Lassus Wherley
Building Better Futures
...a View from the Top

Issue 50, June 5, 2014

An Interesting Start to 2014

June is always an interesting month of the year. Everyone is beginning to think about vacations and fun times.

Here are our thoughts around a little more volatility, answers to some of the great questions we have received, some things to watch out for with email and passwords for identity protection, and happenings at Lassus Wherley.

On April 1st we welcomed some of our professionals to our ownership team at Lassus Wherley. This move is part of our plan for succession and making sure that Lassus Wherley continues to provide a high-level of quality service for many generations to come. Our new owners are:

Patricia A. Daquila, MBA, CPA, Senior Tax Advisor

Cynthia Fusillo, MBA, CPA, Senior Tax Advisor

Lisa McKnight, MBA, CFP®, Financial Planner

Chadderdon O'Brien, CFP®, FRM, Financial Planner

Charles Pawlik, CFP®, Financial Planner

Deborah Rivosa, MBA, CFP®, CFA, Chief Compliance Officer, Director, Business Development

Laurie Wolfe, CPA, Senior Tax Advisor

We are very excited about the future for our firm and know that we have a great group of very bright and energetic professionals to help us continue the growth and success of Lassus Wherley. Please join us in congratulating our new shareholders.

Here We Go

After saying goodbye to a pretty amazing year of performance in the US equity markets we entered a period of higher volatility to kick off 2014. Now that we are well into the second quarter, we wanted to take some time to review what has happened and add some perspective to looking down the road for another interesting year.

The S&P 500 returned 1.81% in the first quarter of 2014, which would be a decent return in any year. The surprise in the quarter was the pretty dramatic turnaround in bond performance after last year when everyone feared

1 Academy Street, New Providence, NJ 07974
Phone: 908-464-0102
www.lassuswherley.com
3333 Renaissance Blvd., Bonita Springs, FL 34134
Phone: 239-495-1520

rising interest rates and bonds sold off. Bonds actually outperformed stocks in the first quarter with a return of 1.84% on the Barclays US Aggregate Bond Index. Global bonds did even better with a return of 2.40% on the Barclays Global Aggregate Bond Index.

Concerns around slowing growth in the emerging markets, Fed policy, valuations of US stocks and events in Ukraine all weighed on stock markets, while giving a boost to bonds. At the end of 2013, the yield on the 10-year US Treasury reached 3.03%, at which point many investors thought that bonds once again represented good value. This, along with disappointing economic data releases in the first two months of the quarter, and plenty of geopolitical worries, caused money to flow back into bonds, at least temporarily.

After rebalancing into the emerging markets over the last year, we have begun to see funds flow into this asset class. In the past few months investors have started to recognize the good value there.

Real estate investment trusts (REITS) were also hit hard by last year's taper talk only to rebound strongly this year. Investors have focused this year on how much REITS' cash flow would benefit from strengthening global economies rather than on how much REITS would be hurt by rising interest rates. Thus, in the first quarter of 2014, the S&P Global REIT Index returned a very healthy 7.27% after a 2.81% return for the full year 2013. This strong performance has continued into the second quarter as investors continue to search out yield. We hold global REITS both as a portfolio diversifier away from stocks and bonds and as an inflation hedge. The potential for the kind of turnaround we have seen this year in REITS is one of the reasons why we believe so strongly in the discipline of rebalancing into underweighted asset classes. It works time after time.

After rebalancing into the emerging markets equities over the last year, we have begun to see funds flow into this asset class in the past month as investors appear to see good value there. Emerging markets equities have lagged developed markets equities over the last year due to worries about the impact of slowing growth in China, and Russia's incursions into Ukraine.

While economic statistics continue to indicate that China's economic growth rate is slowing, the Chinese government has begun to add money to the banking system to support the economy. Over the next few months, we expect to see the Chinese take other measures such as spending more on infrastructure and encouraging private investment.

Recently released Federal Open Market Committee (FOMC) minutes confirmed that the Fed is likely to keep tapering bond purchases by $10 billion per month

unless there are some extraordinary economic data which will cause them to change this pattern. The minutes also reinforced that the Fed is likely to keep interest rates low for a considerable time after the end of tapering. Fed Chairwoman Janet Yellen and most other Committee members feel that the economy still needs the support provided by very low rates. The May minutes reflected discussions around different approaches that could be used to raise short-term interest rates but was framed as simply "prudent planning" and not a sign that interest rates would be raised any time soon.

