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CALDER INVESTMENT ADVISORS

Quarterly Update

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Calder's Comments

"The stock market has shifted to neutral while bonds have gone into reverse, and investors expect the rest of 2015 to be a bumpy ride." That is the opening line to an article titled, "No Easy Way Forward for Markets" by Dan Strumpf in the Wall Street Journal (June 30, 2015). During the second quarter, the S&P 500 Index was up 0.3% and up only 1.2% year-to-date (both figures include reinvested dividends). The index started the year at 2,059, moved to 2,067 at the end of the first quarter, and was at 2,063 to end the second quarter. Meanwhile, the Barclays US Aggregate Bond Index declined 1.7% in the second quarter and is now down 0.1% year-to-date. Like the author said: neutral and reverse.

Our conversations with portfolio managers at a number of mutual funds have had two basic themes: cheap stocks are hard to find and expect increased volatility in the second half of the year. We have seen a number of funds increase their allocation to cash, some to historically high levels. This is because many managers see the potential for stocks to decline as much more likely than for stock prices to increase. Our contact at PIMCO said their fund managers have modified their investments to better handle increases in volatility.

The question worth asking is what could derail the current bull market? It has been more than 1,590 market days since the last market correction of more than 20% (940 market days since the last market correction of more than 10%, the third longest stretch in history). But maybe things are starting to change. Halfway through 2015, the S&P 500 Index has endured four declines that have lasted three days or more and the number of single day declines is way up. Since January, the S&P 500 Index has declined 69 times, more than in any year since 2002. The index has also increased 64% from 2011 to 2014 but has not gone anywhere since.

So, the equity markets are not giving investors they types of returns they have seen in past years. Then you have Greece. Will they make a "Grexit" from the European Union or will an "aGreekment" be reached to bail them out once again? Add to the mix the withdrawal of economic stimulus from the Federal Reserve. Or maybe the more pressing question is will the Federal Reserve make a move to raise rates in 2015? All of these things could have an effect on your investments.

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In-Retirement Withdrawal Strategies

The standard sequence for a tax-efficient portfolio drawdown is required minimum distributions first. Taxable accounts next, followed by Traditional IRAs and 401(k)s. Roth IRAs and 401(k)s last. The overarching thesis is to be sure to tap those accounts where you'll face a tax penalty for not doing so (RMDs) while hanging on to the benefits of tax-sheltered vehicles for as long as possible. Because Roth assets enjoy the biggest tax benefits--tax-free compounding and withdrawals--and may also be the most advantageous for heirs to receive upon your death, they generally go last in the withdrawal-sequencing queue.

That's a helpful starting point for sequencing retirement-portfolio withdrawals, and it goes without saying that you should always take your RMDs on time. That said it may be a mistake to always follow this strategy. The reason is that your tax picture will change from year to year based on your expenses, your available deductions, your investment performance, and your RMDs.

In order to keep your total tax outlay down during your retirement years, it may be worthwhile to maintain holdings in the three major tax categories throughout retirement: taxable, tax-deferred, and Roth. Armed with exposure to investments with those three types of tax treatment, retirees can consider withdrawal sequencing on a year-by-year basis, staying flexible about where they draw their income bases on their tax picture at large. They can help limit the pain of an otherwise high-tax year by favoring taxable and Roth distributions, for example, while giving preference to tax-deferred distributions in lower-tax years.

For example, in a year in which they have high medical deductions that push them into a lower tax bracket, they might actually give preference to withdrawals from their Traditional IRA accounts, even though they have plenty of taxable assets on hand, too. The reason is that it may be preferable to take the tax hit associated with that distribution when they're paying the lowest possible rate on that distribution. Moreover, aggressively tapping tax-deferred accounts like Traditional IRAs in low-tax years will mean that fewer assets will be left behind to be subject to RMDs.

On the flip side, in a high-tax year--for example, when RMDs are bigger than usual due to market appreciation--a retiree might reasonably turn to her Roth accounts for any additional income needed. Although those Roth assets usually go in the "save for later" column under the standard rules of withdrawal sequencing, those tax-free Roth withdrawals (versus, say, paying capital gains on distributions from a taxable account or paying ordinary income tax on tax-deferred withdrawals) may help the retiree avoid getting pushed into a higher tax bracket than would otherwise be the case.

