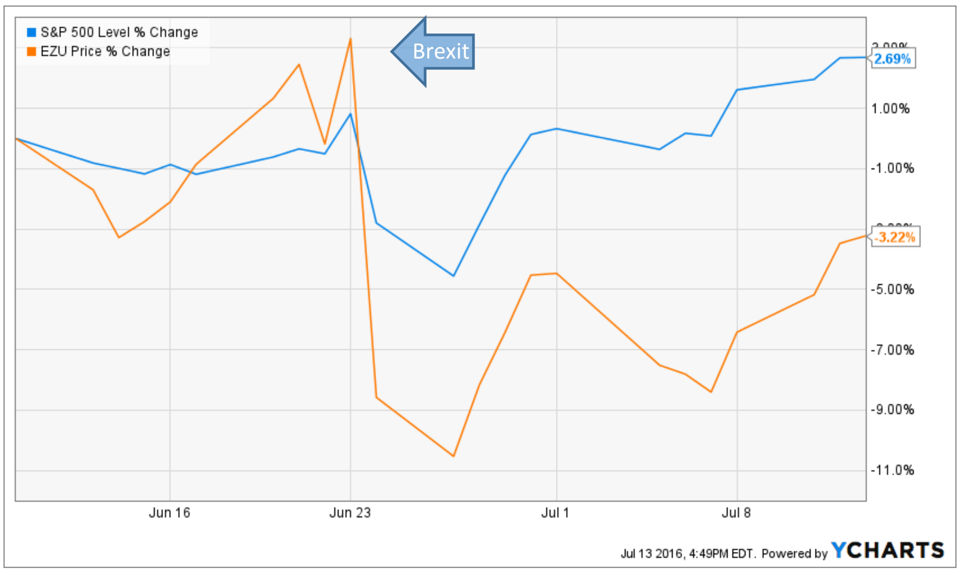
July 13, 2016

Dear Clients and Friends,

On the eve of the British referendum on EU membership – The Brexit – I penned a client letter laying out the what-if scenarios of the pending vote. The less likely outcome happened: the UK voted to leave the EU. Whereas the outcome was unpredictable, the reaction was predictable: markets sold off 5-6% in the US and 10-13% outside the US within 2 days and the British pound dropped more than 10%.

What is more surprising than the sharp selloff, is how fast the stock market recovered. Within 5 trading days the S&P 500 Index – a proxy for the US market – had come within 1% point of a full recovery and within 9 trading days the index was back in the black.




S&P 500 Index, MSCI Eurozone

So far the losers have mainly been European banks, as well as British tourists and expat pensioners who have seen the purchasing power of their pounds drop. Perhaps they will soon be joined by London's financial sector employees, who might see their jobs move to Frankfurt, Zurich, and Paris. But the world will keep on spinning and investors will soon move on to fretting about the next big risk, whatever that may be.

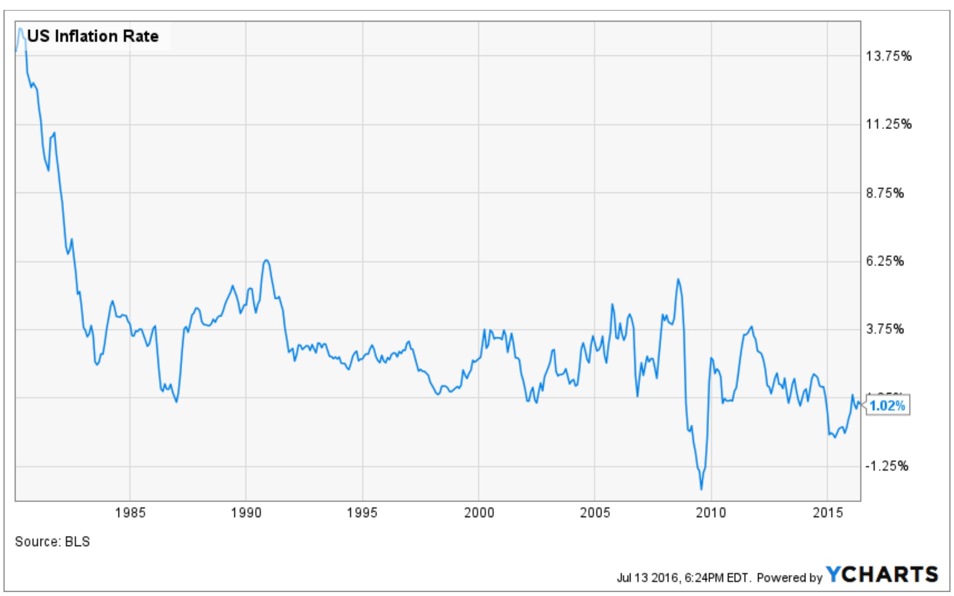
In investing, as in life, we spend a lot of time worrying about things we think might happen, only to be blindsided by things we did not anticipate or prepare for. Locate the emergency exits nearest you, wear your seatbelt or helmet, learn how to hold your breath, own a first aid kit, store water, and diversify your portfolio with a balance of risky and safer assets: it is easier to prepare for the unexpected than to predict it.

