February 2014

McBork Report: 1st Quarter 2014

Our assistant Claudia was born in The Netherlands and moved to the U.S. when she was around twelve years old. Beyond my very favorable impression of Claudia, I make three associations with the Dutch. Two of these three associations are linked to the 2014 Winter Olympics. First of all, the Dutch are extraordinary speed skaters. They won an astonishing 23 medals that included 8 gold medals. Secondly, they show their pride by wearing the color orange, which is the official color of their royal family. On a side note, orange is Bosco's favorite color right now.

My third association with The Netherlands dates back almost 400 years and involves tulips of all things. One of the more interesting classes that I took at Indiana University was an economics class that focused for a few weeks on the Dutch Tulip Bulb Craze of the 1600's. To give you an idea, over a period of several months tulip bulb prices climbed a staggering twentyfold before they promptly fell back to normal pricing levels. For all intents and purposes, the Dutch Tulip Bulb Bubble was just like the Dot-com Bubble that we witnessed from 1999-2001. In both cases, prices rose dramatically for a time, but then fell rapidly and precipitously when the bubble burst.

The S&P 500 Index, a proxy for the U.S. stock market, is up around 175% over the last five years, so one might ask if U.S stocks are forming a bubble like the one The Netherlands experienced nearly 400 years ago. We think there are important differences. For example, since the beginning of 2009, American companies have shed a considerable amount of debt. The consumer is still spending and earnings are improving. One number that we focus on is the S&P 500's forward 12-month price-to-earnings (P/E) ratio. We calculate this forward looking ratio by taking the market price per share and dividing it by the expected earnings per share. Right now the forward looking P/E ratio of the S&P 500 Index is around 15 compared to its historic average of around 14. So stocks are selling at slightly higher prices than usual but not by much. To give you some perspective, when the bubble burst on the dot-coms, this ratio was closer to 40.

At the current level we are not unduly worried, although we still remain cautious regarding stock valuations. Even though the S&P 500 Index was up close to 30% in 2013, we feel that there is still room for US stocks to appreciate. We feel that the prudent approach is sticking with higher quality names that typically have a rising dividend stream. With the DJ World Index lagging the S&P 500 Index by 47% over the last four years, we think there are relatively more opportunities and better values abroad. Thus we want to be diversified globally when we invest in stocks.

As I mentioned last year, our view on bonds is not too rosy. We witnessed the Barclays Aggregate Bond Index fall around 2% last year. We feel that bonds will be under pressure again this year. When interest rates rise, all bonds will be negatively affected, some more than others. We are trying to move more of our bond exposure to those "other" categories such as short maturity, lower quality[1], foreign, and floating rate bonds that we believe will hold up better when rates rise. We are also moving some bond exposure into other asset classes such as Real Estate Investment Trusts (REIT)[2] in order to help mitigate interest rate risk. Property owners typically have the ability to increase their rents, making REITs a unique investment with some edge in the expected rising interest rate environment.

Finally, I wanted to congratulate Molly for achieving the CERTIFIED FINANCIAL PLANNER™ designation in November. This is a very big achievement and we at Responsible Investment Group could not be more proud. Her achievement gives us a better foundation from which to serve you for years to come.

Take care, stay warm, and if you have any questions or just want to talk, please feel free to give us a call or send us an e-mail.

Sincerely

Gregory Bork Jr.

Registered Principal

[1] *High yield/junk bonds (grade BB or below) are not investment grade securities, and are subject to higher interest rate, credit, and liquidity risks than those graded BBB and above. They generally should be part of a diversified portfolio for sophisticated investors.*

[2] *Investing in Real Estate Investment Trusts (REITs) involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained.*

The Dow Jones Global ex US Index is a measure of the global stock market minus US securities. It targets 95% coverage of markets open to foreign investment. The index currently tracks 47 countries, including 26 developed markets and 21 emerging markets. The Barclays U.S. Aggregate Bond Index is an index of the U.S. investment-grade fixed-rate bond market, including both government and corporate bonds. Indexes are unmanaged and cannot be invested into directly. Unmanaged index returns do not reflect fees, expenses, or sales charges. Index performance is not indicative of the performance of any investment. Past performance is no guarantee of future results. International investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors. Stock investing involves risk 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 bonds are subject to availability and change in price. 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 referenced is historical and is no guarantee of future results.