to 0.20% across the board, shows the market was quick to assimilate the negative news. Furthermore, a first Fed interest rate hike is not fully priced in until June 2016 according to fed fund futures--compared with December 2015 for much of the summer. Still, softer economic data--either in the form of upcoming retail sales data or corporate earnings season, which begins this week--are likely needed to push high-quality bond prices meaningfully higher. Further weakness from future ISM manufacturing PMIs or employment reports would also suffice to drive additional bond strength. But continued strength in big ticket consumer purchases, such as autos and homes, run counter to the concept of a looming recession and suggest data must deteriorate further to power another round of Treasuries gains.

FINDING VALUE

We believe value exists among third quarter laggards and negative sentiment in the high-yield bond sector may have gone too far. We find the sector more attractive given the cheaper valuations. As of October 2, 2015, the average yield spread of high-yield bonds stood at 6.9%, the highest level since mid-2012, and just under 7%, which has historically provided an attractive risk-reward for investors [Figure 3]. When the average yield spread of high-yield bonds has been 7% or greater, the following average one-year total return has averaged 17.5%, with a 79% probability of a positive return.* We do not expect a return anywhere near the 17.5% average of prior periods when yield spreads were at or above current levels, due to the prospect of gradually rising defaults. However, cheaper valuations and an average yield of just over 8% offer an attractive opportunity for suitable investors, which we believe compensates for potential risks.



Source: LPL Research, Barclays 10/02/15

Long-term average reflects 25-year average.

High-yield spread is the yield differential between the average yield of high-yield bonds and the average yield of comparable maturity Treasury bonds.

Municipal bonds benefited from high-quality bond strength but, after outperforming during the first half of 2015, lagged Treasuries during the third quarter.** Municipal bonds will likely continue to take their cues from the Treasury market, but cheaper valuations [Figure 4] may provide a layer of protection in the event of high-quality weakness. Average AAA municipal-to-Treasury yield ratios increased during the third quarter with 10- and 30-year ratios firmly above 100% (indicating top-quality municipal bonds yield more than comparable maturity Treasuries). Cheaper valuations translate to more attractive after-tax yields and municipals present slightly better value in a still challenging environment for bonds.

Source: LPL Research, MMA 10/02/15

Past performance is not indicative of future results.

CONCLUSION

High-quality bonds finished the third quarter on a strong note, but bond prices moved quickly to price in disappointing economic reports. Economic uncertainty may linger over the very short term, providing support to high-quality bond prices; however, the low-return environment confronting investors has not changed even if the composition of bond returns did over the third quarter. We find opportunity among third quarter laggards in what is still a challenging return environment for fixed investors.

**Based on Barclays High Yield Corporate Index total return data from January 1990 through the present.*

***As measured by Barclays Municipal Bond Index and Barclays Treasury Index.*

IMPORTANT DISCLOSURES

The opinions voiced in this material are for general information only and are not intended to provide specific advice or recommendations for any individual. To determine which investment(s) may be appropriate for you, consult your financial advisor prior to investing. All performance reference is historical and is no guarantee of future results. All indexes are unmanaged and cannot be invested into directly.

The economic forecasts set forth in the presentation may not develop as predicted and there can be no guarantee that strategies promoted will be successful.

Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values and yields will decline as interest rates rise, and bonds are subject to availability and change in price.

Government bonds and Treasury bills are guaranteed by the U.S. government as to the timely payment of principal and interest and, if held to maturity, offer a fixed rate of return and fixed principal value. However, the value of fund shares is not guaranteed and will fluctuate.

Municipal bonds are subject to availability, price, and to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise. Interest income may be subject to the alternative minimum tax. Federally tax-free but other state and local taxes may apply.

High-yield/junk bonds are not investment-grade securities, involve substantial risks, and generally should be part of the diversified portfolio of sophisticated investors.

DEFINITIONS

The Institute for Supply Management (ISM) index is based on surveys of more than 300 manufacturing firms by the Institute for Supply Management. The ISM manufacturing index monitors employment, production inventories, new orders, and supplier deliveries. A composite diffusion index is created that monitors conditions in national manufacturing based on the data from these surveys.

