Old Port Advisors

Est. 1994

Partners for a Secure Future

VIEWPOINTS

3RD QUARTER 2014	*ADVISORY NEWSLETTER*

2014 - 20TH ANNIVERSARY YEAR

As you can see from the above, it's an exciting time for our firm. We're commemorating our 20th anniversary and thanking people like you who have been the pillars of our past and the promise of our future.

As you may be aware, we changed our name as part of an extensive two-year strategic planning effort which has resulted in our rebranding. We are now Old Port Advisors. What hasn't changed is the service and commitment to excellence you've come to rely on. Our whole team, led by our founders Fred Williams and Tom Donaldson, is thrilled to continue building a bright and secure future with you. To read more about our journey please go to our new website, www.oldportadvisors.com, and follow the link to our story: Yesterday, Today, Tomorrow.

MARKET COMMENTARY **FREDRIC W. WILLIAMS**

Lions, and Tigers, and Bears! Oh My!

"People greet a 10% drop from the highs as if the sky is falling…We're in just about the only business in which discounts are greeted with alarm."

- Rob Arnott; Research Affiliates

Late September and early October brought fear back into the markets as the globe continued to be visited by the Oz-like trifecta of the continuing standoff in Ukraine, the ISIL terror in Syria and Iraq, as well as the Ebola outbreak reaching outside of West Africa for the first time. Sanctions on Russia were impacting European trading partners, the uncertain outcome, and impact, (still) of Mid-East tensions stressed diplomatic relations, while the presence of even limited Ebola cases in Europe and the US put a damper on travel and fright into the citizenry.

Prior to that, the VIX (a.k.a. the fear gauge) had been hibernating most of the summer, hitting a near all-time low around 10 at the end of June, with a brief spike to 17 in early August, before a mid-October move upwards to the 28 area before once again retreating. This pattern was obviously an inverse of the capital markets, which retreated in the presence of Dorothy and her "pals", which also had to deal with concerns about economic softness in both Europe and China. And although the VIX sits lower now than January of 2013, when it hit 28, people seem to forget that in February of this year it was at 22, almost exactly where it stands now. The domestic equity markets' near 10% decline through this mid-October was the first retreat since October 2011, when the markets were facing the same concerns about a recession in Europe and slowing GDP growth in China.

Also contributing to this bout of volatility has been the aforementioned sanctions on Russia and the collateral impact they're having (somewhat unintentionally) on economies throughout Europe – but these are man-made issues that could quickly be removed should the crisis be settled. Although having a terrible impact on affected West African nations given its current fatality rates, Ebola doesn't have nearly the airborne transmissibility concerns that we deal with every year in the US where we lose approximately 10,000 people annually to influenza. The ISIL turmoil, however, will likely be something that the world will have to deal with for a while, but absent any terrorist attacks on western countries' soil, it should have limited impact on overall global GDP.

All that aside, volatility is unsettling for investors and is a factor we strive to mitigate in our portfolio management and research process. But how is that addressed in a practical fashion? The simple answer is to seek out relatively low volatility stocks for that portion of one's equity portfolio. The concern here, however, is the ongoing debate regarding risk and reward and whether one must give up returns in exchange for less price fluctuation in a portfolio's overall value.

> *"Which would you rather invest in: A company that is cool and trendy or one that is so boring that it's been years since any reporter has bothered to mention it? If you're like almost everyone else, you would choose the former. Who wants to invest in a yawnfest?*
>
> *"Believe it or not, that snoozer is the better bet. You pay a higher price for investing in popular and trendy stocks. Researchers reached this conclusion by measuring the performance of stocks that have exhibited the least volatility. They found that greater investor and media attention begets more volatility, which in a vicious cycle begets yet more attention, eventually translating to lower future returns. Boring stocks, in contrast, tend to remain boring and not very volatile, and outperform the volatile stocks getting all the attention."*
>
> \- *Mark Hulbert; MarketWatch*

These summarized observations came from three decades of work by Dr. Robert Haugen (University of Wisconsin), and are consistent with the research noted in this space last quarter by Robert Ibbotson and Jeremy Siegel, who reached similar conclusions while using differing metrics. Ibbotson's latest work focused on low turnover and less popular companies, while Siegel has long championed low price/earnings, high-dividend companies – with both demonstrating performance advantages over the markets as a whole.

We continue to believe that boring can in fact be beautiful, and as we've said numerous times over the years, we're far happier being the tortoise, rather than the hare, within the investing world.

