Friday, July 01, 2016

Well the Brexit vote has come and gone, and while we know they have voted to leave the European Union, no one really seems to know what this might mean for the UK, the EU, China, or investment markets. Many of you will have seen my breakdown of the immediate market reaction on the returns in your accounts in our Risk Adjusted Portfolios (RAPs). The system I use to generate those averages won't let me select a custom period such as 4 days, but I have reviewed a few accounts in the models to see how they did fare over the 2 down and 3 up days since the vote on Thursday.

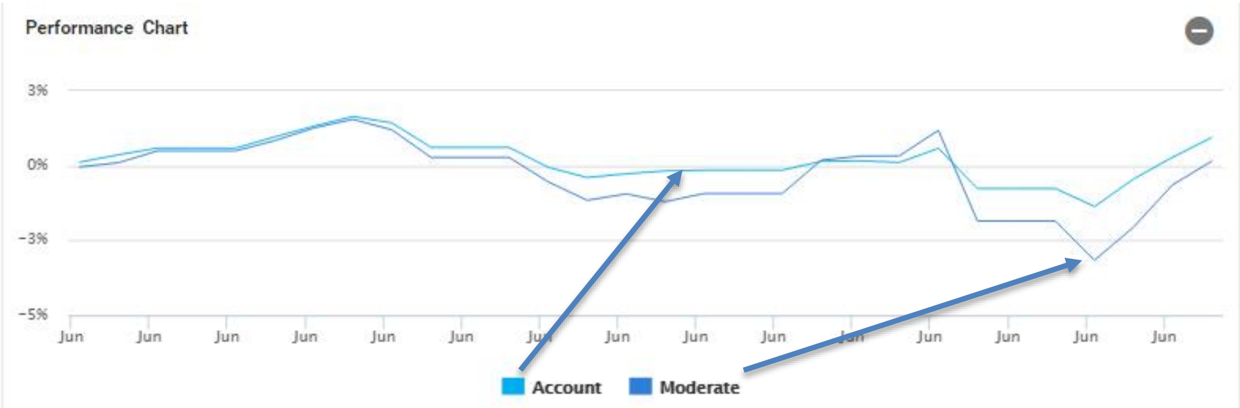
One example of the 5 days is my own 401(k) account which is very closely aligned with the Moderate NTF model, (within a fraction of a percent, and which was just rebalanced recently, along with all of our other qualified accounts (IRA's, Roth IRA's 401(k)'s etc). The table below compares the difference in how returns accumulate over time (rather how we think of them when we look at index performance numbers) and the difference between that and how returns and money invested actually compound. Over the 5 days the benchmark return lost 4.33% then gained 2.37% or a net -0.96%. Or is it? Because of the effects of compounding the daily return on the invested amount, the actual return is -1.02% or 0.06% worse than the headline return numbers.

| Daily, Cumulative, and Compounded Performance Compared | | | | Investing in Model | Investing in Index |
|---|---|---|---|---|---|
| **June 24-30** | **Moderate NTF Account** | **Diff** | **Benchmark** | **$100** | **$100** |
| **Day 1** | -1.34% | 1.66% | -3.00% | $98.66 | $97.00 |
| **Day 2** | -0.61% | 0.72% | -1.33% | $98.06 | $95.71 |
| **Day 3** | 0.93% | -0.21% | 1.14% | $98.97 | $96.80 |
| **Day 4** | 0.73% | -0.71% | 1.44% | $99.69 | $98.19 |
| **Day 5** | 0.66% | -0.13% | 0.79% | **$100.35** | **$98.97** |
| **Cumulative 5 Days (NOT how investing works)** | **0.37%** | **1.33%** | **-0.96%** | | |
| **Compound 5 Days (HOW investing works)** | **0.36%** | **1.38%** | **-1.02%** | **$100.35** | **$98.97** |

Now we were actually up over the period because of our Debt and Hybrid allocations in our models. Because our debt is focused on high quality, interest rate sensitive, long treasuries and less market sensitive, mortgage backed, and high quality municipal securities, during scary days for stocks our, bonds funds are getting a good boost. We

204 WEST WING ST | ARLINGTON HEIGHTS, IL 60005
PHONE: 847.670.8000 | FAX: 847.590.9806 | EMAIL: INFO@RFGWEB.COM | WWW.RFGWEB.COM

will need to watch out for when the perception in the bond market is that the economy is going to heat up and long term treasury yields start to climb. We have a plan for that exit, although no specific trigger. Our hybrid managers have been carrying cash in large amounts and/or use trading strategies not correlated to the stock market. So while they usually just mute equity volatility, this time they actually climbed as equities fell. The chart below shows this same account's return for the month, notice how the benchmark returns both above and below it. We are looking for reliable and more steady returns over time.