Here are some great questions from our clients. Let us know if you have one you would like included.

Question: I watched Michael Lewis' interview on 60 Minutes in which he said that the US stock market was "rigged." How concerned should I be about this claim? Answer: Michael Lewis has just written a new book on the topic of high-frequency trading (HFT). He has appeared on several TV shows as part of the publicity tour for the book. This has created a lot of discussion around the topic of high-frequency trading and its impact on markets and investors.

We addressed the topic of high-frequency trading in the View from the Top Issue 45, published on May 29, 2013. At that time we pointed out that "regulators and legislators are focusing their attention on high-frequency and algorithmic trading, the role of dark pools and efforts to increase liquidity to smaller issuers." We defined high-frequency trading as the "automated, super-fast trading that takes place when sophisticated computerized tools are used to trade stocks, options or futures" and noted that "those who use high-frequency trading claim that it has helped make markets more stable, transparent and efficient."

Our main point then and now remains that "high-frequency trading is still in its early stages. We would expect and hope that as the market matures, more controls and self-policing mechanisms will develop." Last year, we pointed out that the SEC would likely be increasing the attention they pay to high-frequency trading and will most likely implement further regulations for this practice as it develops.

In her recent testimony before the House Appropriations subcommittee, SEC Chairwoman Mary Jo White said that US securities regulators are looking into whether some high-frequency firms engaged in unlawful trading practices and that the Commission has "a number of ongoing investigations

A big thank you to our clients who continue to challenge us with great questions. Please let us know if you have any questions you would like to share. We really enjoy doing the research on some of the tough ones.

regarding market integrity and structure issues, including high-frequency traders." As reported in the Wall Street Journal, "the SEC and the Commodity Futures Trading Commission are looking into ties between high-speed traders and major exchanges, examining whether the firms are getting preferential treatment that puts other investors at a disadvantage."

Meanwhile, the FBI apparently has been investigating the possibility that high-speed trading firms were engaged in insider trading by taking advantage of the fast-moving market information unavailable to other investors. New York Attorney General Eric Schneiderman is also looking into whether high-frequency trading is harmful to the markets.

Meanwhile, the FBI apparently has been investigating the possibility that high-speed trading firms were engaged in insider trading by taking advantage of the fast-moving market information unavailable to other investors.

So, several government entities and regulatory bodies are looking into high-frequency trading. This practice definitely has issues, with perhaps the most concerning one being the propensity of high-frequency traders to destabilize trading by withdrawing liquidity when markets are stressed. That leaves the question of whether the US stock market is rigged. A few points that have been made by John Rekenthaler of Morningstar, as well as Matthew Philips of BloombergBusinsessweek, are worth noting: Small retail investors are not hurt by high-frequency trading since their smaller orders are not executed by high-frequency traders.

Many large-fund managers feel that high-frequency trading has improved liquidity and made markets more efficient.

High-frequency traders now provide the function of stock market makers who profit by supplying liquidity. Rekenthaler notes that stock market makers existed long before high-frequency trading, as did retail brokers, both of which took their cut.

The party who seems to be the most negatively impacted by high-frequency trading are large hedge funds, not small retail investors.

The profitability of high-frequency traders has been declining. Philips notes that according to estimates from Rosenblatt Securities, in 2012, "the entire speed-trading industry made about $1 billion, down from its peak of around $5 billion in 2009."

So, once again we are glad that the SEC, the FBI and other regulatory bodies are looking into whether the high-frequency traders have any unfair advantage, are operating in a way that puts markets at risk, or are doing anything illegal. It just seems to us that saying the "stock market's rigged" on *60 Minutes* is a bit like crying fire in a crowded movie theater and meant more to sell books than to enlighten or to educate.

Question: How do you see the markets going forward? Answer: We think that the markets this year will reward investors who are invested in a broadly-diversified portfolio containing US and international stocks and bonds as well as some alternative asset classes such as REITS and hedge strategy funds.

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Stock markets should be supported by improving earnings as the global economy strengthens. When interest rates do rise, we think that stocks can still hold up since rates will probably be rising at a moderate pace from very low levels and their rise would be driven by the improving global economy.

