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Money Manager Newsletter

December 31, 2014

Investment Consulting Group, Inc.

"Management Is Doing Things Right; Leadership Is Doing The Right Thing"

Patience Wearing Thin

Despite Yellen's assurance the new Fed guidance is the same as the old Fed guidance, the FOMC retreated just a bit at the December FOMC meeting as several of the forecasts in the dot plot drifted lower. As a result, a smooth projection to year-end medians suggests liftoff in June rather than April. But then, the market never accepted April as a realistic possibility anyway. Still, the new "patient" rate guidance is no guarantee the Fed will hold rates low for very long. The Fed is determined to raise rates toward the middle of this year, and in her press conference, Yellen was relentless in dismissing reasons to wait. So, seven FOMC members believe the fed funds rate should be about 1% in December 2015, four think it should be lower and nine think higher. The June liftoff is based on the median, just above 1%, but notice there are more hawks than doves among outliers. Consider Yellen's response to the New York Times' about what would give Yellen confidence that inflation is heading back to 2%. "...let me start by saying the committee has to base its decisions on how to set the federal funds rate looking into the future. Typically we have seen that as long as inflation expectations are well-anchored, that as the labor market recovers, we'll gradually see upward pressure on both wages and prices. ...I will be looking for evidence that I think strengthens my confidence in that view and looking at the full range of data that bears on whether or not that's a reasonable view of how events will unfold. But it's likely to be a decision that's based on forecasts and confidence in the forecast." San Francisco Fed President John Williams told Bloomberg Radio the US economy is in "a very good place," risks are all from abroad, low oil prices are "a very big plus for the US next year" and "June is a reasonable starting point to consider liftoff." We think he's wrong about a few things-the collapse in investment in the oil sector will happen before the boost to consumption, meaning the low oil price will likely slow the economy before growing it-but we believe he speaks for the committee when he says he thinks the Fed's liftoff consensus will settle on June. Later, Williams told Hays inflation won't stop a 2015 liftoff, but it could delay it. Williams is routinely placed at the dovish end of economists' hawkometer scales and even he thinks a June rate hike is reasonable. Bottom line: The FOMC makes policy decisions based on its inflation forecast, not actual inflation. As long as the forecast doesn't veer lower, the Fed won't delay the first hike for long. Chris Low, Chief Economist

Fuel Injection

Cheaper oil should act like a shot of adrenalin to global growth. The typical American motorist, who spent $3,000 in 2013 at the pumps, might be $800 a year better off—equivalent to a 2% pay rise. Big importing countries such as the euro area, India, Japan and Turkey are enjoying especially big windfalls. Since this money is likely to be spent rather than stashed in sovereign-wealth fund, global GDP should rise. The falling oil price will reduce already-low inflation still further, and so may encourage central bankers towards looser monetary policy. The Federal Reserve will put off raising interest rates for longer; the European Central Bank will act more boldly to ward off deflation by buying sovereign bonds. The Economist December 6th 2014

"As an industry, we have battled mightily to foster specific participant behaviors, pursuing increased enrollment, higher savings rates, better asset allocation. But he ultimate goal—the outcome of getting a participant closer to a state of financial well-being in retirement—has proven to be elusive"
Charles Schwab, The New Rules of Engagement for 401k Plans, 2010

12/31/2014	Growth Median P/E	Value Median P/E	Historical Growth Avg.	Historical Value Avg.
Royal Blues	26.1x	13.6x	24.6x	11.3x
Large Cap	20.6x	12.5x	19.8x	10.6x
Mid Cap	22.9x	13.7x	23.3x	11.9x
Sm Cap	27.0x	13.7x	27.3x	11.9x

A New Book By Legendary Life Coach Tony Robbins, Money: Master the Game-7 Simple Steps to Financial Freedom

Remarkably, Robbins has produced a book that will appeal to both the beginner and the most sophisticated money jockey overseeing multibillions of dollars in assets. He lays out persuasive, common sense ways in which people can build up their assets. Robbins tackles the challenge of allowing emotions to sway your investment decisions. Emotions are the enemy. One way to quash performance ruining, emotion-driven actions is to follow the asset-allocation formula. It initially looks like a formula for stagnation: stocks, 30% of your portfolio; long-term U.S. Treasurys, 40% (that's not a misprint); intermediate Treasurys, 15%; gold, 7.5%, and commodities, 7.5%. Robbins rightfully whacks several financial myths, including target-date funds. And he has sober warnings about potential pitfalls in 401(k)s. Forbes—Steve Forbes

For every additional penny that prices at the pump continue to fall, we can think of that as an additional $1.345 billion annual "tax cut" for consumers and alternatively as a $1.345 billion "economic stimulus" for the US economy. Lower oil and gas prices are "unambiguously good for the US economy". The shift to around $80 a barrel from $100 a barrel will somehow close down the American energy revolution and destroy all the new jobs and related infrastructure services that have fueled our recovery. Nonsense, I spoke with a CEO who is literally at the cutting edge of the horizontal-drilling and hydraulic-fracturing revolution about the so-called "profit break-even point," or the marginal cost of producing the next barrel of oil. He told me it averages between $50 and $60 a barrel. And a new report from Citigroup energy analyst Edwin Morse argues that oil has to fall to $50 or less to fully halt shale-production growth. Virtually all consumers and producers will benefit from lower energy cost. Households could save as much as $100 billion because of today's lower fuel costs. Business fuel savings will also be substantial. The result is a much more competitive U.S. Mark J. Perry 10/20/14

