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

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Volatility Continues

The end of one year and the beginning of the next year is a time to review and to think about a new start and establishing those resolutions.

Here are our thoughts around continued volatility, headline risks, answers to some of the great questions we have received, and a discussion about IRA Charitable Gifts.

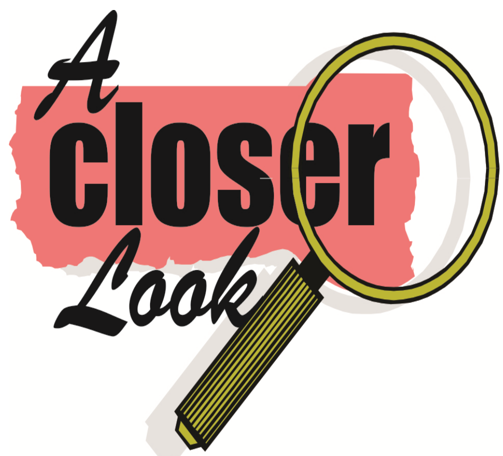
Now What

Volatility seems to be the topic for discussion these days. We really did get used to the boring upward movement of the US stock markets, and now we are having to catch our breath periodically as the ups and downs increase. We see a lot of headlines in our financial press, but I will say one of my favorites was published on January 12, 2015, in **MarketWatch**. The title was "Engage sick bags as stormy markets show no signs of calm," and it was written by Shawn Langlois. His introduction was especially interesting. "Better pop some Dramamine. The market hasn't even dropped 1% in the past month, yet it feels like we've been drawn, quartered and sprinkled with margarita salt. A 4% drop here, a 6% surge there, and the trading action over recent weeks bears no resemblance to the calm march higher we'd become accustomed to."

He goes on to talk about the number of issues we are dealing with and some of the things that continue to drive volatility in the markets such as the Greek elections, terrorism, falling oil prices, and the potential for rising interest rates.

We do believe the volatility will continue, and much of it will be driven by headline risk. Every day is a different headline and different focus by the media and that is the reason we are long-term investors.

The reality is that broad-based di-



versification has worked really well and will continue to be our focus for the long term. As always short-term focus is interesting but doesn't really help you build assets over a long period of time. It does, however, work well if you want to increase your stress level. So…...take that deep breath

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A Closer Look

and remember that you are a long-term investor regardless of what happens in the financial markets today.

Factors to Consider

There were no shortage of reasons for the volatility we experienced in the financial markets in 2014, with a number of geo-political risks, ISIS, continued concerns relative to global growth, mixed economic data domestically, fear over the spread of Ebola, and the Fed ending the monetary stimulus measures that had been in place for some time.

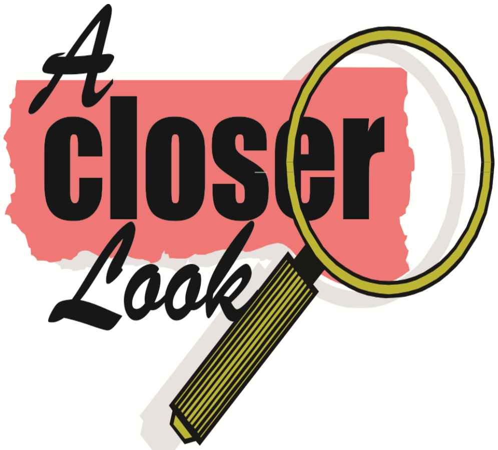
Where US large cap stocks continued to do well, we saw many other asset classes underperform starting with international large caps and emerging markets. We also saw commodities come under pressure with the falling price of oil. Corporate bonds did better than expected but Treasuries were the real winner in terms of overall bond returns.

There were some bright spots other than the US stock market which we will discuss a little later in the newsletter.

Much of the volatility in the financial markets at the end of 2014 was blamed on the continued drop in oil prices and the consequent poor performance of energy companies in the S&P 500. As of the time of this writing, crude oil is trading at well under $50 per barrel, which marks the first time since May of 2009 that oil prices were this low. Slowing global growth, weaker demand, increased supply, and a stronger US dollar have all worked to bring crude oil prices down by over 50% since June of 2014, when prices were around $115 per barrel. There is potential for oil to come down further, based on the supply/demand imbalance, and contribute to continued volatility in the markets. However, prices will eventually stabilize as supply and demand move further in line, with low oil prices likely forcing many high-cost producers out of the market. This will ultimately drive down supply. In the meantime, low oil prices can have some positive effects, leading to more funds for discretionary spending by US consumers, who benefit from lower prices at the pumps. US consumers may end up spending these funds which will benefit retail establishments and in turn can provide a boost to GDP. The airline industry also benefits from lower fuel costs, and some of that benefit will hopefully be passed on to consumers.

