ON THE HORIZON...
NEWS, NOTES, AND COMMENTARY
FOR CLIENTS AND FRIENDS OF THE HORIZON GROUP

BY MARK CONGDON, SENIOR PARTNER

NEW YEAR'S RESOLUTIONS 2014

This is about the time that the excitement and reinvigoration of the New Year fades into work. Steadfast resolutions have already morphed into "if I can get to it" in a matter of weeks. Let's face it, from the weather to the stock market, nothing in the never-ending 24 hour news cycle has many of us feeling particularly motivated or comfortable right now. I thought this was a great time to share my thoughts about the coming year through a half dozen resolutions I'd urge every client to make:

Regardless of market conditions, I will remain fully committed to and appreciate the concept of diversification. You wouldn't be human if you didn't wish you had more of your money in stocks last year. We're all painfully aware that the Dow gained slightly better than 26% while most bonds struggled to break even. So why didn't we have more? Allow me to take you back to New Year's 2013. The Eurozone was in full crisis with Spain and Portugal deep in recession and Britain threatening to leave the European Union. South Korea was launching missiles and Egypt, Syria, Iran, and Mali kept geopolitical worries in the headlines. Here at home we were talking non-stop about the fiscal cliff and the devastating consequences sequestration would thrust upon our economy in the coming year. Analysts were pessimistic, and the average client was reminding us they couldn't take another downturn like 2008 – 2009. Needless to say we held firm to our individual allocation strategy for each client and actually participated in the stellar gains of the market to a great extent. Certainly much more than if we had tried to "time" the market based on consensus forecasts or how things "felt".

We start this year with the opposite occurring. The forecasts are overwhelmingly bullish. Given the putrid return on supposedly safe investments, many clients are antsy and want even more market exposure. But the fact is we never know what the future holds. The only way to invest unemotionally and avoid the fear-hope-greed cycle is to commit to an allocation strategy and allow yourself minor "tweaks". Almost every major study confirms this as fact. According to JP Morgan Asset Management, the 10 year return of a balanced portfolio was 7.2% annually through the end of last year. But diversification isn't sexy. It doesn't make for a great sales pitch – I guarantee you a strategy that will *never* give you the best returns. Who would jump at a chance for that? But the opposite is also true – you won't ever have the worst returns either. And if your goal is to stay solvent and well fed as long as you are breathing, it's really the only strategy that makes sense.

With that said, I remain relatively optimistic on the stock market for the coming year. There is no question we are long overdue for a correction which would be healthy for the market. But the fact is, earnings and historical multiples suggest the market has room to eventually close higher again this year. If the economy picks up steam or market multiples expand, it could be much higher. On the contrary, if the economy or earnings sink, so too will the market. And a large scale terrorist attack or black swan event keeps a market meltdown looming as a constant threat. Truly embrace diversification – knowing to some extent you're participating in the good, tempering the bad, and hopefully avoiding the truly ugly.

I will accept the fact that bonds have an important place in every portfolio and embrace them for the stability and relative security they provide when markets plunge. How can we have bond funds in our portfolio – aren't they terrible investments right now? This question is asked at almost every account review these days. It's understandable, given the dismal performance of most bond funds last year. But let's take a minute to digest what really happened. By last spring when economic growth figures were slowing – and stocks rallied because it meant easing would continue – the rate on the 10-year bond had dropped to 1.61%. But after Mr. Bernanke unexpectedly shocked the markets by merely mentioning the Fed was considering a slight taper of bond purchases, rates skyrocketed and bond prices fell. In fact, the 10-year closed 2013 at 3.03%. When the smoke cleared, some long-term treasuries had lost *over 25% of their value*, and even the shorter maturity Barclay's Bond Index lost 2% for the year. Foreign bonds, especially those of emerging markets, were hit a bit harder because higher rates strengthened the dollar. There were few places to hide in our fixed income bucket, but we did manage to find a few. Several of our negative duration, short duration, and diversified income funds posted respectable gains while their world imploded around them. I am extremely proud of our performance through the disaster and would like to especially thank Putnam, Pimco, Lord Abbett, and Templeton for a job well done.

