Tarheel Advisors Newsletter

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2015 Investment Outlook

Happy New Year! 2014 has come and gone, and assuming you didn't bet the farm on the Russian ruble it was a pretty good year. Before we get into our 2015 predictions, let's take a look at 2014 in review.

2014 Score Card

10% Market Return in U.S.	A
10% Market Return in International	D
3% GDP Growth	A
No Increase in Interest Rates	A
Gold and Real Estate up Double Digits	B+

Year in Review: While we still have yet to get straight A's in our year-end predictions, 2014 was one of our better prognostications. A year ago we predicted 2014 would be another positive year for stocks with the broad indexes up around 10% in the U.S. With the DOW up almost exactly that amount for the year, we were spot on with the first part of our prediction. We expected this return would be driven by an expansion of corporate revenue and profits associated with a modest yet stimulative 3% growth in US GDP. Fourth quarter numbers aren't official yet, but a 3% print for the year seems likely.

While our prediction for domestic stocks was on the money, international markets ended with mixed results and a confusing range of returns. The investment performance of markets in individual countries varied from –44% (Russia) to +53% (China). In aggregate, investors realized a –3.87% return due largely to a very strong U.S. dollar, which rose 12% versus a basket of other major global currencies.

Defying conventional wisdom, bonds posted a 6% aggregate return for 2014 with U.S. Treasuries and municipal bonds leading the way. While many pundits presumed that interest rates would increase in 2014, we disagreed and expected rates to hover in the same range due to low inflation and monetary policy maneuvers. In fact, rates fell slightly in the last quarter of the year, and now 30 year mortgage rates are sub-4%.

Our final prediction in 2014 was for double digit returns in alternative investments, specifically Gold and Real Estate. Real Estate closed the year as one of the best investments of 2014, with the REIT index up 28%. Gold also surged double digits to start off the year, but couldn't hold it's momentum and ended the year nearly flat.

2015 Predictions– After three straight years of double digit returns in the U.S., the bull market we have enjoyed since 2009 is starting to look long in the tooth. As we've mentioned in past newsletters, much of the economic growth experienced in the U.S. and abroad has been generated primarily through government deficit spending. Since 2007, GDP in the US has increased by a total of \$3.7 trillion. However, in order to accomplish this feat, the US has run an aggregate budget deficit of \$6.8 trillion. Nearly a decade's worth of debt super-charged spending and artificially low interest rates seriously bring into question the validity of much of the economic growth experienced over the past 7 years.

With this in mind, we expect 2015 to be a year where the wool is removed from the eyes of the world economy, and we suspect what we are going to see is a lot uglier than the current set of rose colored glasses would portend. In our mind, it is inevitable that the

2014 Market Update

S&P 500	+13.69%
DOW	+10.04%
RUSS 2000	+4.89%
MSCI World	-3.87%
BONDS	+6.07%
GOLD	-0.58%

Mortgage Rates

15-Year	3.07%
30-Year	3.98%
5/1 ARM	2.90%

Did You Know?

* The IRS has raised the maximum contribution limits for 401(k)s. In 2015, employee contributions will be capped at \$18,000 with an additional \$6,000 catch-up contribution available to those age 50 and older.

* According to the *Stock Trader's Almanac*, Market returns in the 5th year of a decade have been positive every time since 1885, with the yearly low occurring in the 1st quarter in every year except 1965.

2015 Investment Outlook (Continued)

world will go into a slight recession in 2015, with the recent collapse of global commodities as a leading indicator. As I'm sure you have noticed at the pump, gas and oil prices have plummeted nearly 50% over the last 6 months. While the media is quick to provide a dozen different reasons as to why prices are dropping, the phenomenon is not unique to oil. Demand destruction has caused the prices of iron ore, silver, copper, soybeans, cotton and a host of others commodities to drop 15-50% as well. In fact, the commodity index is within striking distance of its 2008 crisis low.