Turmoil in Greece has renewed concerns in the Eurozone and also added to the volatility in the markets as of late. A presidential election will be held later this month in Greece, which has the potential to see the radical left-wing anti-

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.



austerity Syriza party come to power as they are currently leading in the polls. A Syriza victory could lead to the failure of Greece to meet its bailout obligations and a potential euro exit. The situation in Greece may continue to add to volatility in the markets this month, heading towards the January 25th election.

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Russia has also been making headlines as of late, with the Russian ruble down as much as 50% vs. the US dollar as of mid-December. Losses in the ruble were initially brought about by the impact of the dramatic drop in oil prices on the oil-export-driven Russian economy, as well as the sanctions levied on Russia by the US and the EU as a result of Russia's actions in the Ukraine. The Russian currency continued to come under pressure by traders. Russia has been selling off foreign currency reserves in an attempt to prop up the ruble, and the Russian central bank drastically raised interest rates to 17% in mid-December in an effort to stem the losses. The decline of the ruble did subside for awhile in late December, but it is under pressure again as oil prices continue to drop. There is potential for the ruble to come down further if we see oil prices continue to fall. The situation in Russia is poised to get worse before it gets better, and their economy is likely in for some tough times in 2015.

We expect to see continued volatility in domestic equity markets in 2015 and reasonable single-digit returns for the year. The US economy should continue to improve.

We are continuing to see our labor market firm-up, with gradual and fairly consistent progress in terms of the unemployment rate, which is now at 5.6%, down from just over 10% at the height of the recession, as well as a longer term trend of a reduction in the number of folks that are filing for unemployment benefits. Inflation remains muted and we would expect rate increases to be small and occur gradually.

Furthermore, the European Central Bank is poised to expand stimulus measures in the first quarter of 2015, which we believe could help provide a boost to global equities. In addition, investors still have quite a bit of cash on the sidelines, with more than $11 trillion still held in liquid savings and money market accounts, money-market mutual funds, CD's, and IRA accounts. These cash balances can serve to bolster the markets as investors look for opportunities to put the cash to work during market pullbacks.

Charitable IRA Rollover

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The IRA Rollover was first enacted in 2006 as part of the Pension Protection Act. The provision has expired and been reinstated multiple times. Most recently the Senate signed off to reinstate the legislation on December 19, 2014. The uncertainty and need for an annual extension has diminished the incentive effect of the IRA charitable rollover. The ultimate effect thereby reduces charitable giving and increases the tax burden on older Americans which is unfortunate. Since the provision was first enacted, Americans have made millions of dollars of new contributions to nonprofits -- including social service programs, religious organizations, arts and cultural institutions, schools, and health care providers -- that benefit people every day.

The provision allows individuals aged 70½ and older to donate up to $100,000 from their IRAs to public charities without having to count the distributions as taxable income.

Individuals may begin taking distributions from their IRAs as early as age 59½, but are **required** to begin taking them at age 70½. Normally, these distributions are subject to income taxes. In order to qualify, contributions must go directly to a public charity and be made from traditional IRAs or Roth IRAs. Donors may receive no goods or services in return for their contributions and must obtain written acknowledgement of their contribution from each recipient charity.

The tax benefits of the IRA charitable rollover are available to taxpayers regardless of whether they itemize their returns. In particular, this helps older Americans who may have paid off their home mortgage and no longer file itemized returns. The mandatory distribution from their IRA would otherwise trigger a tax burden, even if they donate the money to charity. The IRA rollover provision removes these negative tax consequences and encourages Americans to give to charities during their lifetime.

The transfer is directly from the IRA custodian to a qualified charity. Because the transfer is not included in taxable income, there is no charitable deduction. Howev-

er, the transfer may fulfill part or all of the required minimum distribution.

The IRA custodian will report the QCD by sending the IRA owner IRS Form 1099. The taxpayer is required to show the IRA distribution on line 15a and write "QCD" on line 15b of IRS form 1040. A QCD is not included in the adjusted gross income of the taxpayer.

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Who can benefit from making a QCD? Persons with significant IRA assets, persons making gifts that are large relative to their income and persons having so few deductions that they choose not to itemize. (A charitable rollover is not included in taxable income and not counted against the usual percentage limitations on using charitable deductions.)

Here's a quick review of the general rules for QCDs.

- Only applies to IRA owners or beneficiaries age 70½ and over and is capped at $100,000 per person, per year.
- Only applies to direct transfers of IRA funds to charities and not gifts made to grant-making foundations, donor-advised funds or charitable gift annuities.
- No split-interest gifts of any type will qualify.
- Applies to IRAs, Roth IRAs and INACTIVE SEP and SIMPLE IRAs. It does NOT apply to distributions from any employer plans.
- The charitable donation from an IRA will satisfy a required minimum distribution, but the IRA distribution is not includable in income.
- No tax deduction can be taken for the charitable contribution.
- For a married couple where each spouse has their own IRAs, each spouse can contribute up to $100,000 from their own IRAs.
- If more than $100,000 is withdrawn from the IRA and contributed to a charity, there is no carryover to a future year. The excess is taxable income and a charitable deduction can be claimed if the taxpayer itemizes.
- The contribution to the charity would have had to be entirely tax deductible if it were not made from an IRA. There can be no benefit back to the taxpayer.
- The distribution from the IRA to a charity can satisfy an outstanding pledge to the charity without causing a prohibited transaction.
- QCDs apply only to taxable (pre-tax) amounts. This is an exception to the pro-rata rule.