With the 10-year starting 2014 at 3.03%, rates would have to climb to nearly 4.5% to equal last year's disastrous rise. Given true unemployment and our current economic state, this is a **highly unlikely** scenario. In fact, I could make a good case for lower rates and solid returns on bonds in the coming year. How could that be possible in the face of Fed tapering? The simple fact is few people – especially economic commentators – truly understand what the Fed is dong. I will use the example of our current lack of inflation to demonstrate that Mr. Bernanke has installed a permanent easing method that makes tapering inconsequential.

So, if the Fed has printed just over $3 trillion since 2008, why haven't we had run away, double digit inflation all those gold commercials promised? It has everything to do with a seemingly insignificant law passed in 2008 that allowed the Fed to pay banks interest on excess reserves. Banks have required reserves, cash on hand to back up the loans and various business endeavors they undertake for profit. Until this law, banks kept little in excess reserves, since money was forced into circulation or it was a drag to profit. In fact, the total amount of excess reserves on deposit for the entire U.S banking system averaged a mere $1.9 billion in 2007. And then came the financial crisis and the Emergency Economic Stabilization Act of 2008.

In response to the crisis, the Fed started printing money. Through QE3, this newly minted cash was injected into the banking system. The Fed did so by purchasing bonds and mortgages the banks were holding (and in many instances losing money on) in return for cash. But instead of putting all that new cash at risk again out in the economy, they simply kept it as excess reserves, knowing they could send it right back to the Fed and be paid a risk free .25%. Presto, U.S. banks now have healthy balance sheets and risk free profits. But this explains why loans are hard to get, economic growth is slow, and inflation never materialized. The proof lies in the fact that excess reserves shot up to end the year at roughly $2.5 trillion, meaning most of the money printed found its way back to the Fed and is on deposit, rather than turning over in the economy. And here lies the brilliance of that system designed by Mr. Bernanke – the Fed has $2.5 trillion of pent up stimulus it can control by simply adjusting the rate it pays on excess reserves. Now you understand why Janet Yellen is already talking about cutting that rate in half to .125%. This would force some of these reserves back into the system. It also explains why I have a relatively optimistic view on stocks, bonds, and the economy - despite tapering.

I will maintain a healthy skepticism when listening to financial coverage on radio, watching on television, or reading it in print. To continue with the discussion above, "experts" at every turn are scoffing at bonds, predicting certain losses, and commenting on the ignorance of the "average" investor that owns them. Most advice I've seen given is akin to closing the barn door well after the horse is out. But much of this coverage makes sense at first blush because it evokes two investment biases we all battle – recency and hindsight. Recency bias occurs when we extrapolate recent events and project them into the future indefinitely. Hindsight bias is viewing events after the fact as more predictable than they really were. It's hard work to decipher whether a report is credible or a sales pitch, manipulation, misinformation, or just plain bad advice. Have you ever checked on who these "expert" commentators are?

I couldn't help but to do just that when I picked up the weekend edition of the Wall Street Journal on Saturday, January 4th. On the front page of Business and Finance section was a large and highlighted quote inset on an article commenting on Bill Gross's bad year. In explaining why she pulled her clients from the PIMCO Total Return fund, Margaret McDowell of Arbor Wealth Management was quoted, "You don't want to be the last one without a chair when the music stops". For all the reasons previously explained, I vehemently disagree with Ms. McDowell. But because of her quote's prominent placement in the Journal I decided to investigate who she is. She and her firm manage $76 million in assets. I personally manage multiples of that and wouldn't dare to suggest my knowledge could match the intelligence or resources found at PIMCO. For perspective, pretend our firms are towns and the dollars we manage are snowfall. Arbor gets an inch a year, Horizon gets half a foot, and PIMCO is buried with 2,193 feet. Who should you quote when it comes to a story on snow removal?