Now that we have ruined your New Year's champagne with sour grapes, we do have some positive predictions — Even though we expect the world to experience recession, we expect the U.S. to buck some of the trend and still realize modest economic growth of between 1% to 3% in 2015. We expect a 10%+ sell-off in the first part of 2015 with increased volatility in the stock market until commodity prices bottom out. On the plus side for risk assets, we think the constrained world economic backdrop and deflationary commodity pressures will handcuff the Federal Reserve from making significant changes to its interest rate stance. As other global central banks attempt to fight recessionary forces through their own liquidity and stimulus measures, we think asset prices will continue to remain propped up for an extended amount of time, and the resulting double digit rebound in stocks should end the year somewhat flat. As such, we think investors would be wise to once again consider cash as an asset class and raise its target allocation in order to take advantage of lower asset prices further down the line. **-Ryan Glover, CFP®**

Sequence of Returns

Index	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014	Avg
S&P 500 Index Returns	3.00%	13.62%	3.53%	-38.49%	23.45%	12.78%	0%	13.41%	29.60%	11.39%	**7.23%**
Barclays Bond Index	-4.49%	6.64%	9.48%	4.79%	6.93%	5.54%	5.64%	4.32%	-2.60%	5.97%	**4.22%**
50/50 Portfolio	-0.7%	10.1%	6.5%	-16.9%	15.2%	9.2%	2.8%	8.9%	13.5%	8.7%	**5.73%**

Portfolio $ on 12/31/2004:	$1,000,000
Year-end Distribution:	$40,000
Inflation:	2.00%

100% Stocks			100% Bonds			50% Stocks & 50% Bonds		
Year	ROR	Year-end Total	Year	ROR	Year-end Total	Year	ROR	Year-end Total
1	3.00%	$990,000	1	-4.49%	$915,100	1	-0.7%	$952,550
2	13.62%	$1,084,038	2	6.64%	$935,063	2	10.1%	$1,008,243
3	3.53%	$1,080,689	3	9.48%	$982,091	3	6.5%	$1,032,214
4	-38.49%	$622,283	4	4.79%	$986,684	4	-16.9%	$815,837
5	23.45%	$724,911	5	6.93%	$1,011,764	5	15.2%	$896,466
6	12.78%	$773,392	6	5.54%	$1,023,653	6	9.2%	$934,419
7	0%	$728,345	7	5.64%	$1,036,340	7	2.8%	$915,723
8	13.41%	$780,069	8	4.32%	$1,035,163	8	8.9%	$950,954
9	29.60%	$964,103	9	-2.60%	$961,382	9	13.5%	$1,032,467
10	11.39%	**$1,026,111**	10	5.97%	**$970,973**	10	8.7%	**$1,074,281**

One axiom that we teach about during our *Preparing for Retirement* class is that all investment returns are not created equal. When you are retired and taking withdrawals from your portfolio, large investment losses can be more damaging than lower average returns.

Usually, when we discuss this topic, we show an example of how a consistent 8% return ends up with a significantly higher balance ten years later than either a portfolio with double digit upside moves early or late in the cycle while maintaining an 8% average over that time period. After three straight years of double digit stock returns, I thought it would be interesting to take the same concept and do a case study using actual stock and bond market returns from the last ten years.

Let's start with the variables of the scenario. Assume you retired on 12/31/2004 with a $1 million nest egg plus social security to fulfill your retirement income needs. Your savvy advisor has informed you that based on inflation, longevity, and investment returns, a withdrawal rate of 4% or $40,000 would be a historically safe amount to pull annually from your portfolio. Accordingly, you begin taking distributions at the end of each year, adjusting the initial $40,000 amount higher by 2% each year to account for the decreasing purchase power associated with inflation. Remarkably, at the end of 10 years, you would have been better off having a 50/50 stock and bond portfolio even though the average 10 year return was 1.5% less than a 100% stock portfolio! Further, consider the chance involved with retiring in 2004 as opposed to 2008. Having a big down year at the onset would have irreversibly damaged your long-term plan. Volatility can be a killer in Retirement, and that is why mathematically investors should dial down the risk of their portfolios to adjust for this reality. **-Walter Hinson,**

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