Fourth Quarter 2014 Investment Letter

“It’s not the years in your life that count. It’s the life in your years.” – Abraham Lincoln

The end of 2014 brings the start of a new year which is a perfect time to reflect on the moments past and to start making plans for times ahead. My wife, Joanna, and I gratefully celebrated 17 years of marriage on January third. (She surprised me with an overnight stay in downtown Bend!) During our time away we took a few hours to write down several goals, both personally and professionally. One of our personal goals was to “date” each of our children. I was thrilled to schedule these times with my kids on the calendar. As Joanna and I discussed our plans for 2015 in detail, we were able to line up action items on the agenda and worked to see what tools would be necessary to help us achieve our goals during this next year.

One professional goal I established was to deliver a current and working comprehensive Wealth Plan to each family client before the end of second quarter 2015. Everyone whom Sheppard Wealth assists has personal aspirations and complexities, and it’s not just about money. I plan to spend time with each of you and learn what tugs at you most. Then, just as my wife and I put things down on paper, I would like to help create a few goals for you for the year ahead.

The first step is to provide you an overall financial picture— a comprehensive evaluation of your present and future financial status by using all currently known information to help predict future cash flows, asset values, and withdrawal plans. (Andrea and I are currently working on this, and will be contacting you over the next few weeks to gather any additional information we may require.) The second step is for you to complete the attached Risk Assessment Questionnaire, as it will produce a tailored investment policy for your situation. Third, this process will require you to ask yourself the following questions (where applicable):

- Do I have enough money to retire (or stay retired)?
- Will my money go where I want when I die?
- Do I need a trust?
- Are there ways to reduce my taxes?
- What is the best way to pay for college? How much should I save?
- Am I maximizing my company benefits?
- What is the most effective way to give to charities?
- Does my family have enough money (to live or pay estate taxes) if I die? What if I cannot work?

- Am I properly insured against loss, theft or liability claims?
- What about my debt?
- I would like help with (you fill in the blank).

Lastly, after we've completed the Wealth Plan, we'll meet and quantify your goals in terms of resources and identify what needs to be done to implement them. From that point forward I'll check in with you to discuss whether your plan or investment policy needs revising. Change is a part of life, and I want to make sure this plan remains a valuable resource.

Some Year End Thoughts…

"Those who have knowledge don't predict. Those who predict don't have knowledge." – Lao Tzu

How quickly things can change in investment markets. Fourth quarter was disappointing. The S&P 500 set many new record highs (up 13.7% for 2014 including dividends). Eighty five percent of all active stock mutual fund managers trailed the benchmark (according to Lipper, a Thomson Reuters company). In a typical year, there are nearly twice as many managers outperforming, with only around two thirds of funds struggling to catch up. Lipper says this [2014] was the worst year for active managers relative to the market in three decades.

In December, *Fortune.com* published an article titled "2014: The Year That Nothing Worked." The article clearly explained how the vast majority of active mutual fund managers underperformed the widely accepted benchmark of the S&P 500. Below is an excerpt from the article by Joshua Brown:

"Stock pickers encountered difficulty this year in part because of concentration at the top of the market. Just five stocks—Apple, Berkshire Hathaway, Johnson & Johnson, Microsoft, and Intel—accounted for 20% of the market's gains. If you weren't at least equally weighted toward them, you had virtually no shot at making up for missing their enormous, index-driving gains. A majority of the market's stocks did not perform nearly as well. According to the Leuthold Group, only 30% of S&P 1500 stocks posted gains exceeding the index itself. You'd have to go back to 1999 to see anything like this."

My convictions as a value investor (one who looks for a stock trading at a big discount to intrinsic value) began 12 years ago while working along-side the Ragen Mackenzie Group. It was then that I was introduced to some of the greats like Benjamin Graham, Warren Buffet, and Sir John Templeton. The principles of Graham's *The Intelligent Investor* (written in 1949) are just as relevant today as they were almost 70 years ago. However, being a value investor means one can still experience poor performance compared to those of other investors, or the market as a whole during prolonged periods of market overvaluation (i.e., the case in 1999, 2007 and now 2014). However, over the long run, value investing (evidenced by the aforementioned men and many others who adhere to the value approach) has worked so well that few believers of the philosophy ever abandon the process. Valuation of a company matters; it is the single most important reason for acquiring the stock. As I mentioned in my last letter, finding value is difficult and doing so generally requires one to act opposition to the mainstream investment world (the herd mentality). Buying companies that are undervalued typically means investing in unloved, unpopular, and undesired companies. It can take many years before the worm turns, but eventually it does, and the sun rises and the stock price will approximate intrinsic value. With the S&P 500 index outperforming most professionals recently, it is clear why the index fund industry has exploded. However, one thing people forget as they rush to follow the herd and ascribe to passive investing is that the underlying still needs to perform for them.

Index funds have experienced significant growth in new assets under management (AUM) as investors seek more independence, lower costs, more clarity, and less effort on their part. After all, many investors would rather adhere to what has worked in the past 12-18 months than to stay focused on a time-tested process. We all know that age-old saying, "past performance is no guarantee of future results." This goes back to the *herd mentality* and this approach usually ends poorly in the years to follow. Look at the graph below and conclude which asset class will perform best in 2015. I'm going to follow the words of Mr. Tzu and not predict this one!

