VIEWPOINTS

4TH QUARTER 2015	*ADVISORY NEWSLETTER*

MARKET COMMENTARY **FREDRIC W. WILLIAMS**

The Year Nothing Worked…

From an asset allocation standpoint it could be argued that 2015 will go down in the annals of investment lore as one of the worst in almost 80 years[1]. When viewing the relative history of the four core asset classes (stocks, bonds, cash and commodities) it's expected that there would be relative performance divergences between them where one class may have gone down and be offset by another asset class going up…but not last year. As is seen in the table below, as well as in the subsequent capital markets overview, none of the major asset classes provided a haven in the cross currents that were last year's trademark. Reasons for this muddied performance range from the "lift off" in US interest rates (the first in almost 10 years), to the decline in commodity and energy prices, as well as concerns about the status of the Chinese economy, now that it's the 2nd largest in the world.

Markets have always gone through periods of expansion and contraction based on a variety of the globe's macro-economic forces, and cycles like this have been shown to impact investors' behavioral psyche, so it's always instructive to make sure we keep an eye on the past so we learn from it, but not focus on it at the expense of seeing what may be over the horizon.

"Never look back unless you are planning to go that way."
- *Henry David Thoreau*

Coming to grips with what someone's true investment time horizon may be (recall that the Oracle of Omaha suggests a multi-decade perspective), it's instructive to view short term volatility within the lens of longer term statistical probabilities, realizing that, for example, those investors who left the markets near the lows in 2009, faced the daunting task of deciding when to return as the markets continued to retrace all their declines over the next 4-plus years. Although not intended to be a patronizing panacea, sometimes prudently staying

[1] According to data compiled by Bianco Research LLC and Bloomberg Business; 12/28/15

the course allows for a greater likelihood of taking advantage of mean revisions on the upside as markets eventually recover from declines.

> *"According to Bianco's study, gains from the best-performing assets had surpassed 10 percent in all but one year since 1996. During the past nine decades, 23 years, or a quarter of the total, saw at least one asset class returning more than 30 percent, and only four ended with gains smaller than 4 percent."*
>
> \- *Lu Wang, Bloomberg Business 12/28/15*

The difficulty of the above, of course, is in maintaining one's intestinal fortitude when experiencing the *other* side of the performance summary that they reference, given that the overall goal of the asset allocation investment discipline is to remain exposed to all the asset classes – the good, the bad, and the ugly. Helpful in this process is some additional statistical insight that can help salve the concerns from short term volatility:

> *"A common market observation is that crashes are fast and recoveries slow. Looking at the 17 declines since 2009, that rule of thumb is surprisingly inaccurate. Over those declines, it took an average of 26 trading days to bottom out, but it also took a surprisingly equal 26 days to recover to the same value, an almost 1-to-1 recovery-time ratio. Median statistics show an even stronger result with 19 days to bottom but only 15 days to recover.*
>
> *"A study of correction recovery time frames by Wealthfront from 1965-2014 shows similar results. Looking through 14 corrections, they found the average peak to bottom took 85 days and bottom to recovery took an average of 107 days a 1.26 recovery ratio."*
>
> \- *J.J. Zhang, MarketWatch 9/18/15*

As mentioned above, recognizing one's true investment time horizon can many times mitigate the emotional extremes that sometime accompany market volatility. Even investors in their mid-60's needs to have a 20 year time horizon at this point in time – a reality that is often overlooked within the context of the media's minute-by-minute reporting of the globe's financial markets. Faced with lengthening lifespans, 65-year old "retirees" should likely be continuing to work as productive members of our society, AND maintaining their portfolio equity exposure to preserve future purchasing power (something particularly true now given the impact that rising interest rates will have on bond market holdings).