Purchasing Managers' Indexes (PMI) are economic indicators derived from monthly surveys of private sector companies, and are intended to show the economic health of the manufacturing sector. A PMI of more than 50 indicates expansion in the manufacturing sector, a reading below 50 indicates contraction, and a reading of 50 indicates no change. The two principal producers of PMIs are Markit Group, which conducts PMIs for over 30 countries worldwide, and the Institute for Supply Management (ISM), which conducts PMIs for the U.S.

INDEX DESCRIPTIONS

The Barclays U.S. Aggregate Bond Index is a broad-based flagship benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate taxable bond market. The index includes Treasuries, government-related and corporate securities, MBS (agency fixed-rate and hybrid ARM pass-throughs), ABS, and CMBS (agency and non-agency).

Barclays U.S. High Yield Loan Index tracks the market for dollar-denominated floating-rate leveraged loans. Instead of individual securities, the U.S. High Yield Loan Index is composed of loan tranches that may contain multiple contracts at the borrower level.

The Barclays U.S. Corporate High Yield Index measures the market of USD-denominated, noninvestment-grade, fixed-rate, taxable corporate bonds. Securities are classified as high yield if the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, excluding emerging market debt.

The Barclays U.S. Corporate Index is a broad-based benchmark that measures the investment-grade, U.S. dollar-denominated, fixed-rate, taxable corporate bond market.

The Barclays U.S. Mortgage Backed Securities (MBS) Index tracks agency mortgage backed pass-through securities (both fixed rate and hybrid ARM) guaranteed by Ginnie Mae (GNMA), Fannie Mae (FNMA), and Freddie Mac (FHLMC)

The Barclays U.S. Municipal Index covers the USD-denominated long-term tax-exempt bond market. The index has four main sectors: state and local general obligation bonds, revenue bonds, insured bonds, and pre-refunded bonds.

The Barclays Municipal High Yield Bond Index is comprised of bonds with maturities greater than one-year, having a par value of at least $3 million issued as part of a transaction size greater than $20 million, and rated no higher than 'BB+' or equivalent by any of the three principal rating agencies.

The Barclays U.S. Treasury Index is an unmanaged index of public debt obligations of the U.S. Treasury with a remaining maturity of one year or more. The index does not include T-bills (due to the maturity constraint), zero coupon bonds (strips), or Treasury Inflation-Protected Securities (TIPS).

The Citi World Government Bond Index (WGBI) measures the performance of fixed-rate, local currency, investment-grade sovereign bonds. The WGBI is a widely used benchmark that currently comprises sovereign debt from

over 20 countries, denominated in a variety of currencies, and has more than 25 years of history available. The WGBI provides a broad benchmark for the global sovereign fixed income market. Subindexes are available in any combination of currency, maturity, or rating.

The JP Morgan Emerging Markets Bond Index is a benchmark index for measuring the total return performance of international government bonds issued by emerging markets countries that are considered sovereign (issued in something other than local currency) and that meet specific liquidity and structural requirements.

This research material has been prepared by LPL Financial.

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Millennials: The "Slow and Steady" Generation of Investors

For Millennials, the Great Recession was a wake-up call that investing presents real risks -- and their approach is to take steps to avoid falling foul of that risk even though they have decades of investing ahead of them.

With some $30 trillion poised to change hands over the next several decades from parents and grandparents to so-called Millennials -- those 90-million-plus Americans aged 18 to 33 -- the financial services industry will have its work cut out for it. Popular investing wisdom states that the younger you are, the more time you have to ride out market cycles and therefore the more aggressive and growth-oriented you may be in your investment choices. Yet Millennials are hearing none of it.

As Investors: Wary and Conservative

Indeed living through the Great Recession and watching their parents and other older family members suffer financial losses may have taken a toll on these young investors -- and made them wary of investing in general and conservative in their investment choices. For instance, according to Wealthfront, an online financial services start-up that caters to this demographic group, Millennials "have lived through two market crashes … " and … "value simple, transparent, low-cost services," typically favoring index-based fund options over more exotic investment fare.[1]

Elsewhere, research conducted by MFS Investment Management found that Baby Boomers take a more aggressive approach to retirement investing than the much younger Millennials. Further, each group's selected asset allocation is inconsistent with what financial professionals would consider to be their target asset allocation, given their age and investment time horizon.

