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Bradley C. Fields, CFP®
Delta Financial Group
6600 SW 92nd Ave Suite 260
Portland, OR 97223-0704
www.bcfields.com

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Prepare for the Bear, Whenever It Arrives

Legendary investor Sir John Templeton often reminded investors that bear markets are inevitable, and nobody can reliably predict their depth or duration. The current run for U.S. stocks is well past the average bull market's life of just over four years. The S&P 500 Index is hovering near its all-time high, and the September-October time frame has been prone to sell-offs.

This bull market does not appear to have produced areas of obvious overreach like the 2000 tech stock mania or the mid-decade bubble in home prices and financing. But if the catalysts for bear markets were obvious in advance, it would be much easier to dodge the decline. That said, there are some steps to consider, depending on one's age and investment objectives.

Assess your progress. Stocks have produced outsize returns for those who held or expanded their equity positions in late 2008 or early 2009. Perhaps you can *afford* to lower your portfolio's current risk profile a bit without undermining your long-term goals. Prime candidates are those positions that have shown the strongest gains. It's not an all-or-nothing decision; even modest repositioning can make a quantitative and psychological difference in a significant downturn.

Bear Markets by Decade

During the ...	# of Bear Markets	DJIA % Decline
1900s	3	46%, 49%, 27%
1910s	3	24%, 40%, 47%
1920s	1	89%
1930s	3	23%, 49%, 41%
1940s	1	24%
1950s	1	29%
1960s	3	27%, 26%, 36%
1970s	2	45%, 27%
1980s	2	24%, 36%
1990s	1	21%
2000s	2	38%, 53%

Source: Toews Corporation

Check your diversification. There are market sectors that haven't shot the lights out and display relatively low correlation to stocks. They may not be less risky in the near term, but their *risk-reward* equation may be more favorable.

Respect cash. There's practically zero yield these days on "cash equivalents" such as money market funds and short-term CDs. But with so many other asset categories having traded up, padding that cash position may be strategic. In a broad financial market sell-off, cash lets you buy what's really down without having to sell something else that's also down, just not as much.

Don't fear being a little bit wrong. What's so bad about reducing one's risk even if the market does continue higher? This isn't about bragging rights or the ability to predict market moves. It's about measuring and managing risk from a position of strength and equanimity rather than fear and loathing.

Embrace the Bear. For long-term investors, market downturns can be welcome events, and the ability to act rationally and timely can be very rewarding. Historically, in the early stages of bull markets, about 70% of the return comes in 50% of the time. The S&P 500 bottomed on March 9, 2009, then gained more than 37% in just the next two months. Missing that initial spurt would have knocked the cumulative bull-market gain through August from approximately 230% to 140%.

Only short sellers truly relish the prospect of a bear market. The trick is to accept its inevitability and treat it as just another phase in a disciplined, long-term strategy. ■

Opportunities in Surprising Places

This may sound crazy given the mayhem in the Middle East, but the kingdom of Saudi Arabia recently approved foreign direct investment in Saudi equities. The Tadawul All Share Index includes over 160 companies with total market cap of about $560 billion, seventh among Emerging and Frontier Markets equity exchanges. Average daily trading volume exceeds both Russia's and South Africa's markets.

Parsing Saudi Listed Companies
Tadawul All Share Index by Sector

Market Sectors	% of the Index
Financials	37.9 %
Materials	31.0
Telecommunications	7.6
Consumer Staples	6.9
Consumer Discretionary	6.5
Industrials	5.7
Energy	1.7
Utilities	1.6
Health Care	1.1

Source: Bloomberg, Ashmore Investments

You may be surprised that there are *no listed oil companies* on the Saudi exchange. There are, of course, downstream energy players such as refineries, oil services, shipping, materials and petrochemical concerns. But the basic resource itself belongs to the Saudi state.

Since the Arab Spring, Saudi Arabia has introduced labor reforms, raised minimum wages, introduced unemployment benefits, and opened doors to more women entering the workforce. One focus of these reforms is to encourage native hires and reduce the economy's reliance on cheaper foreign workers.

