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

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And the Markets Finally Take a Break!

September is always an interesting month of the year. Everyone is getting in the back-to-school mode and already missing Summer vacations.

Here are our thoughts around a little more volatility, answers to some of the great questions we have received, some things to think about in your digital estate plan and what's happening at Lassus Wherley.

It has been quite some time since we have experienced volatility such as we have over the last few months. It is very easy to forget about things like "headline" risk when the markets just keep rolling along. I read somewhere that we had 62 straight days without a 1% daily move up or down from April to mid-July. I understand that is the longest stretch of such low volatility since 1995.

We actually breathed a sigh of relief when the markets took a break and started going down instead of just up. It **is** healthy for profit-taking to occur when you have had such a great run in the financial markets. We all know there are risks, and we monitor many different indicators to determine how worried we need to be. The biggest risk we currently face is "headline" risk. Every day is a new headline, and the headlines generate a lot of stress both for individuals and for the financial markets.

There are many moving parts to follow including the Federal Reserve. With the Fed ending bond-buying and looking at raising interest rates within the next year, there has been a lot of uncertainty in terms of how this will impact the economy and the financial markets. Investors seem to be taking it in stride, but it does create some uncertainty in the short term.

Current geopolitical risks in other parts of the world such as the Ukraine, Russia, Iraq, Syria and Israel have led to increased volatility and may continue to drive more volatile markets.

There are so many different variables when dealing with the world

of finance today, and most of them are not under our control. We expect the volatility to continue as we move through September into October. September has typically been a very interesting but not necessarily fun month. We continue to focus on maintaining our target diversification and taking profits in those asset classes that have experi-

enced very strong returns.

And for those who are concerned about what happens when the Fed starts raising interest rates, here's what Professor of Finance at the University of Pennsylvania's Wharton School Jeremy Seigel recently told CNBC. "If you look at history, the bull markets do not end when the Fed starts raising interest rates. Bull markets could go on for another nine months to two years," Seigel said on "Squawk Box." "Maybe it will be March or April instead of June or July. That should not matter at all, in terms of the big picture."

And for those who are concerned about what happens when the Fed starts raising rates—it shouldn't matter in the big picture as long as you maintain that target asset allocation and broad diversification.

We agree that it shouldn't matter in the big picture as long as you maintain that target asset allocation and broad diversification that works for the long term.

Digital Estate Planning

Generally when we think of estate planning we think wills and health and financial powers of attorney. When most people prepare their wills, they often only consider their physical property and give little thought to intangible property. In an increasingly complex digital world, many of our important personal and financial assets are stored online. So what happens to this important information when we are gone? Consider where you may have a digital presence:

- Multiple computers, flash drives and iPods
- Blogs, Facebook accounts, Twitter accounts and multiple e-mail accounts
- Photos on Flickr or even on your computer, documents in Google Docs and videos on YouTube
- Online bank and investment accounts, online medical information and subscriptions of all kinds
- Multiple online shopping accounts that might hold credit card information, subscriptions and memberships

Our survivors would likely be overwhelmed. That is why planning for digital assets is becoming such an important piece of good estate planning.

To assist you with getting your digital estate plan together, here are some ideas to consider.

Inventory and identify your digital assets. This can include computers, CDs, DVDs, USB drives, digital cameras and even iPods or other devices. This inventory should include your software programs and all of the various websites, blogs, Facebook and social media and any other site for which you have established an account with a log-in.

Next you want to think about who should take care of these areas when you are gone. It is important to have someone who is tech savvy and can deal with these things.

Utilize a software system for storing your passwords such as Roboform.com or 1Password (www.agilebits.com). These services will encrypt your log-in and password information and keep them stored on your own computer. This means you will only need to have one password to identify for your family, and you can keep that with your other estate documents.

Provide instructions for your family. If you have a blog or website, make sure you leave information for your family on how you want them handled. Also, make sure you leave updated information on digital photos, software or in-the-cloud storage so the photos aren't lost.

Give appropriate authority. Consider signing a statement, which can be drafted by an estate attorney, authorizing the companies that hold your online information to disclose that information to your executor or other representative. Most state laws don't offer specific support to executors in taking control of digital assets. Even where such laws exist, they are often well behind the reality of today's technology. The Uniform Law Commission, a nonprofit that drafts model legislation for states to adopt, passed the Uniform Fiduciary Access to Digital Assets Act (UFADAA) on July 16, 2014. The purpose is to vest fiduciaries with the authority to access, control or copy digital assets while respecting the privacy and intent of the account holder. But there is no guarantee that states will adopt the legislation.