For example, Baby Boomers, on average, reported holding retirement portfolio asset allocations of 40% stocks, 14% bonds, and 21% cash, while Millennials allocated less than 30% of their retirement assets to stocks, and had larger allocations to bonds and cash than their much older counterparts -- 17% and 23% respectively.[2,3]

Further, when asked about their retirement savings priorities, 32% of Baby Boomers cited "maximizing growth" as the most important objective, while two-thirds of Millennials cited conservative objectives for their retirement assets -- specifically, 31% said "generating income" was a top concern and 29% cited "protecting capital" as their main retirement savings goal.[3]

Perception Is Reality

The study's sponsors infer that the seemingly out-of-synch responses from survey participants reflect each group's reactions -- and perhaps overreactions -- to the recent financial crisis. For Baby Boomers, the loss of retirement assets brought on by the Great Recession has made them more aggressive in their attempts to earn back what they lost. Fully half of this group reported being concerned about being able to retire when they originally planned. For Millennials, the Great Recession was a wake-up call that investing presents real risks -- and their approach is to take steps to avoid falling foul of that risk even though they have decades of investing ahead of them.

Educating Investors: An Opportunity for Advisors

Cumulatively, recent research suggests that there is a considerable opportunity for advisors to dispel fears and misperceptions by educating investors of all ages about the importance of creating and maintaining an asset allocation and retirement planning philosophy that is appropriate for their investor profile.

[1]*Wealthfront.com, Wealthfront News, "$1 Billion in 2.5 Years," June 4, 2014.*

[2]*Investing in stocks involves risks, including loss of principal. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and are subject to availability and change in price. An investment in a money market fund is not insured or guaranteed by the Federal Deposit Insurance Corporation or any other government agency. Although the fund seeks to preserve the value of your investment at $1.00 per share, it is possible to lose money by investing in the fund.*

[3]*Plansponsor, "Baby Boomers, Millennials Should Switch Retirement Investing Goals," October 2, 2014.*

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Since your teen will probably apply to only a handful of schools, you may need to narrow the field by comparing schools on big issues such as course offerings, tuition costs, and financial aid packages.

Life After High School: Educating Your Teen

Choosing the right college or trade school may be the biggest decision you and your teen make together. Above all, you will likely be looking for a quality education at a reasonable price. But other factors will affect the decision. Here are some ideas and resources for organizing your search.

First Things First

Set priorities: Ask your teen to list 10 things he or she would like to see in a college or trade school. Also, keep your teen's school records handy. Being able to match strengths and goals to a school's offerings will help when making a decision.

Other factors to consider include:

- Size/setting: Should it be a big public school or a small private one? Is a big city preferred over a small-town setting?
- Campus/social life: Should it be a same-sex or co-ed school? What about religious affiliations? Sports and arts programs?

The Selection Process

Since your teen will probably apply to only a handful of schools, you may need to narrow the field by comparing schools on big issues such as course offerings, tuition costs, and financial aid packages.

While costs for colleges and trade or vocational schools will differ, the average tuition and fees at public, in-state, four-year institutions increased about 2.9% for the 2014-2015 academic year. Tuitions and fees at four-year private schools increased about 3.7% over the prior year. When you add in room and board costs, today's college bill adds up to roughly $19,000 a year for a four-year, in-state public college and $42,400 for a four-year private school.[1] And if your child is still many years away from college you can undoubtedly expect to pay more.

Finding Financial Aid

Billions of dollars are available in federal, state, and privately funded financial aid if you know where to look. Start with guidance counselors and financial aid offices. In addition, the following organizations offer ample, free information:

- The College Board: Call your regional office or visit www.collegeboard.org.
- FinAid: Visit www.finaid.org.
- U.S. Department of Education, Federal Student Aid Information Center: Call (800) 433-3243 or visit www.fafsa.ed.gov.

[1]*The College Board, "Trends in College Pricing 2014," November 13, 2014.*

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Your Credit Report: Can You Afford to Ignore It?

Federal law requires the three major nationwide consumer reporting companies -- Equifax, Experian, and TransUnion -- to each provide you with a free copy of your credit report, at your request, once every 12 months.