Reversal of Fortunes…

> *"Some participants expressed concern that the persistent shortfall of economic growth and inflation in the euro area could lead to a further appreciation of the dollar and have adverse effects on the US external sector… slower economic growth in China or Japan or unanticipated events in the Middle East or Ukraine might pose a similar risk."* ***~ From the minutes of the September policy meeting of the FOMC.***

The economic picture remains difficult to decipher, even for the members of the Federal Open Market Committee, the government branch most able to directly influence the direction of interest rates and consequently the course of the economy. Through most of 2014, market participants had been concerned about inflation and the Fed's need to contain it with higher rates. The missing piece of the puzzle had been wage pressure. The wording in the minutes of the September meeting brings in the opposite fear – slowing growth domestically and abroad. A sharp drop in crude oil prices combined with a stronger dollar rapidly adjusted the economic and investment outlook as the fourth quarter began.

Late September brought volatility back to the equity markets as this new economic outlook became more apparent and investors modified their holdings. In the third quarter, large cap domestic stocks were the place to be invested. These shares (best represented by the S&P 500) recovered from a sharp sell-off in July to post a about a 1% gain during Q3 – bringing the return for all of 2014 to over 8%. Health care stocks were the strongest sector of the S&P 500 followed closely by information technology shares. Falling oil prices caused a decline in energy stocks while utilities, industrials and business services did slightly better. Smaller cap stocks saw meaningful declines.

The US economy showed more signs of life during the quarter. GDP growth for the second quarter was revised upwards and the labor market looked better than expected. Unemployment fell to 5.9% in September but, as noted above, wage growth remains static. Particularly strong reports came from the manufacturing sector and the much larger service sector. Housing starts cooled off from earlier gains but overall construction remains in a slow and steady recovery. The lack of wage increases along with headline and core inflation levels below 2% reinforces that, at the moment, there still is no sign of inflation.

Fixed income markets saw more varied results in the third quarter than in the first half of 2014. Yields rose in the shorter end of the Treasury curve as rates on two and five year US government notes rose while 10 and 30 year yields fell. Investment grade bonds outperformed high yield as risk was reduced.

Outside of the US, financial markets had negative returns in US dollar terms as they struggled with effects of the volatile situation in Ukraine, continuing unrest in the Middle East and signs of slowing economic growth in China and Germany. The proximity to geopolitical tensions weighed on the Eurozone and in particular was felt by the German economy, which had been the strongest member of the EU. However, Germany has deep economic ties with Russia and is their largest trading partner in the EU. The pain of the sanctions against Russia for Putin's undertaking in the Ukraine will be felt by the German economy. One example of the connection and history of the continent is the fact that German Chancellor Angela Merkel grew up under Communism in East Germany and speaks Russian.

The Asian markets did better than the EU. Japan had positive returns with exports – but only after converting to dollars. Chinese economic growth also slowed from its recent pace.

A strong dollar directly impacts US exporters as our goods and services become more expensive for foreign consumers who, as a result, buy fewer US products. Companies that have productive capacity spread around the globe suffer less since they can avoid switching or translating currencies. For instance, if a US company makes a product in Japan, pays wages and taxes in Yen, sells the product in Japan receiving Yen, then the company will make a certain profit in Yen. The relative value of the dollar will have no effect. Those companies that produce here in the US and then export their goods will have a problem if the dollar continues to rise. When profit is repatriated and brought back to the US for corporate purposes or to distribute to shareholders, it will not translate to as many dollars or be worth as much as it was when the Yen was stronger.

For the consumer, a strong dollar will buy more in relation to other currencies. This lowers the price of foreign goods and services in dollar terms. These cheaper foreign goods divert income from domestic providers of goods and services, and overseas holidays become slightly more affordable. Ideally, the dollar and all currencies should be valued at a level that is neither too high nor too low. Such a level would help sustain long-term economic growth and stability both here and abroad. However, this ideal is difficult to reach since there are many factors that affect the value of a nation's currency. These include monetary and fiscal policy, economic growth and currency speculators. So both consumers and investors learn to adapt and take advantage of these fluctuations.

The ride may get bumpy, short-term fluctuations matter less than a disciplined approach to long-term investing. To realize the proven gains found in the financial marketplace, an investor cannot allow emotion to interfere with a balanced plan based on a portfolio of high quality equities and solid fixed income holdings. Any investment strategy will have to weather the occasional downturn – that is the difference between *investing* and *playing the market*. In riding out such times, patience typically proves more important than timing.