I will keep my finances and important information well organized and shared with my loved ones. **Conversely, if I have been ignoring or just pacifying my well-organized spouse when they try to involve me in the details of our situation, this is the year I will fully participate**. Nothing is harder than trying to guide a grieving spouse or child who is totally clueless about a situation. Just because you are well organized and the master of your domain doesn't mean that your spouse could find a power of attorney or know what bills have to be paid should you have a stroke tomorrow. Often in the best of relationships, one partner has no interest in finance and legal matters. Attempts to share and involve this partner are often met with, "Honey, you do such a great job" or "I trust you completely, thanks for handling our finances so well". Confirmations of trust and acknowledgements are nice, but your family "administrator" would appreciate your involvement and understanding far more. True peace of mind comes from knowing the people you love have the knowledge and ability to carry on if you are taken out of the picture. As your trusted financial advisor, I play a very important role in that process. Unfortunately, I have far too much experience helping people pick up the pieces after someone is gone. But it's far less stressful if they know where all the pieces are – not to mention passwords, wills, insurance coverages, and on-line banking details.

I will voice my opinions when those I love are making unwise financial decisions, especially if I am serving as their "safety net" when it comes to money. Often clients are put in a position where they feel they have to help a child, grandchild, sibling, or even a parent out of a financial mess. I fully understand the need to help – especially if you won't be jeopardizing your own existence and it's due to a truly unforeseen or unfortunate circumstance. But I am always concerned when those who provide aid feel it's not their place to say anything when help is needed because of someone's poor judgment, bad choices, or financial irresponsibility. If you don't speak up, who will? Your advice and counsel could ultimately be far more valuable than any check you end up writing. An area where this is especially true is higher education.

Clients often call to withdraw money or ask if they should co-sign loans to help kids and grandchildren with college expenses. While I truly believe in college, it's not for everyone. Furthermore, very few students or parents have done a realistic cost/benefit analysis on particular degrees and colleges, or modeled what student loan payments look like later in life. I talk from great personal experience. Lisa, a friend of my son Michael, was recently lamenting her $12 hour job after 4 years at LeMoyne and 2 years at Syracuse for a Masters in Social Work (MSW). She was caught truly unaware of the low pay in the field. Contrast that with me making Mike factor in the salary he was giving up as an additional cost of pursuing his MBA, or debating loan payments from Syracuse when he had a scholarship that brought LeMoyne down to a SUNY tuition level. It's a fact that 44% of college graduates are in jobs where no education is required. There are more people with Bachelor degrees in our country working as janitors than engineers. College is expensive, loan repayments are huge burdens, and the advice given to kids by schools is far from objective. If people did a thorough analysis, more kids would "find themselves" at a community college, attend state schools, or pursue a six figure career in the trades.

I will accept that I have to stay invested, and fundamentally change the way I think about the process. Stop immediately if you ever find yourself wondering, "Is this a good time to invest?" Your money has to be put somewhere, and a mattress isn't an approved vehicle for an IRA. The fact is that sound and prudent investing rarely feels comfortable and success requires a strategy. A far more productive way to frame the question is in terms of better or worse. If there is room for improvement or things are moving the right way – even slowly – there is upside potential. I look forward to the coming year! *Mark*

THE NEW AND IMPROVED HORIZON GROUP!

Last year we were busy laying the foundation for another round of vast improvements to the client experience at The Horizon Group. For the first time since 2007 we engaged the services of an outside consultant. Although he was extremely impressed with the organization, there were three initiatives he thought imperative for a more secure client experience with our group. The first involved having a more formalized succession plan should I pass away unexpectedly. Secondarily it was decided we'd add the position of Chief Investment Officer for additional capability and stability of our actual money management. Finally, roles and responsibilities have been streamlined to free Tim from administrative and compliance burdens so he has more time to do what he does best – help you with anything you need!

Our last consultant demanded we create the position of Operations Manager – and was shocked when our young receptionist Carrie tested off the charts for traits and skills the job required. Seven years later I can say she's been an overwhelming success. History repeats itself. Ken Blazick has been promoted to Chief Investment Officer. He has been working on the rigorous CFA designation held by many fund managers. I started mentoring Ken in February of 2011 and hired him later that fall - he's extremely familiar with our culture, strategy, investments, and clients. Over the past year his research and recommendations have been invaluable to me. He will now split his time equally between duties as CIO and Financial Advisor like me.

