THIRD QUARTER
SEPTEMBER 30, 2014

DEIGHAN
WEALTH ADVISORS

20 Years

Deighan Wealth Advisors
1994-2014

MARKET COMMENTARY

In September, markets stalled a bit limiting the gains for most worldwide stock funds for this past quarter and the year-to-date. US stocks eked out a small gain of 1.1% for the quarter, and most international stocks rose slightly as well. In other asset classes, investment grade bonds were generally flat for the quarter, while long-term Treasury Inflation Protected Securities (TIPS) and high yield bonds both dropped around 2%. Real assets pulled back too: natural resources, lead by oil dropped 7.8% for the quarter; global real estate and global listed infrastructure each pulled back just under 4%. But the biggest loser for the third quarter was gold, dropping 8.4% and wiping out gains for the year to less than 1%. On balance, returns for the year were diminished, but for most asset classes stayed positive. US equities closed the quarter up a solid 8.3%, and most bond results stayed positive in the 3.5% to 4.0% range. Natural resources were slightly ahead at 0.4%, but global real estate delivered a strong 7.2% return and infrastructure registered an impressive 11% gain year-to-date. Only the developed international markets delivered a tiny loss of -0.1% for the year, and that loss was due to an 8% surge in the US dollar that took positive results in local currencies into negative territory by the time they hit our quarterly statements on this side of the pond.

Like parents of a teen delivering a less than favorable report card, a little analysis is in order to understand what the "grades" mean. In short, they mean we are still winding our way out of the woods worldwide. Here in the US, the economy remains uneven, but overall, our economy has improved significantly. Overseas, especially in Europe, some progress has been made, but challenges remain. To help move the economy along, the European Central Bank unexpectedly cut interest rates twice driving Eurozone bond yields lower. Back stateside, the Federal Reserve Bank is moving in the opposite direction, announcing that it plans to cease bond purchases this month and hinting strongly that it may start to slowly, but actively raise rates by mid 2015.

A direct result of the divergence of the US and European central banks policies was the strong rise of the US dollar against most foreign currencies. During the third quarter, the currencies of most developed markets dropped between 7% and 8% against the US dollar. The British pound, Canadian dollar and emerging markets currencies held up better, dropping 5.2%, 4.7%, and 5% respectively against the dollar. While this resulted in disappointing results on international stock funds for this past quarter, the currency shift means foreign goods will sell cheaper in the US, possibly boosting the future earnings of foreign companies and stiffening competition for US goods. It also means that US citizens traveling abroad may notice their dollars stretching a bit further, and US parents may breathe a little easier if their college juniors spend a year abroad since we may not be swimming so hard against foreign currencies as we have in years past.

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The best scenario for a stronger economy would be for low interest rates to continue for a while longer allowing businesses and homeowners alike to borrow more favorably. Corporate merger and acquisition activity has increased recently and would be positive for the economy if it could continue as well. The residential real estate market has certainly had its ups and downs, but transactions have increased and prices are starting to pick up a bit.

While retirees looking for more yield on their bond portfolios might herald the return of higher rates, businesses and home buyers might see this as a cooling trend. Higher rates make it harder for businesses and would-be homeowners alike to borrow, and some worry that it may have a chilling effect on the overall economy. As the Federal Reserve Bank executes interest rate hikes in an effort to return rates to normal levels, the worry is that it may result in a market backslide. Northern Trust recently provided a historical analysis of financial market behavior during five recent Fed tightening cycles starting with 1986. They concluded that stocks generated positive returns in four of the five Fed tightening cycles between 1986 and 2004. Specifically, they said, "Risk assets typically fared well in the twelve months that straddle the first rate hike despite the tendency for some level of correction around the first hike." In other words, following a brief period of heartburn, the US economy has been able to digest Fed rate increases. Northern did point out that defensive stocks; that is, those with characteristics of low volatility, solid dividend yield, quality and value, generally outperformed in the year following the start of a Fed rate hike. They further noted that both developed and emerging international equities have outperformed US equities during prior rate hikes possibly reflecting the mismatched policies of central banks. "Looking at future rate expectations, the market has priced a steady level of rate increases over the next one, three and five years - with the 3-month U.S. Treasury expected to yield nearly 3% by 2019. We believe that the rate normalization process will occur at a slower pace than the market believes and therefore do not anticipate material adverse price impacts." In sum, as we march resolutely toward a Fed engineered, more normalized interest rate environment, we should expect moderate volatility. For those with medium to longer term time horizons, they will be best served by patiently riding through it. We invite clients who may require significant amounts of cash in the short-term to let us know, and we will prepare for it by maintaining adequate liquidity for you. Meanwhile, at least in the short-term, the dollar will strengthen possibly for sound business reasons as we regain some of our footing as an international economic leader.