The reluctance to embrace this dynamic is often as a result of the confusion surrounding the concept of "volatility" and "risk" and was touched on in Mr. Buffett's 2015 annual shareholder letter:

> *"The unconventional, but inescapable, conclusion to be drawn from the past fifty years is that it has been far safer to invest in a diversified collection of American businesses than to invest in securities — Treasuries, for example — whose values have been tied to American currency. That was also true in the preceding half-century, a period including the Great Depression and two world wars. Investors should heed this history. To one degree or another it is almost certain to be repeated during the next century.*
>
> *"Stock prices will always be far more* **volatile** *than cash-equivalent holdings.* **Over the long term***, however, currency-denominated instruments are* **riskier** *investments —* **far** *riskier investments — than widely-diversified stock portfolios that are bought over time and that are owned in a manner invoking only token fees and commissions. That lesson has not*

customarily been taught in business schools, where volatility is almost universally used as a proxy for risk. Though this pedagogic assumption makes for easy teaching, it is dead wrong: Volatility is **far** *from synonymous with risk."*

Understanding these concepts, although sometimes challenging to experience, can help maintain one's more realistic time horizon, along with the discipline to back away from the "sell" button in the midst of unsettled markets.

CAPITAL MARKETS OVERVIEW JASON FOSTER

Multiple themes and developments emerged throughout 2015. The markets started the year strongly and then faded. Tepid earnings, a collapse in oil prices, a slowing China and the end of the Federal Reserve's zero interest rate policy proved too much pressure for many asset classes to generate positive performance. The fourth quarter of the year, however, provided some relief to investors.

The final quarter of the year coincided with the first correction of the S&P 500 in over three years. The market recovered quickly as all sectors within the S&P 500 participated in a rebound that began in October. The benchmark climbed 7%, repairing the majority of its losses of the prior months. Mid and Small Cap stocks participated in the rebound to a lesser degree, bouncing +3.6% each for the quarter, but finishing the year with losses, down –2.4% and –4.4% respectively. Developed international markets participated too, as the MSCI All Country ex-US index rallied 8.27%. But it proved too little too late to reach positive territory as the group finished just under –4% for the calendar year. Emerging Markets were nearly unchanged for the quarter doing little to improve the benchmark's double digit loss for the year. In contrast US large cap stocks lead the pack with a 1.38% return for 2015.

Index Returns			
Equities	*Percentage Change for the 4th Quarter*	*Percentage Change for the Year*	*Annualized 10-Year Returns*
S&P 500	**7.04%**	1.38%	7.31%
DJ UBS Commodity Index	**-10.52%**	-24.66%	-6.43%
MSCI EAFE	**4.71%**	-0.81%	3.03%
MSCI EM	**0.66%**	-14.92%	3.61%
NAREIT Equity REIT Index	**3.98%**	7.26%	7.41%
Fixed Income			
Barclays Aggregate	**-0.57%**	0.55%	4.51%
Barclays U.S. Treasuries	**-0.94%**	0.84%	4.18%

As equity markets recovered in the 4th quarter, fixed income investors honed in on the possibility of the first interest rate hike in nearly a decade. US corporate bonds and the Barclays US Aggregate index, anticipating the hike that eventually came in December, both slipped in value by roughly 50 basis points. For High Yield bonds, weakness accelerated, not so much from rising interest rates but more so from the deteriorating energy and commodity sectors. Newcomers to the energy space, like the frackers, began feeling the consequences of

OPEC's strategy to keep production elevated and thus oil prices down. For many companies in the industry, profitability was no longer possible if oil prices remained below $40/barrel for too long, and their bond values were adjusted accordingly. The best fixed income sector of the year was Municipal Bonds. The asset class gained an additional 1.6% in the quarter. Their high quality, along with yields that often matched or exceeded treasury counterparts, attracted investors helping the asset class bank a +3.76% return in 2015.

As we look ahead to 2016 we face similar challenges to those we saw a year ago. Stock valuations appear reasonable assuming earnings meet expectations. Yields on fixed income securities remain historically low and face the continued threat of tightening monetary policy. And as of the writing, just a few days into 2016; the Chinese stock market/economy has inserted fresh concerns on hampering global growth.