As for the succession plan, a triumvirate will assume the reigns should I die, with Carrie heading day-to-day operations, Tim advising and reviewing with clients, and Ken managing portfolios. In addition, Kristin is taking her test to become a licensed trader in Diane's absence. I'm not planning on going anywhere, but these moves prepare us for the unexpected. We owe that to the clients and employees who've made our success possible. I'd also like to thank everyone for making The Horizon Group the sixth ranked firm associated with Cadaret Grant, Terry the tenth ranked advisor, and me their top advisor in the nation for the third consecutive year.

CONGRATULATIONS MIKE SILVERSTEIN

How time flies. It seems like yesterday when it was rumored that HSBC was leaving town and I approached Mike Silverstein about becoming an independent financial advisor affiliated with The Horizon Group. It's a source of deep personal pride that Mike has just been named to the elite "Top Advisor" level within Cadaret Grant. This is an extraordinary achievement in just his second year with the firm. Although I played an important role at the start, it's clear the addition of Judy Plain to help with client service and the management of his practice has accelerated his development. Together they have built an effective office - providing sound money management and peace of mind for their clients. With my blessing, they are being granted their own branch office of Cadaret Grant, and are now known as Freedom Financial Services.

This was our ultimate goal when we joined forces – the hard work of everyone involved and a cooperative market made it possible sooner than we dreamed. Although financial and money management ties remain between Freedom Financial and The Horizon Group, Mike and Judy now have autonomy to run their own client website, events, communications, and meet client needs as they see fit. I congratulate them. It is a privilege they have truly earned.

TAX TIME

It's that time of year to pull together all of our tax information and get it into an organized format for the accountant or turbo tax. One mistake clients often make is filing too early, only to have a stray 1099 or statement roll in after the return has been filed. Remember that new laws forcing companies to provide cost basis information on "covered" investments grants them additional time to deliver tax statements. The old January 31st deadline is now more like a suggestion to firms. My advice is that unless you are certain you have every statement needed, I wouldn't actually file until the end of February. As for us, tax information from Pershing is available by download at www.myedocumentsuite.com if you have previously registered for the service. We've been told all corrected documents should be available no later than February 28th.

Many clients have used Joe Valvo as their CPA. He has recently merged his practice with the larger Fredericksen & Sirianni group. Both Kevin and Joe have moved over to their office in Pittsford. I expect the relationship to remain the same as we've known, but with a slight price increase (Joe was a bit underpriced for a CPA). The new contact information is as follows:

Fredericksen & Sirianni	Phone: 585.546.5660 x 21
Attn: Joseph Valvo	Fax: 585.248.5332
1160 Pittsford-Victor Road, Suite J	
Pittsford, New York 14534	joev@gfsf-rochester.com

LONG TERM CARE PRICE INCREASE

In September 2010, John Hancock filed in New York for a substantial rate increase for many of their NYS Partnership Long Term Care policies. The State has finally granted the request effective April 2014 but fortunately has given consumers an out. Partnership policyholders will be offered an inflation "landing spot" of 3.5% which will allow them to avoid the premium increase completely – with no impact on Partnership status. Our understanding is that the inflation benefit will be reduced from this point forward. Obviously this is the option I would recommend – a detailed and customized explanation will be mailed 60 days prior to your renewal *if you are affected.*

FINANCIAL FAIR / CLIENT UPDATE / APPRECIATION

Late this week we are meeting with Roberts Wesleyan to discuss holding our Fall Client Update in their state-of-the art and very comfortable theatre. Its acoustics make it the favorite place of the RPO to perform – perfect for our song and dance! If you recall, our client survey revealed your wish to move the Fair to the September/October timeframe. The only available date at this time is Saturday, October 18th. We have it on hold and will let you know when details are finalized. In the meantime, feel free to share ideas and topics you would like covered! Another date you may want to pencil in is July 12th for our Client Appreciation Day at the National Warplane Museum's Airshow. We'll be mailing VIP tickets and schedule of events to all clients in late June!