Our lifetime digital presence has grown exponentially, and the issues involved have become increasingly more complex. Take the time to plan your digital estate today.

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

Question: *Is the recent market downturn the end of the bull market, and is it time for investors to throw in the towel?*

Answer: After the market backed up in July, there has been a lot of discussion about market corrections and the end of the bull market. For the month of July, the S&P 500 index was off 1.38% while small caps, represented by the Russell 2000, were off over 6%. The S&P 500 index came roaring back in August gaining 4% while small caps gained 4.96%. So far in September, both indices are negative for the month at –.33% and –.77%. We believe this downturn in the financial markets was reasonable and a healthy response following the recent positive returns in the financial markets. Prior to the July pullback, the S&P 500 had returned 24.61% over the previous 12 months, while the Russell 2000 returned 23.64%. Both figures are well above returns most investors expected to experience. So the

financial markets reacted as expected and gave back some of the excess gains. Does this mean that the bull market is over? Probably not. The bull market may in fact be intact, even if we expect somewhat lower returns in the future.

Each year, whether markets perform positively or negatively, there tends to be volatility in the returns. In fact, over the last 34 years (going back to 1980) the average intra-year market loss was 14.4%. This refers to the ups and downs of the financial markets during the year, which can be pretty extreme in the short term. And in spite of these intra-year losses, the market had positive yearly returns over 76% of the time! In 2014, we have experienced a 6% pullback in the S&P 500 and a near 10% pullback in the Russell 2000. While these pullbacks are difficult for investors to stomach, they are normal and expected. It is easy to forget that there is a down part to market cycles when the financial markets go straight up for such long periods of time. Since we know markets tend to revert to their longer term averages, we do expect additional pullbacks will occur in the future.

We look at equity market volatility in context with some of the indicators we follow. Valuation, in terms of where the market is currently priced relative to long-term averages, is normal. As of June 30th, the forward looking P/E Ratio for the S&P 500 was 15.6 and right in line with its 25-year average. Another commonly used metric, the CAPE ratio (Cyclically Adjusted Price to Earnings Ratio) is in line with its 25-year average as well, at 26.6 vs. 25.1. While neither of these metrics suggests stocks are "cheap," they certainly do not indicate that stocks are significantly overvalued.

The state of the economy is encouraging as well. Companies are reporting solid earnings. In fact, 74% of the companies that have reported earnings for the second quarter of 2014 have beaten analyst estimates. In addition, 64% of the reporting companies have also beaten their revenue targets. These are encouraging signs that consumers are spending money and companies are efficiently managing those revenues. Companies also have record amounts of cash on hand and very low levels of debt. This leaves companies less dependent on capital markets for cash needs and allows them the flexibility to invest in areas which may promote further growth (research and development, capital expenditures, labor growth, etc.). This is a good sign for stock prices going forward. Consumer confidence is also improving, with the monthly gauge improving over the last few months. We see evidence of this in a number of different metrics, including improving trends in automobile sales, inventories, capital orders and housing starts. In August, both the unemployment rate

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.

(6.1%) and the number of unemployed persons (9.6 million) changed very little. Over the last year, the unemployment rate was down 1.1% and the number of unemployed persons was down 1.7 million. We haven't solved the problem of the longer term unemployed or underemployed, but we are moving in the right direction.

So, it is definitely not time to throw in the towel. We believe that in this environment diversification among asset classes is still the best defense against market volatility. While equity markets may in fact give back some of the gains we've experienced over the last few years, we continue to review portfolios to rebalance where necessary. This includes taking profits in stocks and rebalancing into less risky assets. Doing this in a systematic way allows us to manage the risk and realize some of the portfolio gains while still participating in future growth the markets provide to investors over the long term.

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Question: *Should I be worried about the Argentine debt default and what does it mean?* ***Answer:*** It is important to recognize the backdrop behind Argentina's recent default, which is the country's second default in 13 years. Argentina defaulted on roughly $100 billion of sovereign debt back in 2001-2002, in the midst of the worst economic crisis in the country's history. Argentina subsequently underwent a process of debt restructuring in 2005 allowing it to resume payment on the majority of the defaulted bonds by issuing exchange bonds worth roughly 33 cents on the dollar. Argentina went through a second debt restructuring in 2010, which brought about 93% of the bonds out of default. However, the remaining 7% of bondholders did not agree to the restructuring terms with Argentina, and on-going legal battles began.