When was the last time you obtained a copy of your credit report? If your answer is "never" you are not alone. A recent survey found that one in four Americans have never checked their credit report. The simple reason? They don't think it is important.[1]

Credit reports ARE important to every consumer. They typically are a major factor in determining if you will be approved for a loan, be able to rent an apartment, or even get hired at a new job. They qualify your creditworthiness and are one of the first places to detect whether you have become the victim of identity fraud.

If all of those reasons are not enough to convince you that monitoring your credit report is a good idea, the no-brainer fact you can't deny is: It's free and has been for more than a decade!

The Fair Credit Reporting Act (FCRA) requires the three major nationwide consumer reporting companies -- Equifax, Experian, and TransUnion -- to each provide you with a free copy of your credit report, at your request, once every 12 months. These three companies sponsor an official website -- annualcreditreport.com-- that allows you to request credit information from all three agencies in one place.

Once you receive your report(s), be sure to review all of the following for accuracy:

- Your name (including any variations or nicknames)
- Your Social Security number
- Date of birth
- Current and previous addresses
- Employment data
- Credit accounts and history
- Public records (e.g., liens, bankruptcies, etc.)

If you find errors in the report, you'll need to contact the credit bureau and provide documentation to correct the error.

Confusion Compounded

Even among those who have checked their credit reports fairly recently, confusion persists about what is included in the report and why it matters to them. For example, a survey of more than 4,300 adults conducted in early 2015 by Credit.com found that:[1]

- 27% of those surveyed were surprised by some of the information included in the report.
- One in five found (21%) incorrect or outdated information.
- One in 10 (10%) found a collection account they didn't know existed.
- 15% were unsure of the relevance of each section of the report.

Further, the study showed that many consumers only saw their credit reports in conjunction with an application for housing or a loan and were left with little or no time to respond to any problems or mistakes that may have surfaced.

Don't be blindsided by errors in your credit report that could cost you a job or disqualify you from a loan application. Credit experts generally encourage individuals to check their credit report at least annually to ensure that the information it contains is accurate and up-to-date.

[1] *Credit.com, "Are Credit Reports Important? Many Americans Say No," March 3, 2015.*

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The Right Staff

Small companies often find themselves nudged aside by larger companies in the recruiting game.

Hiring and retaining talented employees can be one of the most crucial building blocks in the growth of your business. Here are some guidelines for establishing a recruiting process that works for you.

- Develop a strategy. Evaluate standard recruiting methods: place advertisements in local newspapers and online; publish internal announcements/requests for referrals; enlist professional recruiting firms, college placement offices, and government job centers; utilize social media strategies. Determine which of these yields the best candidates for the money invested. While you may find that advertising in a newspaper or posting on LinkedIn or another online networking site garners more responses, working closely with a recruiter who can screen applicants may save you time and result in more suitable candidates.
- Build a referral network. Contact professional organizations in your community and ask your lawyer, banker, or accountant for referrals. Implement an employee referral program to encourage recommendations. Make creative use of social media. One example comes from British Petroleum (BP), which created a fun and shareable "weekly playlist" on Facebook featuring a different type of content for each day of the week (e.g., Monday showed images of global BP locations where a candidate could potentially end up living and working; Tuesday incorporated a multiple-choice quiz that tested general knowledge about the company, and so forth).[1]
- Accentuate the positive. Small companies often find themselves nudged aside by larger companies in the recruiting game. Emphasize the unique benefits of working for a small company and then stress the qualities that make your company special.
- Refine the hiring process. If you are not finding the candidates you want, look for ways to improve your hiring process. Get feedback on your interviewing techniques and brainstorm new, more probing questions for candidates. When asking for references, request a well-rounded list that includes bosses, mentors, and others who know the candidate professionally.
- Be flexible. Flexibility is the key advantage for small companies, so make the most of it when recruiting new talent. If, for example, you find an exceptional candidate whose background doesn't quite fit the position, consider hiring the individual and modifying the position to take advantage of his or her unique strengths. Or, if a candidate can't commit to a full-time schedule, consider splitting a full-time job into two part-time positions or propose a telecommuting arrangement to accommodate scheduling needs.

[1]ERE Media, "Employee Stars, Imaginative Campaigns, and Cool Referral Programs Highlight the Best in Recruitment Advertising," January 14, 2015.

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