You are all aware that recently we have NOT beaten our benchmarks. Here is the same account for the year, our performance on it, gross of fees was 2.72% compared to the benchmark's 2.85%. Close as they say, but no cigar. However, I'd like you to notice the circled area on the chart below. During most of the year our models have tracked slightly below the benchmark when it is high and above, when the benchmark is low. What I am very pleased by is that when volatility spiked, our portfolio model did not and


it actually countered the downside much better than when normal ranges of returns are experienced. This has been the objective of much of my research and portfolio shifts over the last year. The narrow and increasingly pricey US stock market has been a challenge for every manager that uses valuation, market size and diversification to create portfolios and reliable returns over time. That includes us. I exacerbated those problems with one untimely security selection in 2014 into the midstream energy space, which was resistant to modest changes in oil and gas prices but was not resistant to the massive swings in oil prices that occurred last year. Otherwise, our returns lagging global benchmarks were due primarily to the effect of the market indexes advancing on increases in the (P/E) multiple of the stocks in the indexes, and not increased earnings power of those stocks. I do not think we can expect to see more expansion of (P/E) multiples driving returns and are likely to see in the not too distant future and gradual grinding away of the multiple or a rapid, rather scary decrease.

We have designed our portfolios to thrive (relatively) in those environments and we have plans in place for how to adjust the portfolios further to take advantage of substantial downturns.

We DO want you to work with us to ensure that your planning is up to date. That your risk preferences are updated, and that weathering a downturn in the markets is part of your plan. Do you know how it is part of your plan? Are we on the same page? Let's make sure your plans and portfolios are working together. Is debt under control and mortgage debt all that you have? Do you have adequate emergency funds? For those taking income from their investment assets, is two years' worth readily available as cash and near cash and another three to five years' worth allocated to high quality debt securities. Have you insured your assets; home, vehicles, real assets, income, health and your ability to care for yourself against other risks?

I hope you have been enjoying our new communications abilities, both the weekly updates on your accounts, if you have kept them, as well as our more general emails with interesting content. I hope to get better at using it to provide more customized material for your interests. Sorry about some of the repeats, it is a powerful system but it takes some practice to keep it well fed! In addition to our weekly email updates, you can also subscribe to SMS text message or email updates of balances or performance or both on your own.

Login to your MyAccounts portal, and at the top right click on your name and then on your user profile. Once there you can update your address, phone, security, verify your text message address, and select which notifications if any that you would like. Once you verify your text message number (by text of course), you will have the number in your phone and can add it to your address book. When you want your balance, performance, my contact info or to schedule a meeting with me, you text the request (to the number you received your verification from.

We have been asking for your communication preferences when we have our review meetings, and as a result of that feedback, we have updated our statements to try to make them more informative and at the same time less complex. You will find more graphics and we have updated some of the performance numbers to reflect year by year information so that you can compare one year to the next. Our statements will reflect a "Distribution Rate" so that you can get a feel for how much you may have withdrawn from your investment assets in each year. We have added a chart showing performance year-to-date by asset category; something that I think is central to your awareness of why your portfolios are doing what they are doing. Then, in the holdings detail area, you can see what category each security is in. There are graphics illustrating your asset allocation and how it has changed over time. Our Advisory Fee Schedule has been cleaned up and made much more concise. Lastly, we have removed the list of transactions from this report as it simply duplicates what is on your custodial statements and the information they mail or email to you when we trade.

Our ability to measure the expected risk when building portfolios, evaluate the risk in your specific account after we have invested it, and understand how it is and how we expect different hazards to affect our models and your accounts has grown immensely over the last two years. If you have specific concerns, please reach out to one of us. We can review your portfolios, either online via a shared screen, or in person with you and illustrate the up and downside potential we would expect both in general and in severe or even specific scenarios. We can review with you, your Risk preference, which will reflect directly on the returns you can expect over time and we can show you the portfolio options that can help you get to where your preferences and your investment requirements meet comfortably.

I hope you all have a great summer. Keep in touch!

It is an honor and a privilege to be your financial advisor, thank you for your confidence and trust.

Sincerely,

Benjamin G. Baldwin III, CFP®, ChFC
President