The remaining 7% of bondholders are primarily what are known as "vulture funds." This is the term reserved for hedge funds that seek to profit from buying the distressed securities of a company or country very cheaply on the secondary market, with the intention of suing the debtor in order to recover a larger amount on the debt than they paid for it. These hedge fund holdouts have been involved in on-going legal disputes with Argentina revolving around an attempt to recover full principal and interest payments on the bonds vs. the exchange bonds that were provided to other creditors for roughly 33 cents on the dollar.

It is this strategy pursued by hedge funds such as Elliott Management, along with a recent ruling by New York District Court Judge Thomas Griesa, that triggered the current technical default. The hedge funds suing Argentina argued that the debt restructuring that Argentina underwent in both 2005 and 2010 could not occur without Argentina paying

the hedge funds in full for their debt holdings due to a clause in the old bonds known as pari passu. This clause essentially says that debtors are obligated to treat all bondholders the same. Judge Thomas Griesa ruled that the pari passu clause meant that Argentina couldn't pay the exchange bonds without paying the hedge fund holdouts as well. He also declared that any financial institution that was involved in paying the exchange bonds would be in contempt. Argentina was left with the choice of paying the holdouts in full or defaulting on the exchange bonds, even though it had the funds to pay them. Argentina chose default, as making full payment owed to the holdouts would trigger a roughly $120-billion payout to the other 93% of bondholders, as a result of a RUFO (Rights Upon Future Offers) clause that is in effect through the end of this year.

Although this and other geo-political events always have the potential to impact markets on an on-going basis, it is important to remember that Argentina did not default due to an inability to pay its bondholders.

This is still an on-going story with a few potential resolutions. Perhaps one of the more likely ones being the purchase of the defaulted bonds by a third party bank such as JP Morgan, which Argentina's Economy Minister Axel Kicillof has publicly stated Argentina would not be opposed to. Argentina could also look to strike some kind of deal with the holdouts and attempt to get the exchange bondholders to waive their rights to be paid the same amount as the hedge funds, or try to wait to make a deal until the RUFO clause has expired. Finally, Argentina could issue new exchange bonds to the current exchange bondholders that are exclusively set up in Argentina. These bonds, of course, would be outside the jurisdiction of Judge Griesa and would allow them to continue to make payments going forward. This appears to be the route that Argentina is taking, with President Cristina Fernandez de Kirchner announcing a plan on August 19th to skirt Judge Griesa's order. The plan does this by making payments on foreign bonds through a local trustee beyond the jurisdiction of the US court and offering investors an exchange into identical bonds that would be issued under Argentine law. Argentine's Congress gave final approval to the proposed debt restructuring law on September 11th. However, it is not likely that Argentina will see a significant participation rate relative to this proposal, with Judge Griesa having declared the new law illegal in that it violates his order. It has become clear that the Argentine default will not be resolved quickly.

Although this and other geo-political events always have the potential to impact markets on an on-going basis, it is important to remember that Argentina did not default due to an inability to pay its bondholders. Given the nature of the Argentine technical default, we don't expect it to have a lasting effect on US markets, and believe the

focus will continue to be on the pace of growth in the economy, corporate earnings, and the Fed. Events such as this highlight the importance of allocating across several asset classes and several regions and maintaining diversified exposure to world markets.

News from Lassus Wherley

We have several new happenings at Lassus Wherley. First, Anne Kehl has retired. We will miss her and wish her the best as she moves into a new phase of enjoying life.

We also welcome a new team member, Vanessa Franco, who has joined us as an Investment Analyst. Vanessa is a recent graduate of the Financial Planning Program at William Patterson and just completed an internship at Charles Schwab in Orlando.

We congratulate Chad O'Brien for being named a winner in the 2014 *NJBIZ* Forty Under 40 awards program. The Forty Under 40 awards program honors men and women under the age of 40 who have been making headlines in their field and who share a commitment to business growth, to professional excellence and to the community.

And we congratulate Charles Pawlik for passing all three parts of the Chartered Financial Analyst® (CFA) exam. The CFA credential has become one of the most respected and recognized investment designations in the world. A job well done!

Enjoy a wonderful Fall!

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