



S H E P P A R D

W E A L T H

First Quarter 2015 Client Letter

**“The pessimist complains about the wind; the optimist expects it to change; the realist adjusts the sails.”
- William Arthur Ward**

A week ago I was invited to have lunch with a friend on Broken Top Mountain. For those of you unfamiliar with the Cascades, Broken Top is a local mountain that’s only accessible by hiking in. Mountaineering is a sport extremely dependent on weather conditions. The day before we were scheduled to climb it appeared the weather had changed and our conditions were less than ideal. When morning arrived we reevaluated the conditions and factored into our gear some additional margin of safety (avalanche gear). The day finished great, but it was filled with constant monitoring of the weather, and a few adjustments to our route due to snow conditions.



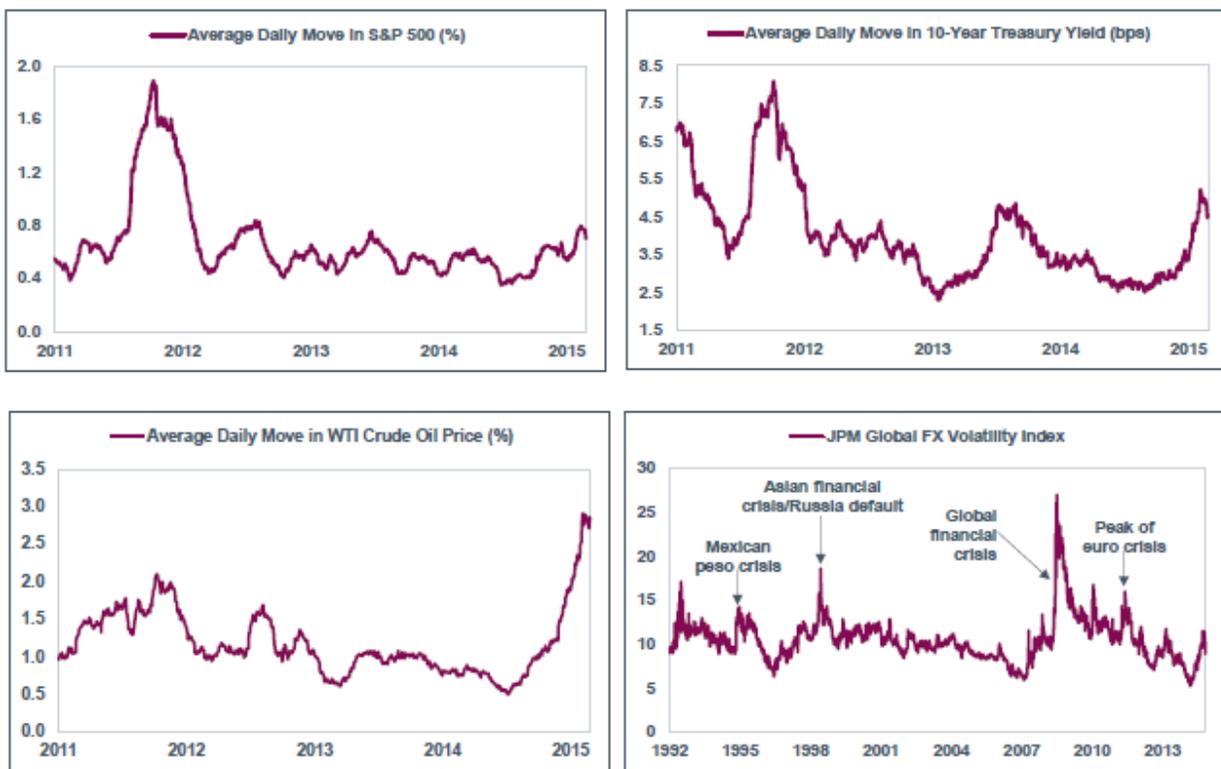
On our way up Broken Top

Market volatility can be like mountaineering. Our team here at Sheppard Wealth continues to evaluate our positions and revisit our thesis on what, and why, we own what we own. Warren Buffet said it best: "To invest successfully over a lifetime does not require a stratospheric I.Q., unusual business insight or inside information. What is needed is a sound intellectual framework for making decisions and the ability to keep

emotions from corroding that framework." At Broken Top we needed to keep our emotions (excitement for fresh untouched powder) at bay. So, too, for investing. As portfolio managers, we must remove our emotions, and view the roller coaster of the markets as opportunities to buy (or sell) companies at discounted (or high) prices.