FIDUCIARY CORNER — STEPHEN L. EDDY

The (not-so) "New" Fiduciary Standard

In a recent article, Reuters columnist Mark Miller wrote the following on the topic of the fiduciary rule proposed by the Department of Labor:

> *"The U.S. Department of Labor is applying the finishing touches to the so-called fiduciary rule - a geeky-sounding phrase that actually will mean a great deal to anyone with a 401(k) or Individual Retirement Account (IRA). This rule will reshape the retirement advice business because it will require banks, brokers, mutual fund companies and insurance agents to keep fees low and protect your savings from excessive risk when they advise you, rather than focus on how much they can earn in commissions. (<u>A specific subset of advisers called Registered Investment Advisers, or RIAs, who typically work independently or for smaller firms, already are subject to a fiduciary duty standard.</u>)"*

I have underlined the last sentence, which appeared in parentheses in the article. Old Port Advisors is a Registered Investment Advisor, which as the article states, means we are already subject to a fiduciary duty standard. Being fiduciaries – putting the best interests of the client ahead of everything else – is nothing new to us. It's what we're paid to do, how we think, and the basis of how RIA's are regulated. What you should be aware of and what is really important and ground-breaking about the proposed rule is that the DOL is trying to apply the fiduciary standard concept broadly across the rest of the financial services industry.

How important is this? The lobbyists for the non-RIA groups tried to put a rider into the December 2015 omnibus federal spending bill that would have stopped the rule from being implemented. They are hiding behind all sorts of rhetoric about the difficult and cumbersome process to implement the fiduciary standard across non-RIA practices. The fear is that non-RIA advisors will lose clients if held to a different standard than that under which they currently operate.

I guess that's the whole point isn't it? Being a fiduciary takes a mindset of putting the client first. That's how RIA's like Old Port Advisors work. If you haven't been working in your client's best interest previously, maybe you shouldn't be in that business?

As Miller references, those impacted include brokers, insurance agents, bank investment reps – basically anyone who gets paid by a company for selling that company's product.
The types of payment they receive range in complexity from one-time commissions and front-end loads to ongoing "wrap" fees to the embedded "12b-1" fee, and they are not all necessarily in the best interest of the client.

If implemented, the fiduciary rule would force the broker to do what is in the client's best interest. The DOL expects the new standard to have a significant impact on client assets, from lowering costs to improving risk management strategies. While RIA's like Old Port Advisors can sit back and say "that's how we have always done business", the other product-based business models are going to need to make major changes. Ultimately, every client will benefit.

PLANNING CONCEPTS

"Plans are nothing; planning is everything."
- *Dwight D. Eisenhower*

The Retirement Smile **Tracy Rogers**

Well hopefully just the title made you want to read this. Recently, David Blanchett, head of retirement research at Morningstar published an article on retirement spending habits. He found that the spending habits at retirees' different stages mimic a smile pattern. Some have suggested that because of this people could be saving too much for retirement based on some of the general assumptions that abound – like the generality that you only need 70% to 80% of your preretirement income. I thought I would highlight the salient points of the article.

1) Early Years: These are the peak activity levels of retirees. While you lose some expenditures, travel to work, gas, lunch out and work clothes. You now also have time to complete your bucket list. You may travel more, enjoy your hobbies (golf is expensive when you buy new clubs every year), visit grandchildren and may even be helping children or parents.

2) Mid Years: In the mid 70's you may have done what you wanted to do. Travel has slowed down and your mind and body may have has well. The study showed that spending decreases in this age range.

3) Later Years: This is where spending again increases. The main reason is health care costs which have outpaced inflation. Most people have had rising medical costs, a long term care situation or have become dependent on others.

There are some strategies that come from this. One is to try and accurately think about the early years and what you may want to do early in retirement. If you have a bucket list, we should plan for it. This also ties into an earlier article I did and the retirement buckets. Having a few years of expenses in cash at the onset of retirement reduces the uncertainty (called "sequence risk") of having to sell investments during a market downturn.

