Lifetime Financial Advisors, Inc.

LFA Quarterly Newsletter

1st Quarter 2015

INSIDE THIS ISSUE

CONTACT US

2210 Encinitas Blvd.
Suite C
Encinitas, CA 92024

760.943.0430 phone
760.943.0950 fax

www.lfa-inc.com
info@lfa-inc.com

Steve's Perspective

By Steve Van Houten, CFP® | LPL Registered Principal

As April greets us, I marvel how quickly another quarter has passed. The 2014 tax year has come and gone and was more challenging than ever as new Federal regulations complicated the generation of 1099 tax forms. Over the past few years the trend has been to issue these tax documents later and later in an effort to reduce the number of corrections that inevitably had to be sent.

Added to the frustration of receiving tax forms later than expected, many clients with taxable accounts also experienced more capital gains distributions than expected. After six years of market advances, there were few losses in the portfolios that could be used to offset the realized gains on stocks that were sold. If you own individual stocks and/or bonds, a capital gains tax is not triggered until you sell, but investment companies are required to total the capital gains that were realized during the year and distribute them proportionately to shareholders.

We have communicated to you over the past two years of our concern about current market valuations and increasing risks of sudden surprises. Risk management, like earthquake insurance if you live in Southern California, is not appreciated until you need it. The last major earthquake was in 1994. When the earthquake suddenly hit without warning, we soon learned where the additional fault lines were. This analogy with earthquakes is appropriate-- our core managers are looking where the fault lines are now. The future is always uncertain but, currently, it appears to be more uncertain than usual. We will continue to work diligently to seek the best investment opportunities while maintaining prudent risk management.

One last note: Corey Solorzano has taken a position at another firm. Corey joined LFA after he graduated from college and served our clients for ten years. During this time he has grown to be an experienced and well respected professional who will soon be a Certified Financial Planner. I am more than proud of Corey's progress and greatly appreciate his loyal service over the years. He will be missed and we all wish him the very best success.

Best Wishes,

Steve Van Houten, CFP®

Top Themes of the First Quarter

- On Mar. 27, the P/E ratio of the S&P 500 Index was 20.52, 32% higher than its historical average of 15.5.
- In 2014 the Euro fell 14.0% vs. the U.S. dollar, and has fallen another nearly 11% since the beginning of 2015 (to 3/30/15).
- Overall unemployment claims are steady as holiday and weather distortions fade, but claims in the eight largest oil-producing states are still elevated.

Surprise Happens!

Volatility is back in a big way and, as always, it signifies uncertainty or doubt. Even market economists appear flummoxed, as evidenced by the Citigroup Economic Surprise Index which seeks to quantify measures of economic news. This index, which is calculated daily for a rolling three-month timeframe, was in positive territory throughout the second half of 2014, but has turned decidedly negative for the first two months of this year. A negative reading suggests that economic releases did not perform as well as consensus estimates would have indicated.

As we head into the second quarter of 2015, we find ourselves potentially vulnerable to a laundry list of surprises which could serve as trigger points for market corrections: six complete years of the bull market, high equity prices, unknown consequences of a stronger dollar and weaker oil prices, potentially rising interest rates, ongoing geopolitical risk from countless areas of the world, including Greece's financial woes and China's economic slow-down. In this newsletter we would like to explore three of the biggest surprises which may help to explain the recent downturn.

1. Markets are overpriced. There have been only three periods in the last 53 years in which the market appreciated more than earnings growth for at least three consecutive years (1988–1991, 1994–1999, and now 2011–2014). Why are valuations rising during a period of decelerating earnings growth and slowing global GDP growth? Part of the answer lays in the perception of the relative attractiveness of U.S. equities versus non-U.S. global equities as well as the appeal of U.S. equities versus fixed income investments.

While U.S. equities did quite well in 2014, European equities and many emerging market equities performed poorly due to decelerating economic growth, declining currencies, political instability in certain regions and countries, commodity weakness led by the decline in oil and agricultural prices, and poor earnings growth. While the U.S. economy did not show much acceleration during 2014, the stability of underlying trends in the U.S. compared to the rest of the world helped attract investor dollars into the U.S. and drove valuations up. In addition, with interest rates on longer duration government bonds falling across most of the developed world, including the U.S. and Europe, the allure of equities relative to many fixed income alternatives helped to prop up valuations in the U.S. equity market.

While the comparative stability of the U.S. compared to other regions of the world helps to explain the inflated domestic valuations, we must also look to the construction of the S&P 500 Index itself for another piece of the puzzle. As we explained in our last newsletter, we feel that the MSCI ACWI (index of All Country World) is the

Surprise Happens!, Continued…

closest comparison for our global balanced approach. Still, we understand that many investors look to the S&P 500 to track the U.S. market. As such, it is important to understand the shortcomings of this index.