At the end of the first quarter of 2015 the possibility of an interest rate hike continues to loom. It has been over six years since the Federal Reserve started the flood of dollars into the economy – more commonly called QE (Quantitative Easing). Unemployment peaked at just over 10%. It is now down to around 5%. The S&P 500 is up 255% on a total return basis since the bottom in March of 2009. All of the stimulus to the economic system seems to be working, but with uncertainty surrounding the timing of the first rate hike by the Fed's, market volatility is likely to continue.

Volatility up across all asset classes



As of 2/27/15. Average Daily Move=50-day moving average of absolute daily change. bps=basis points. WTI=West Texas Intermediate. JPM Global FX Volatility Index is an index of global foreign-exchange volatility that tracks options on currencies of major and developing nations in percentage points. Source: Bespoke Investment Group (B.I.G.), Bloomberg.

All of this uncertainty didn't provide much in the way of stock gains over the quarter. It finished about flat with the major indexes turning in a mixed performance. The S&P 500 eked out a tiny gain, its ninth in a row, while the Dow turned negative for the quarter after taking a 200-point hit in the last few days.

Over the course of the quarter, the S&P saw several 2% to 3% dips, but these were short lived as investors quickly bought up the discounts. Along with all of this volatility stocks saw higher highs and lower lows, but in the end it looks like investors still have an appetite to buy on dips and add to their exposure in equities.

Crude oil continued its fall with another 10% to the downside extending the 2014 46% plunge. This is the third straight quarter that futures have been heading lower. With record high crude supplies and locations to store it decreasing rapidly, it would seem that prices have only one way to go – as supply goes up and demand goes down. Thus, leading to short-term lower prices. No one knows when the bottom hit except in retrospect. (As a side note, we have made a few investments in the energy space that fit our investment criteria – further discussion below.)

Sheppard Wealth adds a new face...

I am excited to announce that James Hua joined Sheppard Wealth as a research analyst in January. James Hua is the Portfolio Manager and founder of Opal Advisors, a value-oriented asset management company in Seattle, Washington. Prior to starting Opal Advisors, James served on the investment team and reported to the Investment Committee at Freestone Capital. At Freestone James researched and analyzed liquid and illiquid investments in traditional long only strategies, hedge funds, fund of funds, and real estate. Prior to joining Freestone, he was Controller of Liberty Capital, a private equity firm focusing on distressed investments in real estate and real estate related loans.

James earned his bachelors in Accounting and Business Administration from the University of Washington. During undergrad, he interned at Merrill Lynch for the VP of Investments who managed \$160 million in assets.

Investor Behavior...