Asset Class Returns

2000	2001	2002	2003	2004	2005	2006	2007	2008	2009	2010	2011	2012	2013	2014
REIT 26.4%	REIT 13.9%	HG Bnd 10.3%	EM 56.3%	REIT 31.6%	EM 34.5%	REIT 35.1%	EM 39.8%	HG Bnd 5.2%	EM 79.0%	REIT 28.0%	REIT 8.3%	REIT 19.7%	Sm Cap 38.8%	REIT 28.0%
HG Bnd 11.6%	HG Bnd 8.4%	REIT 3.8%	Sm Cap 47.3%	EM 26.0%	Int'l Stk 14.0%	EM 32.6%	Int'l Stk 11.6%	Cash 1.4%	HY Bnd 57.5%	Sm Cap 26.9%	HG Bnd 7.8%	EM 18.6%	Lg Cap 32.4%	Lg Cap 13.7%
Cash 5.8%	HY Bnd 4.5%	Cash 1.6%	Int'l Stk 39.2%	Int'l Stk 20.7%	REIT 12.2%	Int'l Stk 26.9%	AA 7.6%	AA -22.4%	Int'l Stk 32.5%	EM 19.2%	HY Bnd 4.4%	Int'l Stk 17.9%	Int'l Stk 23.3%	AA 6.9%
AA 0.5%	Cash 3.4%	HY Bnd -1.9%	REIT 37.1%	Sm Cap 18.3%	AA 8.9%	Sm Cap 18.4%	HG Bnd 7.0%	HY Bnd -26.4%	REIT 28.0%	HY Bnd 15.2%	Lg Cap 2.1%	Sm Cap 16.4%	AA 11.5%	HG Bnd 6.0%
Sm Cap -3.0%	Sm Cap 2.5%	AA -3.8%	Lg Cap 28.7%	AA 14.1%	Lg Cap 4.9%	AA 16.7%	Lg Cap 5.5%	Sm Cap -33.8%	Sm Cap 27.2%	Lg Cap 15.1%	AA 0.3%	Lg Cap 16.0%	HY Bnd 7.4%	Sm Cap 4.9%
HY Bnd -5.1%	AA -0.2%	EM -6.0%	HY Bnd 28.2%	Lg Cap 10.9%	Sm Cap 4.6%	Lg Cap 15.8%	Cash 4.4%	Lg Cap -37.0%	Lg Cap 26.5%	AA 13.5%	Cash 0.1%	HY Bnd 15.6%	REIT 2.9%	HY Bnd 2.5%
Lg Cap -9.1%	EM -2.4%	Int'l Stk -15.7%	AA 25.9%	HY Bnd 10.9%	Cash 3.2%	HY Bnd 11.8%	HY Bnd 2.2%	REIT -37.7%	AA 24.6%	Int'l Stk 8.2%	Sm Cap -4.2%	AA 12.2%	Cash 0.1%	Cash 0.0%
Int'l Stk -14.0%	Lg Cap -11.9%	Sm Cap -20.5%	HG Bnd 4.1%	HG Bnd 4.3%	HY Bnd 2.7%	Cash 4.7%	Sm Cap -1.6%	Int'l Stk -43.1%	HG Bnd 5.9%	HG Bnd 6.5%	Int'l Stk -11.7%	HG Bnd 4.2%	HG Bnd -2.0%	EM -1.8%
EM -30.6%	Int'l Stk -21.2%	Lg Cap -22.1%	Cash 1.0%	Cash 1.4%	HG Bnd 2.4%	HG Bnd 4.3%	REIT -15.7%	EM -53.2%	Cash 0.2%	Cash 0.2%	EM -18.2%	Cash 0.1%	EM -2.3%	Int'l Stk -4.5%

Abbr.	Asset Class – Index	Annual	Best	Worst
Lg Cap	Large Caps Stocks – S&P 500 Index	4.24%	32.4%	-37.0%
Sm Cap	Small Cap Stocks – Russell 2000 Index	7.38%	47.3%	-33.8%
Int'l Stk	International Developed Stocks – MSCI EAFE Index	2.97%	39.2%	-43.1%
EM	Emerging Market Stocks – MSCI Emerging Markets Index	7.38%	79.0%	-53.2%
REIT	REITs – FTSE NAREIT All Equity Index	12.68%	37.1%	-37.7%
HG Bnd	High Grade Bonds – Barclay's U.S. Aggregate Bond Index	5.70%	11.6%	-2.0%
HY Bnd	High Yield Bonds – BofAML US High Yield Master II Index	7.54%	57.5%	-26.4%
Cash	Cash – 3 Month Treasury Bill Rate	1.24%	5.8%	0.0%
AA	Asset Allocation Portfolio*	7.08%	25.9%	-22.4%

Past performance does not guarantee future returns. The historical performance shows changes in market trends across several asset classes over the past fifteen years. Returns represent total annual returns (reinvestment of all distributions) and does not include fees and expenses. The investments you choose should reflect your financial goals and risk tolerance. For assistance, talk to a financial professional. All data are as of 12/31/14.

*Asset Allocation Portfolio is made up of 15% large cap stocks, 15% international stocks, 10% small cap stocks, 10% emerging market stocks, 10% REITs, 40% high-grade bonds, and annual rebalancing.

Final Thoughts…

We will stay the course and continue to look for worthy buys that exhibit the characteristics of "value." I am not interested in following the herd and I get concerned when so many investors are flocking in one direction.

Finally, I am re-reading a great book titled *The Little Book of Behavioral Investing.* I encourage each of you to add reading it to your list of 2015 goals.

I want to thank you for the trust you have placed in me. I am accountable to you. Please contact me if you have any questions whatsoever.

Warmly,

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.