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On October 2, 2014, the "Oracle of Omaha", Warren Buffett, said it all in a CNBC interview. Becky Quick queried him with, "There are so many concerns about what's been happening with the stock market. The Dow dropped 230 points yesterday and volatility seems to be creeping back. What's your view of what's ahead?" Buffet said, "Well, we bought a business yesterday, and we would have bought it if the market had been up 200 points yesterday or down 200 points or up 1000 points last week or down 1000 points. The idea of what the market does on any given day is meaningless. What you really have to look at is what the business you are buying is going to look like five to ten years from now. It is what people do when they buy a farm or an apartment house or any other business. That is how we look at any transaction except purchasing stocks, and that is because you can look at stock prices minute by minute. That should be an advantage, but many people turn it into a disadvantage. I don't know how to tell what the market is going to do, but I do know how to buy reasonable businesses." Buffet concluded his comments by saying that in the short-term, he is delighted if a publically traded company he just bought goes down in price. He can buy more at cheaper prices. "Nothing is wrong with those companies." Buffett is a seasoned and smart investor. As we look to the months ahead, let's take a page out of his book, and resolutely ride through what may lie ahead confident that we have built thoughtful, resilient portfolios.

Best wishes for a lovely Fall and holiday season, from the Deighan team!

A TALE OF TWO TEACHERS

As Deighan Wealth Advisors has increasingly developed financial planning services to help clients, we have found ourselves working more with clients and their CPAs to determine the best mode and timing of taking Social Security benefits. As one of our clients put it recently, "I thought Social Security was a simple decision, but it seems to be more like brain surgery." He was actually right on both counts. For many, the mode and timing of taking Social Security is pretty straightforward. However, if you have ever worked for an employer, such as the State of Maine, that does not withhold Social Security from your salary, any pension you get from that work may permanently reduce your Social Security benefits. In these cases, the mode and timing of taking both Maine State Retirement Benefits and Social Security must be carefully analyzed.

There are two bodies of law that apply to these situations: the Windfall Elimination Provision (WEP) and the Government Pension Offset (GPO). WEP applies to benefits from *one's own* Social Security account; and GPO applies to *spousal benefits*. We can only generally outline the provisions here, and will use the examples of two teachers to illustrate the provisions.

One teacher, Jack, retired from teaching in Maine public schools at the age of 52 after 30 years of service and moved to teach in a private school where

Jack paid Social Security taxes for the next ten years. Jack could have left his Maine State Retirement System (MSRS) benefits intact and collected a pension upon his retirement, but his Social Security would have been reduced in light of his MSRS pension. Instead, before his contribution and earnings vested into a pension at age 62, Jack took his MSRS contributions and earnings in a lump sum and rolled it over into an IRA. When he retired at age 66, he had the requisite number of quarters paid into Social Security to receive full benefits and suffered no reduction due to his years working for the State of Maine. Jack was able to avoid the provisions of WEP because his right to a pension from Maine never vested at age 62.

Ann, a second teacher, stopped working and contributing to MSRS at age 60. Four years later, Ann (now age 64) and her spouse (age 66) decided to fully retire. Ann is entitled to a small monthly pension from MSRS, or she can take her contribution and earnings of about $10,000 and roll it to an IRA. Under WEP, because Ann is over age 62, and is now vested to receive a MSRS pension, if she were to either take the small pension or roll her $10,000 to an IRA, she would experience a permanent reduction in her Social Security benefit of about $100 a month. However, WEP will not apply to Ann's benefit because she will not be taking Social Security on her own account. Instead she will be taking a benefit of one half of her husband's Social Security on his account, so GPO will apply instead of WEP. Again, under WEP, if Ann takes the pension, she will experience the reduction in Social Security benefits. However, if she takes the lump sum of her contribution and benefits, GPO treats this as an exception and does not consider it a pension triggering the reduction in Social Security. Ann has an option to carefully consider. If half of her husband's Social Security benefit is greater than her own benefit less the WEP reduction of $100/month, she may wish to take the GPO and roll the lump sum of her pension contribution and benefits to an IRA.

To conclude, please consult with your financial planner and CPA well before you take any pensions and/or retirement benefits. Look before you leap! As always, we stand ready to answer any questions you may have on this or any related subject. We like all tales to have happy endings.