By James Hua

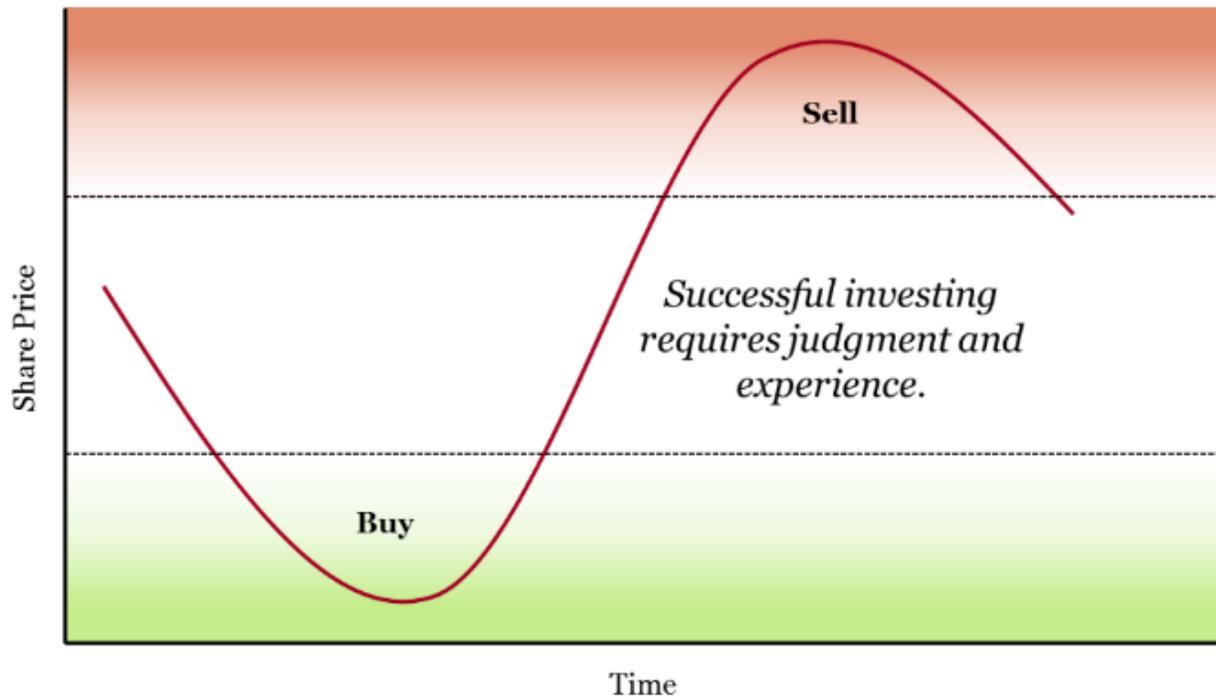
Everyone has heard it before, buy low and sell high. However, the challenge is in the execution. By nature, we're not only inclined to buy at the worst time (position envy) but also sell at the worst (prospect theory). We're envious when we see others making money so we jump in when it's too late; and then we compound the situation by selling when we should be buying. Prospect Theory explains that people feel more pain from a dollar lost than pleasure from a dollar gained which is why people often "sell at the bottom."

At SWM our core stock strategy helps maximize return and lower risk by reducing these tendencies through systemically screening for companies that rank highest among two main criteria: earnings yield and return on capital. Earnings yield is inversely related to (stock) price. As price goes up, earnings yield goes down and vice versa. Thus, what typically fits our screens are out of favor companies with low stock prices. This is key to buying "cheap."

The other component which is equally important is buying companies with high returns on capital (ROC). ROC is a quick and dirty metric that indicates whether the company is earning a decent return per dollar invested in the business. A company with a high ROC tends to have "franchise" value, or as Buffett calls a competitive moat, which allows the company to charge higher prices. This is typically indicative of a good business.

Last, after combining cheap prices with quality businesses, our proprietary overlay further screens for criteria such as strong balance sheets, cheapness by multiple metrics, and increasing revenues and earnings.

While we may deviate from time to time, these are the overarching guardrails that drive the investment process. Purchasing companies that fit the high earnings yield, high ROC and overlay should turn out satisfactory results over the long run. It is time tested and makes logical sense as to why these investments should and ought to do well over time.



Wealth Plans...

We have completed each of your Wealth Plans, and will be contacting you over the next several weeks to schedule a meeting. Here we will go through our findings and start building the framework for setting future goals and expectations. We want to make sure this plan remains a valuable resource going forward.

Thank you for the trust you have placed in Sheppard Wealth.

Warmest Regards,

John Swanson
Sheppard Wealth

Introduction to Sheppard Wealth...

If you have a friend, family member, or colleague that may benefit from our counsel, please consider making an introduction. Thank you for your continued trust and confidence.

DISCLOSURES

This letter is intended for existing client only, it is for informational purposes only and is current as of the date noted. It reflects the views of its author at the time of this writing. These views may have changed in response to changing circumstances and market conditions.

The information set forth herein was obtained by sources which we believe reliable, but we do not guarantee its accuracy. This summary contains generalized investment opinions. Such opinions are subject to change without notice; do not constitute legal, accounting, tax, or investment advice; do not take into account your investment objectives, financial situation, or particular needs; and do not constitute a solicitation or recommendation for the purchase, sale, or holding of any financial instrument or product, or a representation that any investment strategy or product is suitable for you.

A copy of Sheppard Wealth's current written disclosure statement (ADV II) discussing our business operations, services, and fees is available from Sheppard Wealth upon written request.