Excluded charities are: donor-advised funds, supporting organizations and private foundations.

Since the House failed to advance a permanent bill for charitable giving incentives, the provision remains in annual limbo. So how do you plan for 2015 QCDs? You can always make charitable gifts directly from your IRAs to charities. If the law is extended, you will not be taxed on the distributions up to the $100,000 limit. If the law isn't extended, you will be taxed on the distribution as usual and you can claim a charitable deduction for the money that went directly to the charity.

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.

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

Question: *What is happening with global real estate? I noticed my fund did really well last year.* **Answer:** Although 2014 was another strong year for large-cap US equity markets, with the S&P 500 again posting double-digit returns (13.7% for 2014), real estate holds the distinction of the best performing asset class for 2014. Global real estate had a total return of 14.73% in 2014, as measured by the FTSE EPRA/NAREIT Global Real Estate Index. US equity REITs (real estate investment trusts) in particular had a banner year in 2014, with a total return of more than twice that of the S&P 500 at 28%. US equity REITs are no stranger to holding this distinction, having been the top performing asset class compared to traditional domestic and international equity, fixed income, alternatives, and cash in 5 of the last 10 years, including 2006, 2010, 2011, 2012, and 2014. Consequently, annualized returns over the last 10 years were second only to that of emerging market equity returns.

Residential REITs and apartment REITs posted returns of 46.20% and 39.62% respectively and were the top performing sectors in 2014. Investors continue to be attracted to gaining cost-effective access to real estate holdings managed by REITs and the return and diversification benefits that real estate can offer as an asset class. We believe that investment in a well-diversified and liquid global real estate fund remains the best way to gain access to the benefits of investment in the REIT market.

Question: *What is going on in Russia and how does it affect my portfolio?* ***Answer:*** Russia is dealing with many issues regarding the effects of falling oil prices, the weakening ruble and government sanctions that have been discussed in many stories by the media. We currently invest in two funds that have investment in Russia and Russian companies. Our investment exposure to the risk in the Russian markets is very low. The risk does ex-

ist that the issues faced by Russia may have a ripple effect on other countries.

Over the last 10+ years, the relationship between the US dollar and the Russian ruble has been fairly consistent. $1 has generally been able to buy approximately 28 to 35 rubles. Beginning in the summer of 2014, this relationship began to change as the value of the dollar strengthened while the ruble weakened. The dollar continued to strengthen throughout the fall and winter, until it spiked dramatically at $1 to 74 rubles on December 16, 2014.

This is one of the primary reasons our investment in international bonds is made in dollar-denominated securities; there is little value added in assuming the currency risk. However, the weaker ruble can increase the credit risk of the bonds, which has the potential to negatively impact performance.

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The more important aspect to the falling ruble is the impact it has on the Russian economy and how it may impact their economy and investment performance in the future. As the ruble becomes cheaper, it makes buying locally produced products/services more attractive relative to the now more expensive imports for Russians. However, the Russian government has strong controls over output and production and has been largely inefficient in meeting domestic demand. A Russian-imposed sanction on imported food from the US, the European Union and other countries hasn't helped either. Relative demand for core goods and services tends to be fairly consistent over time, and since domestic production cannot meet demand, consumers must buy the more expensive imported products. This inflationary result can have a rippling effect on many parts of the economy and will be a lasting problem for Russia. Russia is currently experiencing 9% inflation. At high levels of inflation, consumers are forced to be more selective in what they buy, which can affect corporate profits and the economy.

Along with the ruble, oil prices have continued to fall. As many of you know, Russia is one of the world's primary suppliers of oil. In the first half of 2014, Russia exported $173 billion worth of oil, which accounted for 68% of total exports. During this time period, the average price per barrel of oil was $109. More recently, oil has been priced well under $50. If oil continues to be priced in the $40-$50 range, the reduction of exporting revenues would continue to fall. Large reductions of exporting revenues will affect many aspects of the Russian economy and may continue to impact their financial

strength.

While the risks to Russia are apparent, our small exposure and diversification among countries help to mitigate some of these risks. We will continue to monitor the news coming out of Russia and review the potential implications to the portfolio.

Keep in touch and remember that you are a long-term investor regardless of what happens in the financial markets in the short term.

Happy New Year. Stay safe and warm!

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