Index Returns			
Equities	*Percentage Change for the 3rd Quarter*	*Percentage Change for the Year*	*Annualized 10-Year Returns*
S&P 500	**1.13%**	8.34%	8.11%
DJ UBS Commodity Index	**-11.83%**	-5.59%	-1.04%
MSCI EAFE	**-5.88%**	-1.38%	6.32%
MSCI EM	**-3.50%**	2.43%	10.68%
NAREIT Equity REIT Index	**-2.51%**	13.36%	8.53%
Fixed Income			
Barclays Aggregate	**0.17%**	4.10%	4.62%
Barclays U.S. Treasuries	**0.34%**	3.06%	4.22%

The Benefits of an Independent Fiduciary in the Institutional Asset RFP Process…

Finance and investment committees of boards have increasing fiduciary responsibility for the institutional assets that they oversee. Institutional assets can be loosely defined as endowment, foundation, pension and municipal assets, and usually require the services of an investment management firm to manage the risk and return components of the accounts. As fiduciaries, the committees are responsible for being aware of the marketplace and periodically reviewing their managers. This due diligence is usually performed through a request for proposal (RFP) process.

One of the truisms for investment firms that compete to manage institutional assets is if you do not have input into what goes into the RFP document, you are unlikely to win the business. The investment firm that finds itself "helping" the client write the RFP often slants questions in the document to favor their way of managing assets (commission vs. asset-based fee, active vs. passive, funds/ETF's vs. individual securities, etc.) and, unknowingly to the client, uses the process to hide the investment firm's weaknesses (high fees, lack of experience, poor performance track record, etc.). This more often than not leads to the business being awarded to the "helpful" firm. For this reason, the RFP process is often political, which puts the investment and finance committees in a tough spot and makes it difficult for them to perform their fiduciary duty.

At IMCG (now Old Port Advisors), we have acted as independent investment fiduciaries in the best interests of retirement plans for many years. Lately, we have developed a market niche by creating a similar independent investment fiduciary functionality for institutional asset RFP's. In the past nine months we have successfully independently managed the RFP process for over $80 million in institutional assets, helping our clients award their asset management to the right firm. The benefits of having an independent investment fiduciary like us manage the RFP process are tremendous:

- We do not bid on the management of the account. Consequently, we remain an independent, unbiased and conflict-of-interest-free resource for the client during the RFP process. We charge a fixed cost to handle the entire process: RFP generation, communication, submission, review, documentation and analysis.
- We are experts in the investment field and therefore able to identify the managers that best fit our client's needs; we ask the right questions in the RFP process that result in the greatest benefit for our clients.
- We prepare a very thorough set of presentation-level documentation for the process which allows our client base to demonstrate that the decision making methodology was independent, unbiased and exercised fiduciary caution.
- We control all of the communication which limits the awkward interaction between a client and its incumbent manager and time-consuming follow-up with potential bidders.

If you have any reason to discuss our relatively new fiduciary service offering, please contact our independent fiduciaries at Old Port Advisors (formerly IMCG).

Saving for College Tips: How to Handle it When Your Child Does Not Attend College…

TIP # 1: Changing the beneficiary on a 529 Plan

You are considering starting a savings plan for your child's/children's college education, but you are worried one or both might choose not to pursue a post-secondary education. What do you do? After all, you know you should start saving early to have the biggest impact on taking a bite out of the tuition costs. If they don't go to college (or better yet, get a full ride), what happens to the money you accumulated for them? Can you name someone else as the beneficiary of your child's college savings plan?

The simple answer is YES: the rules state if you are the owner you can change the beneficiary to one of the following relatives of the current beneficiary:

- Son or daughter or descendant of son or daughter
- Stepson or step daughter
- Brother, sister, stepbrother or stepsister
- Mother or father or parent of mother or father
- Stepmother or stepfather
- Son or daughter of brother or sister
- Brother or sister of mother or father
- Spouse of any individual listed above
- First cousin of beneficiary
- Brother-in-law, sister-in-law, son-in-law, daughter-in-law, father-in-law and mother-in-law

TIP # 2: Using a Roth IRA for college savings

Another option if your child does not want to go to school: utilize a Roth IRA as your primary savings vehicle for paying for college. A couple of benefits to this strategy are:

- The Roth IRA savings are not committed to college expenses, they can be used for other expenses like retirement, so if your child doesn't attend college you have access to the balances.
- The Roth IRA contributions and earnings grow tax free, and after five years you can access the money.
- The Roth IRA does not count as an asset on the Free Application for Federal Student Aid (FAFSA). However, you would have to report the withdrawals as untaxed income the next year on FAFSA which might hurt your chances at receiving any aid.
- For the 2014 tax year, a Roth IRA account is available to married couples making less than $181,000 and a single person making less than $114,000.

Let us know if you would like to discuss these or any other college savings strategies.

Post Office Box 4802 ♦ 130 Middle Street ♦ Portland, Maine 04112
207.774.6552 ♦ 800.605.6552 ♦ FAX 207.775.2969
www.oldportadvisors.com ♦ info@oldportadvisors.com