International stocks look better valued than US stocks at this point. They should be supported by slowly-improving economic conditions in Europe and in the developing markets, barring an economic/political meltdown in Eastern Europe. We expect that bonds will find buyers as rates rise. This rise is likely to be limited by the economic/political uncertainty.

We see geopolitical risks as being one of two big wild cards this year. The other would be an early end to stimulus by the Fed, although this seems very unlikely at this point.

We continue to find a range of 2.45%-3.25% as a reasonable range for yields on the 10-year US Treasury this year and think that stocks will provide returns in the 5%-7% range, but with greater volatility than we have seen in the recent past.

Question: I keep hearing about a computer virus or something called heartbleed. What is heartbleed? Answer: Heartbleed is the name that has been given to a serious security flaw that impacts most Internet servers and which could enable hackers to intercept encrypted traffic such as e-mail messages, banking information, usernames and passwords.

The flaw was discovered by researchers at Google Inc. and the Finnish security firm, Codenomicon, and disclosed on April 7. The bug was unintentionally introduced two years ago into the set of encryption tools called OpenSSL, which is used by two-thirds of servers on the web. Governments, websites, and network-equipment companies use OpenSSL to protect personal and other sensitive information online.

These governments, institutions and corporations for the most part have found a way to fix this flaw in

their encryption software and have installed the fix on their websites by now. We say "for the most part" because we cannot know for sure that every one of these entities has been able to remedy the situation.

So, if you have not already done so, it is important to change your passwords in order to protect your personal data from being accessed by others. It is also important to remember to use different passwords for every website you visit regularly. You do not want to make it easy for hackers to access every website you use, including websites of your banks and other financial institutions, just by finding one password.

The message is to always stay aware and check your accounts periodically to protect yourself and your assets.

Identify Theft Protection

For those of us who have more than a handful of passwords to change, this task can quickly become very onerous, and it is unrealistic to think you can change all of your passwords without writing them all down. You might want to consider increasing your security by using a tool called a dedicated password manager that you can install on your Mac, PC, or mobile device. Once installed, a password manager will create, store, and recall all of your user names and passwords while offering the highest possible levels of encryption. You only need to remember one password and won't have lists of passwords hanging around on your desk (PLEASE DON'T EVER DO THIS) or growing stale in your safe-deposit box.

We have recently called some of you to let you know that your email account had been hacked. Some of these email accounts were with Yahoo or AOL, for example. We suggested when we called that you change your password immediately. Some of you have elected to move to a new email service entirely.

The world of technology and software today is changing so fast it is impossible to keep up with the changes. Maintaining secure passwords and changing them periodically is the best way to protect yourself and your assets. And please make sure not to use things that could be easily figured out like your birthday, a family member's birthday, your child's name, or your dog's name. You get the general idea. The more complex passwords with numbers, symbols and upper and lower case letters in them are much more difficult for the password cracking software programs to identify.

The message is to always stay aware and check your accounts periodically to protect yourself and your assets.

More News from Lassus Wherley

We have recently appointed a new committee at Lassus Wherley. It is called the Fun Committee and is made up of employee volunteers. These volunteers have committed to making sure Lassus Wherley stays one of the Best Places to Work in New Jersey by increasing the fun element, starting with a lunch cookout this Friday. Thank you to the members of our Fun Committee: Pat Daquila, Laurie Wolfe, Lisa McKnight, Chad O'Brien, Betty Thomas and Jaime Szewczuk.

Lassus Wherley came in #16 out of 62 small/ medium size companies in this year's Best Places To Work in New Jersey. There are only 14 companies that have made the list in all of the past four years in which Lassus Wherley has been ranked. Though there is always room for improvement in rank, we are the only company whose rank has improved consistently over those four years. Something we definitely smile about.

Enjoy the sunshine and warmer weather and have a wonderful Summer!

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Investment Committee:

Diahann W. Lassus, CFP®, CPA, PFS, Chair

Anne L. Kehl, Investment Officer

Lisa McKnight, CFP®, Financial Planner

Chadderdon W. O'Brien, CFP®, FRM, Financial Planner

J. Charles Pawlik, CFP®, Financial Planner

Deborah J. Rivosa, CFP®, CFA, Chief Compliance Officer, Director, Business Development

Betty S. Thomas, Investment Analyst

Compliance Disclosure