Research suggests that Asia will account for two-thirds of the world's middle class citizens by 2030. Median ages in Asia have risen over the last 30 years and now range from the mid-20s in the Association of Southeast Asian Nations (ASEAN) and India to between 35 and the early 40s in prosperous North Asia. So, as these wealthy Asians reach their peak earnings years, they have a greater need for trustworthy, efficient capital markets to help them save for retirement. To serve these needs, insurance companies and pension funds require a healthy return with a measure of security to cover their long-term liabilities. But so far, financial innovation and retail investment have taken time to gather pace. Even in markets considered quite sophisticated, certain financial products are new. Financial reform may sound "irrepressibly drab" compared to the romance of national revolutions and the development of entrepreneurial economies. But the era of the accountant—if it is truly beginning in Asia—marks an exciting step in the evolution of capital markets, from volatile and speculative casinos to trustworthy institutions capable of supporting the investment needs of Asia's middle class.
Robert J. Horrocks, PhD, Chief Investment Officer and Portfolio Manager—Matthew's Asia

The political scene in 2015 will be different, and not in a good way. At the end of the 1990s most people in the rich world had enjoyed the fruits of the boom: median American wages rose by 7.7% in real terms in 1995-2000. Since 2007, by contrast, they have been flat in American, and have fallen in Britain and much of the euro zone. All over the rich world voters are already grumpy with their governments, as polling numbers and their willingness to vote for protest parties show. If they are squeezed next year discontent will turn to anger. The economics of 2015 may look similar to the late 1990s, but the politics will probably be rather worse. The Economist December 20th 2014

"Everyone has brainpower to follow the stock market. If you made it through fifth grade math, you can do it." Peter Lynch

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Treasury Market Yields	12/31/2014	12/31/2013	12/31/2012
2 Year	0.67%	0.38%	0.25%
5 Year	1.65%	1.75%	0.72%
10 Year	2.17%	3.04%	1.78%
30 Year	2.75%	3.96%	2.95%
Commodities			
Oil ($bal)	$53.27	$99.29	$91.82
Gold ($/oz.)	$1183.90	$1203.10	$1674.80
CRB Index	$229.96	$282.57	$295.01

Those who forget history are doomed to repeat it. That phrase has attributed to many, most recently Jack Kennedy. Somebody should remind Congress. It has only been about ten years since the government agencies known as Fannie Mae and Freddie Mac led the way into the world of sub-prime loans—no money down, no credit checks, no job necessary. The banks followed later and have been blamed ever since. Well the government can't sue itself. When the famous Willie Sutton was asked why he robbed banks, he replied, "Because that's where all the money is." Well, it's easy for the government to sue the banks because there is money there, and they cave in pretty easily rather than go to court. Now the government is putting Fannie and Freddie back in business and telling them they can back mortgages originated with 3% down. Yes, 3%. It's been less than ten years and already the government has forgotten how we got into this mess. Dana Investments

Why So Many Predictions Fail

Markets are hard to beat, but markets can be pretty wrong. Human behavior is a wild card, how do you weight it? Tell us when building a model, the less assumptions you mark, the better the model. People are unpredictable, you can predict how unpredictable people are.

Presidential stock cycle show the Dow Jones industrial average has a better performance during the third year of president's term in office (regardless of whether it's a first term or second term) than it does in any of his other years. The consistency is remarkable. Since 1896, according to Barrons, the 30 companies included in the Dow Jones industrial average have gained an average of 15 percent, including dividends, during a president's third term, with an 82 percent degree of reliability. So tell your broker to buy 100 shares of the Dow Jones Industrial Average ETF (DIA-$180.06). The biggest fear, and it's unspoken, is that Russian President Vladimir Putin will try to solve his country's economic problem by engaging the West in some form of hostility. It would work because war creates full employment, which helps people forget their miseries. Malcolm Berko

It's hard for most people to understand the self-correcting aspects of economic events.

- A decline in the price of gasoline induces people to drive more, increasing the demand for oil.
- A decline in the price of oil negatively impacts the economics of drilling, reducing additions to supply.
- A decline in the price of oil causes producers to cut production and leave oil in the ground to be sold later at higher prices.

In all these ways, lower prices either increase the demand for oil or reduce the supply, causing the price of oil to rise)all else being equal). In other words, lower oil prices—in and of themselves—eventually make for higher oil prices. This illustrates the dynamic nature of economics. Howard Marks — Oaktree Capital Management

What will the next 10 or 20 years bring? Who knows? Since 1950, the U.S. has seen four wars (Korea, Vietnam, Iraq, Afghanistan), 10 recessions, riots, presidential assassinations and attacks on U.S. soil. The stock market had a 22.6% drop in a single day. Yet here we are, and the S&P 500 has gone from 16.93 on Jan. 5, 1950 to 2020.58 today.

Defined Contribution Plans: A Historical Look

1970-1980s	1990s	2000-2008	2008-Present
ERISA passed in 1974	401 (k)/defined contribution plans cover as many American workers as defined benefit plans	401 (k)/defined contribution plans now the primary retirement saving vehicle for American workers	Investors lose confidence in ability to control retirement savings plans
Section 401 (k) - a loophole in the code - was exploited, giving rise to the modern 401 (k) plan	Millions of American workers become "do it yourself" investors as the US stock market sustains an unprecedented 10 year bull market run	Investors demand multi asset manager open architecture and choice	"Do it yourself" investors become "do it for me" investors, giving rise to various asset allocation and advice solutions
401 (k) plans gain popularity as a "supplemental" savings plan for American workers	Self directed brokerage accounts gain in popularity	"Auto" features popularized with the passage of the Pension Protection Act in 2006	Investment menus are simplified
Limited investment choice offered			Fee transparency with the passage