The influence of each stock on the S&P 500 Index is proportional to its market valuation. Market valuation, or capitalization, is calculated by multiplying number of shares outstanding by share price. By calculating the index in this manner, rather than by companies' stock prices alone (as in the Dow), it is simple to see how market behemoths such as Apple (AAPL), Exxon Mobil (XOM), Microsoft (MSFT), Johnson & Johnson (JNJ) and General Electric (GE), the five largest cap companies in the S&P 500, can have a significant pull, or drag, on the overall index. While all 500 of the companies that comprise the Index are "large cap" (minimum $5 billion) Apple, by rising 40% in 2014, single-handedly added 1.3% to the S&P 500's return.

2. The U.S. Dollar is soaring. A strengthening dollar is one in which the U.S. dollar has increased in value compared to another currency. This means that the U.S. dollar now buys more of the other currency than it did before. While the stronger dollar makes it cheaper to travel abroad and lowers the cost of imported goods, the flip side is that it makes U.S. exports more expensive in comparison to the offerings of competitors, thus hurting foreign demand for U.S. goods. It also reduces the value of corporate profits earned overseas, erodes the investment returns of any unhedged international investments, and undercuts the attractiveness of commodities such as gold and oil that are traded globally, usually in dollars.

The sudden, meteoric rise of the dollar speaks not so much to the strength of the U.S. economy, but to the continuing weakness in much of the rest of the world. The main driving force of the surge in the dollar has been monetary divergence, with the Federal Reserve tightening policy and the European Central Bank maintaining rock-bottom interest rates and launching quantitative easing.

As the dollar rises against other currencies, its rippling effect is threatening emerging economies where companies and governments have taken on $9.2 trillion worth of dollar-based debt in recent years, up 50 percent since 2009. Years of low-interest-rate policies from the Fed have encouraged companies in these fast-growing economies to borrow dollars because they could do it more cheaply than if they took out loans in their local currencies. The surprisingly rapid rise in the value of the dollar has caught the world off guard and presents a risk and a challenge to many emerging markets in that their debts have become more burdensome. What will likely follow are bankruptcies, layoffs and cost-cutting for individual companies that borrowed too aggressively.

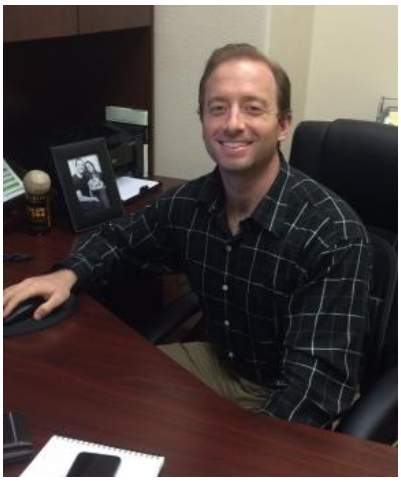
3. The price of oil has plummeted. The economy got an immediate shot in the arm from falling oil prices. The average American household spent almost $3,000 in 2013 at the pumps so the dramatic decline in oil prices has created annual savings of about $1,000. This affects the economy the same as a tax cut, resulting in about a trillion dollar benefit.

There will, of course, be intermediate-term ramifications as many energy companies cut capital spending jobs in the field and, in turn, suppliers are forced to make their own cuts. The sudden and unexpected declines in the price of oil are damaging earnings at oil-related companies and the banks and suppliers that serve them. Large banks face tens of millions of dollars in losses on loans they made to energy companies last year. The losses show the danger banks face when unforeseen events create a chain reaction across an industry.

The Spotlight Is On…

Joe Stenovec

LPL Registered Sales Assistant



Joe has been with LFA since January, 2014 and spends his time working with clients on financial planning and investment management. He enjoys the challenges that come along with those responsibilities and finds it very rewarding.

Surprise Happens!, Continued…

Without the $300-$400 billion annual contribution by America's oil and gas industry, GDP growth would have been negative in recent years. Only time will tell if the surprising fall in the price of oil is temporary or permanent. Oil patch debt may well be another triggering event for a broader selloff.

"There Be Surprises"

The phrase, "There Be Dragons," was utilized by medieval cartographers to indicate dangerous or unexplored areas of the world. In this newsletter we have examined a few of the sources of volatility we have encountered as we have plied uncharted economic waters. We believe our investment approach has served to reduce the choppiness of the voyage and the temptation to give in to the fears that are stoked by daily headlines. Neither the rapid rise of the dollar nor the rapid decline of the price of oil was anticipated by many, including the executives of oil/shale companies. It is surprises like these, which often create opportunity, that justify a defensive posture and holding some cash. Our circumspect approach, a stance also adopted by central banks in the developed world today, is much better positioned to withstand negative surprises than is a complacent, perennially optimistic approach.

Our strategy is based on buffering against uncertainty via diversification of mangers, asset classes, and approaches. We believe our multi-cap, multi-asset global approach has been validated this year as foreign stocks and small-to-mid cap domestic stocks, which lagged badly last year, have outperformed this year. Rather than letting price fluctuations in the market drive us in one direction or another, we steer a steady course that historically has delivered reasonable rates of return while avoiding permanent impairments of capital. We have done this by constructing portfolios with the expectation that there will be surprises--to the downside as well as to the upside.