I am by no means a wine expert, but I know enough to know that the vintage matters. In the case of Oregon Pinot Noir, which I have a particular fondness for, 2012 was one of the best vintages in the region's 50-year history. What does that have to do with anything? Well, when you reach retirement age and start spending your savings, vintage matters too. Or in other words, prevailing interest rates, inflation, real estate prices, rents, and stock and bond price levels in the year you retire, have a big impact on your retirement income and portfolio composition.

Retirees of the 1984 vintage were sitting pretty. The 10-year Treasury was yielding 12%, inflation was on the decline, and you did not have to take much risk to earn a handsome return. The stock market had delivered a 70% return (excluding dividends) over the previous 5 years, boosting retirement nest eggs prior to retirement. 1981 and the first part of 1982 tested investor patience with a declining stock market, but that had a greater impact on earlier vintages and the (retirement) class of 1984 had ample time to recover and hit new all-time highs.

Unfortunately, retirees of recent vintages and those of upcoming ones, don't have as easy sailing. The 10-year Treasury rate is near 1.5% and the only respectable yields are in riskier assets. "Stretching for yield," or buying higher yielding assets to boost retirement income, is a tradeoff between risk and return that retirees in the 1980s did not have to make. That is not to say that investors cannot succeed. It just requires a more selective approach to picking investments and a careful calibration of the right risk level; not too much, but not too little.

One silver lining is that inflation is low, which at least takes one issue off the table for the time being. Another, is that global growth has been subpar for years now and any signs of an uptick could boost the valuations of foreign assets, which are cheap relative to their historic averages. Be that as it may, there are probably more headwinds than tailwinds. I accept that challenge and look forward to continuing to work with my clients to optimize the financial aspects of their retirement.




While we are on the topic of retirement, I am often asked when to file for social security benefits. You can assume that the government actuaries have nailed down the average life expectancy pretty accurately. Payout amounts are based on life expectancy at the age of filing, so if you file early you will receive less because you are expected to live longer. Vice versa, if you file late you will receive more as your remaining estimated lifespan is shorter. It is therefore hard to "win" from the Social Security

Administration unless you die earlier than the government expects in the case of an early-filer, or live longer than the government expects, especially in the case of a late-filer.

One will never experience the joy of having received more in Social Security benefits by filing early vs. on time or late, because it requires dying. The chances that surviving friends and family are happy that you have “won” from the SSA are small too. Therefore, unless you have a high confidence that you will not beat the life expectancy tables, you are generally better off not filing early. A big component of planning for retirement is ensuring that you don’t outlive your money. That is easier to do with a larger social security check, which is the main reason I advocate late filing, all things being equal. Of course, all things are never equal; cash flow needs and other personal circumstances may come in to play that change the equation.

I welcome you to contact me with any questions or to learn more about our investment strategies and financial advisory services.

Wishing you a bright and fun summer.

Best regards,

Jan Schalkwijk, CFA
JPS Global Investments