In the mid years it is important to start to save again if possible. This is where many people fail. Spending has slowed down and discretionary income has increased and it is not being saved. This savings can help offset the increased spending in medical or personal care expenses in later years.

For soon to be retired clients this may be a good time to revisit projections and a "bucket list" if you have one. For retired clients who are slowing down, it may be time to talk about expenditures possibly increasing and are we prepared for it.

Measures in Place to Protect Client Assets **Missy Lyon**

Not so long ago, you went to your bank for Bank-related products and you went to your stock broker for Investment-related services. Those lines are now blurred and consumers can often accomplish all of their financial-related transactions in one place. This is a quick refresher on which entity is providing the insurance for what products and how much coverage is available to investors.

The most common and well-known entity is the FDIC (the Federal Deposit Insurance Corporation, established in 1933). The FDIC is a federal agency that insures bank deposits up to $250,000 per account registration. If you use the Bangor Savings location in Waterville for your personal accounts and also maintain accounts through their Machias location, bear in mind that is considered one bank for insurance purposes. Also be aware when a large national bank owns a smaller regional bank, although sometimes branded under two different names, it's considered one insured bank for FDIC purposes. The flip side of that is you can have a joint account with your spouse at TD Bank and the very same account registration at a different bank next door, and both accounts are entitled to the full FDIC coverage. This insurance covers your checking accounts, CDs, savings accounts, some retirement accounts like IRAs, and some trust accounts. Visiting the FDIC's *EDIE* estimator website can help you get an accurate handle on your bank insurance coverage www.fdic.gov/edie/calculator.

If you are a credit union member, you receive similar coverage from the NCUSIF (the National Credit Union Share Insurance Fund, established in 1970). Like the FDIC, the NCUSIF is a government agency backed by the full faith and credit of the United States government. The NCUSIF has similar rules about account registrations and also insures up to $250,000 per individual depositor.

FDIC and NCUSIF do not insure stocks, bonds, mutual funds, life insurance policies, annuities, or municipal securities, even if these investments were purchased while you were sitting in your banker's branch office.

SIPC (the Securities Investor Protection Corporation, also established in 1970 as part of a broader financial protection legislation package) is a non-profit membership corporation created to insure stock and bond portfolios typically held at brokerage firms. This insurance is triggered in the rare event that a member firm becomes insolvent and goes bankrupt, steals cash or securities from customers, or never purchases securities that have been ordered and paid for. The insurance doesn't cover poor investment choices or market declines. SIPC's

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current limits are $500,000 per account registration (with $250,000 of that being in cash). Visit www.SIPC.org for specific examples.

Most major brokerage firms purchase additional or "excess-SIPC" insurance to cover investors with larger accounts. Many utilize Lloyds of London for this additional coverage. Actual excess-SIPC limits vary somewhat firm-to-firm, so check your brokerage's website for its particular policy limits or ask your OPA financial advisor. Excess-SIPC would only come into play after the maximums on the SIPC per account registration coverage had been exhausted.

Keep in mind that if you own 100 shares of IBM, you own those shares regardless of the financial stability of your brokerage firm. The shares continue to exist and are held in custody with you as the beneficial owner. Shares of money market funds in your brokerage accounts, although viewed as cash by investors, are actually considered securities by SIPC and protected at the same levels by both basic SIPC and excess-SIPC in terms of per account coverage.

Your OPA advisor would be happy to review your bank and brokerage statements with you so you can see a summary of what your household's asset insurance coverage is across the various providers.

INSIDE THE MARKETS — FRANCIS J. DAVIES, III

Sino-centric concerns…

The beginning of 2016 has been a harsh period for global markets largely due to mounting concern about the health of the Chinese economy. Fears of a Beijing slowdown triggered a 10% drop in the Shanghai Composite Index in just the first week of the year. Tremors were felt internationally as well with global markets getting off to the worst start to a new year in 20 years.