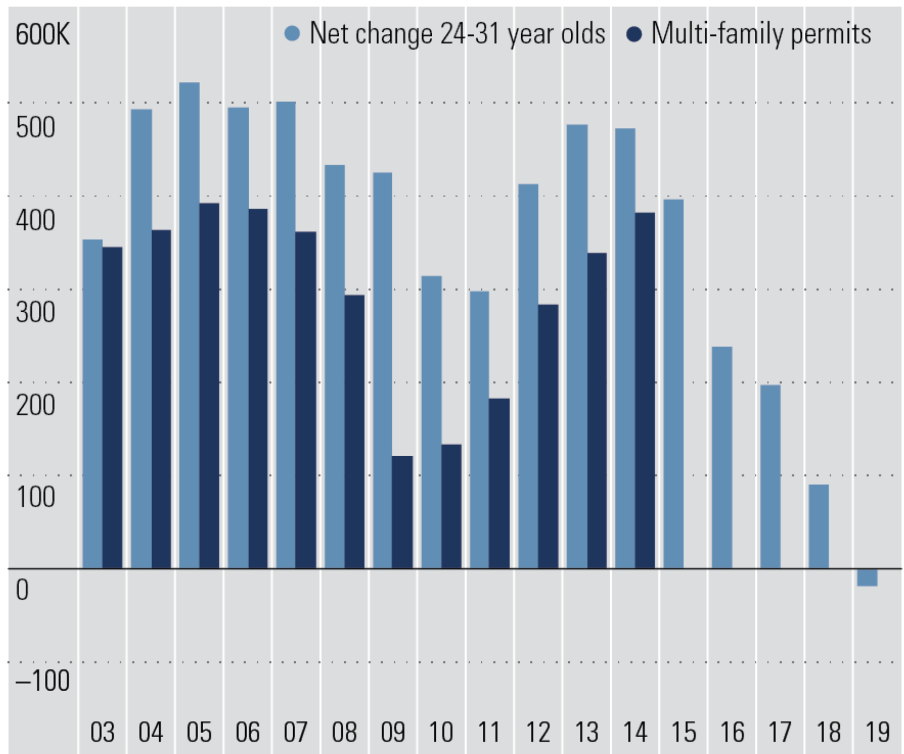
401(k) plans are long-term retirement savings vehicles. Withdrawal of pre-tax contributions and/or earnings will be subject to ordinary income tax and, if taken prior to age 59 1/2, may be subject to a 10% federal tax penalty. Funds in a traditional IRA grow tax-deferred and are taxed at ordinary income tax rates when withdrawn. Contributions to a Roth IRA are not tax-deductible, but funds grow tax-free, and can be withdrawn tax free if assets are held for five years. A 10% federal tax penalty may apply for withdrawals prior to age 59 1/2. Please consult with your financial advisor at Calder for advice specific to your situation.

This article contributed by Christine Benz, Director of Personal Finance with Morningstar.

Aging Millennials Should Drive Up Single-Family Home Sales

In this recovery, there has been a surge in interest in apartment buildings. Meanwhile, single-family home sales are still running about 50% below their previous peak. The chart illustrates what may be behind some of that change. Following the decline in the 24-31 year old cohort, that group is now growing again. Not surprisingly, so are multi-family permits and interest in apartment buildings over the last several years. Looking at the data for 2014-2019, that age dynamic will begin to shrink according to Morningstar economists. That's bad news for people building apartments, but great news for the overall economy. Single-family homes utilize more labor and more materials than apartment buildings do. So, as the age group begins to buy homes instead of living in apartments, it should drive up single-family home sales and boost the economy.

Demographics Drive Renting Business



This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results.

Source: Census Bureau, Morningstar

Calder's Comments - continued from page 1

Steve Romick, Chief Investment Officer of the FPA Crescent fund, gave a speech to the Chartered Financial Analyst (CFA) Society on June 25, 2015. The general outlook of the Investment Committee at Calder Investment Advisors would mirror his comments. Here is an excerpt from his speech.

> "It's not complicated. When we find opportunities, we commit capital, increasing our risk exposure. Conversely, when the environment is more barren, cash builds by default and our risk exposure declines. What we won't do shares equal billing with what we will do.
>
> Just because we may not be invested doesn't mean we're sitting around doing nothing. We never stop learning about businesses. School is in session every day but exams tend to come in a cluster, which brings to mind a Bill Parcells quote: 'This is what you work all season for. This is why you lift all them weights.' Similar preparation allows us to be ready when the inevitable opportunities present themselves. At that point, we'll draw down cash to make investments.
>
> We find that our clients' patience can sometimes be tested by virtue of our episodic willingness to not act as we prepare for those moments. This has led to some periods of underperformance but only during segments of complete market cycles. When it comes to hugging a benchmark, we are clearly way out of the closet. And yet, we have still successfully achieved our objective to deliver a return equivalent to stocks while avoiding permanent impairments of capital."

FPA Crescent fund (FPACX), managed by Steve Romick, is carrying a historically high cash allocation of almost 40%, based on the most current information we have from Morningstar. This fund has a strong track record that demonstrates that their investment team will increase cash at the right times and deploy it when markets correct, doing a wonderful job of protecting investor's capital in down markets.

Many of the other funds that we employ are in agreement with Mr. Romick's view of the markets. They, too, are implementing strategies to help preserve investor capital, even though their strategy may differ from that of FPA Crescent. Over the next 3-5 years, owning these funds will provide a higher likelihood of meeting your long-term investment goals.

Don't hesitate to give us a call to discuss any questions you may have about your account.

A transcript of Steve Romick's entire speech to the CFA Society can be downloaded from the FPA Funds' website: http://fpafunds.com/special-commentaries-folder/don't-be-surprised---steven-romick's-speech-to-cfa-society-of-chicago

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