INVESTMENT CHANGES

The following investment changes were made this past quarter. Depending on your portfolio holdings and Investment Policy Statement, these changes may or may not be applicable.

Added
Wells Fargo Absolute Return Fund
Ticker: WARAX

WARAX invests substantially all of its investments in the GMO Benchmark-Free Allocation Fund. The fund seeks annualized excess returns of 5% above the Consumer Price Index. It has an additional target of annualized volatility of only 5-10%, as measured by standard deviation, over a complete market cycle. According to mutual fund ratings service Morningstar, "It will make significant shifts among asset classes when it believes that valuations have moved beyond their long-run norms. With an absolute rather than benchmark-focused target, this fund is the purest play on the [GMO] team's views. The team's asset class calls have largely been on point during the past two decades." GMO Benchmark-Free Allocation Fund, the underlying investment for WARAX, has an initial minimum investment amount of $10 million. This is obviously way too high an initial purchase amount for the typical client portfolio, so we found a way to access GMO's investment expertise and the strong long-term performance and risk reduction benefits of this fund via the Wells Fargo offering.

SOUNDBYTES

Tyler Hoxie successfully completed the Series 65 – Uniform Investment Advisor Law exam, a license required by most states in the U.S. for investment advisors. The exam covers such topics as securities laws, regulations, ethics, retirement planning, portfolio management strategies and fiduciary responsibilities. Congratulations, Tyler!

Jean Deighan attended Insider's Forum in Dallas, TX, a conference for financial professionals that features the highest caliber of established thought leaders in our industry as well as trailblazing newcomers.

Jenifer Wilson traveled to Seattle, WA for the Financial Planning Association annual conference, the largest gathering of CFP® professionals in the U.S., where financial professionals have the opportunity to connect with peers and participate in educational sessions.

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Removed
PIMCO All Asset Fund
Ticker: PASDX

PASDX turned in sub-par performance relative to peers in 2013, but the main reason for removing the fund and replacing it with WARAX was to better diversify client holdings among fund companies. This past January, we noted with concern the management turmoil at PIMCO that led to the departure of former CEO and co-Chief Investment Officer, Mohamed El Erian, following disagreements with co-Chief Investment Officer, Bill Gross. For decades, PIMCO had enjoyed the well-earned reputation of being the premier mutual fund family with regard to bond management. Recently, we decided it prudent to eliminate at least one of four PIMCO funds held in client portfolios in favor of another fund family choice. While PASDX has seen much improved results year-to-date, we decided that it should go, especially in light of the long-term solid results of the underlying fund of its replacement, WARAX. Please see *PIMCO Notes* below for further discussion about management changes that followed this fund's divestiture from client portfolios.

PIMCO Notes

Our decision to sell PIMCO All Asset Fund preceded the September 26th sudden resignation of Bill Gross, founder and Chief Investment Officer of PIMCO, and portfolio manager of the PIMCO Total Return Fund (PTTDX). We carefully screen all mutual fund holdings for many factors including style drift, administrative and management fees, performance, and management changes. We continue to hold PIMCO Total Return Fund, Short Term Bond Fund, and Foreign Bond Fund in client portfolios. While Bill Gross was the face of PIMCO, and this is a surprise management change, we believe that PIMCO has a deep bench of highly capable investment staff. Now that the distraction of discord has been removed at PIMCO, we hope that the considerable talent that remains will have ample opportunity to show its strength. The new managers of PTTDX are Scott Mather, Mark Kiesel, and Mihir Worah, all seasoned executives and portfolio managers who have long been a part of PIMCO's investment strategy team. We do not see reason for a knee-jerk reaction to sell PTTDX during this management transition as the fundamental strategy of the fund remains intact.

SEASONS OF MAINE EVENT

Our annual Seasons of Maine art show was once again a resounding success! The artists wowed the crowd with their paintings and sculpture, displayed throughout our building and in an outdoor tent. There were styles and genres to please all palates from stunning landscapes to an eight foot tall glass sculpture of a blue Manhattan cocktail! This year's artists included Matt Foster, June Grey, David Haskins, Jill Hoy, Richard Kapral, John LeBlanc, Claude O'Donnell, Linda Packard, Jerry Rose, Paul Thibodeau, Cheri Walton, and Diana Young. The event featured the classical guitar music of award winner Kevin Morse, delicious hors d'oeuvres, and plenty of opportunity to mingle with friends old and new while enjoying the beautiful art. We committed to donate 10% of art sales proceeds to the University of Maine Museum of Art this year. Artists reported sales of nearly $10,000, so we are happy to report that we will be donating $1,000 to UMMA. Thank you to all for attending!

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