The turbulence in China comes as the US moves to a normalized economy. As discussed in the October update, financial systems have been tightly controlled by central bank action for the past seven years. This changed in December as the Federal Reserve raised Fed funds 0.25%. The size of the increase is minor but the direction is significant. It signals the end of the Fed pumping funds into the system. Without the cushioning afforded by central bank intervention, market disruptions will be felt more acutely.

The Chinese economy is also going through a period of transition. The Chinese Communist Party (CCP) is attempting to change from an economy fueled by export dominance and massive government spending to one driven by domestic consumption and a consumer class. As part of the plan, this past summer the government encouraged its people to buy stocks. Constant cheerleading articles in the official newspaper strongly implied an unwritten state guarantee against loss and encouraged speculation.

With stocks at unwarranted levels, any sign of slowing in the economy is magnified by selling in the markets. The People's Bank of China (PBOC) has spent billions to prop it up so far and this will likely continue. As the chart below illustrates, the meddling has been constant.

Now the CCP is in a real bind. Large losses in the market would hurt its citizens which could cause them to question the competence of the central planners. This is not something the CCP can allow. Its response might go beyond economics to political action. That is a development we do not want to examine in this short update.

As mentioned, China got to their current position through being the low cost producer of goods, exporting to the world. Their ravenous consumption of raw materials boosted commodity based economies, especially the developing nations. Now these countries face the most severe slowdowns. The export revenues drove spending on infrastructure. While this is necessity and something we desperately need domestically, there reached a point where there were no meaningful projects left to build. The combination of monopolies and corruption in China allowed the building to continue. Industrial capacity became over built; ghost cities were constructed and excess inventory looms over the economy. To a smaller degree, the same type of imbalance created the domestic real estate bubble.

The Chinese economy grew to a size where it can exist on export alone. They need to encourage domestic consumption – which is an enormous cultural development, one that Japan still struggles with. And China is trying to achieve this change in a very compressed time period. Even if the transition happens, a consumer based economy is never going to grow at the same rate as one running on strong exports and a government spending like a drunken sailor. Expectations and prices will have to adjust.

An outside agency, like a central bank, can set an artificial level for a currency or stock market. But market forces will inexorably grind away until they reach true price discovery. An asset's real value can only be determined by a free market of buyers and sellers balancing supply with demand. Attempts to control free markets inevitably prove as futile as trying to control the ocean. Seawalls and jetties are stop gap measures; the ocean always will go where it wants. Markets are much the same. It is unstoppable. It is better to find that level now rather face a larger pent up market situation later.

The story is far from done, but at least it has started. The Chinese stock market still has myriad restrictions in place that will delay reaching a realistic level. It will be a bumpy ride as their market looks for reasonable valuations. Keep in mind, however, that volatility means fluctuation in prices, not collapse. We will react to opportunities as they arise, but only in line with reasonable risk levels.

OPA NEWS & COMMUNITY EVENTS

Steve Eddy – Was recently re-elected to the Board of the Maine Employee Benefits Council (http://www.maineemployeebenefits.org), an educational organization that provides unbiased information to Maine employers and employee benefits service providers in order to facilitate compliance with ever changing laws and regulations.

Donation to University of Southern Maine's Greater Portland Community Radio Station – WMPG – OPA Managing Director Fred Williams is seen with Station Manager Jim Rand after dropping off his collection of jazz and classical LPs from the '70s and CDs from the '80s and '90s. WMPG will use the approximately 1000 pieces to augment its existing library as well as for fund raising efforts.

Old Port Advisors was founded more than 20 years ago as Investment Management & Consulting Group (IMCG), with a vision to create a boutique independent investment management firm centered on the best interests of our clients. Our principles were simple and still ground us today: a values-driven, personalized, collaborative, and strategic approach to investing, wealth management, and fiduciary consulting. We changed our name to embark on the next 20 years, but our leadership and our calling remain. We're excited to build on our past experience and success to deliver on our promise of building a secure future for our clients.