Companies may be challenged to adjust to higher wages, but some observers expect Saudi Arabia's

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Despite Bouts of Nervousness, the Muni Market Had a Pretty Good Year

A year ago we looked in on the bankruptcy filing by the city of Detroit and its potential implications for the mainstream municipal bond market. A key issue then was the uncertainty over the relative status of promises to Detroit's bondholders versus the unfunded retirement benefits promised to municipal workers and retirees. This uncertainty had boosted tax-exempt municipal bond yields to levels that compared favorably, especially on a taxable equivalent basis, to quality corporate and Treasury securities.

Recently the muni market took another forearm shiver with Puerto Rico's passage of its Public Corporation Debt Enforcement and Recovery Act, with provisions that differed from certain tools and protections provided under the U.S. Bankruptcy Code.

These sorts of situations have kept muni bond yields relatively high. Yet last year's suggestion that munis were attractive compared to other popular fixed income sectors has played out well. According to Lipper, the average General Municipal Debt mutual fund posted total return of 11.4% for the 12 months ended September 5, 2014. High-yield (lower rated) muni funds averaged 14.6% for that same period.

Many upper-income taxpayers are paying higher marginal tax rates than was the case a few years ago, especially on investment income (interest and capital gains). Recently the taxable-equivalent yield on AA-rated muni bonds was comparable to the yield on A-rated emerging market sovereign debt. BBB-rated municipals have been yielding about 3½ percentage points more than Italy's sovereign debt.

The advantage really stands out in the high-yield muni sector, recently averaging taxable-equivalent yields in the 12% range. That's nearly twice the pull on Greek government debt and well above the 8% or so at which the market was recently pricing Ukraine's bonds. Yes, we're talking about *that* Ukraine.

From time to time, headline situations such as Detroit and Puerto Rico can produce an exaggerated market effect, and there will be others. But municipal defaults have been rare, especially compared to comparable corporate bonds. According to Moody's Investors Service, the 32 ten-year periods between 1970 and 2012 saw a ten-year cumulative default rate of just 0.07% for investment grade municipal securities, and 5.67% for high-yield munis. By comparison, that same study showed a cumulative ten-year average default rate of 33.9% for high-yield *corporate* bonds.

U.S. Census Bureau data show that state tax revenues have increased on a nearly uninterrupted basis for 18 straight quarters. Local government revenues have reflected better economic conditions and a recovery in home values. Municipal securities certainly are *not* risk-free, but they have generally been treating tax-sensitive investors rather well lately. ■

Cold Data Provide Clues to Emerging Market Consumers

The folks at AllianceBernstein think the best way to grasp the dynamics of consumer spending across emerging markets is to look in their refrigerators. More than just places to store perishables, fridge proliferation and contents say much about a country's economic progress and spending habits. The OECD projects that spending to rise eightfold, to $63 trillion, by 2030.

Of course, there are other measures of relative living standards, including the spread of computers, smart phones, and other consumer electronics and appliances. But after a rather limited sampling of refrigerator contents in rural and urban homes across 12 developing countries, AllianceBernstein believes the refrigerator snapshots to be at least as revealing as many larger scale statistical readings.

In working-class refrigerators efficiency items and staples such as eggs, fruits, vegetables, and some

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Investment Performance Review	**TOTAL RETURN *** (dividends and capital gains reinvested)			
Selected Mutual Fund Categories *	**--- Annualized thru Sept. 5, 2014 ---**			
	1 yr.	***3 yr.***	***5 yr.***	***10 yr.***
Large-Cap Stocks (Core)	22.0 %	20.7 %	15.5 %	7.8 %
Mid-cap Stocks (Core)	20.4	20.7	16.9	9.5
Small-cap Stocks (Core) †	16.2	20.2	16.5	9.2
Foreign Stocks (Multi-cap) †	13.7	11.6	8.5	6.6
Emerging Markets †	18.2	5.1	7.3	11.2
Natural Resources	18.8	12.3	12.6	10.8
Real Estate Related	25.3	15.4	19.1	8.3
Flexible Portfolio	12.9	9.9	10.4	6.8
General Bond	8.5	4.8	6.3	5.8
Int'l Fixed Income †	8.0	1.4	4.2	5.3
High-Yield Taxable Bond †	8.9	9.3	10.8	7.3
General Municipal Debt	11.4	5.3	5.4	4.1

* Source: Lipper, as reported in the online *Wall Street Journal*, Sept. 6, 2014.
Past performance is NOT indicative of future results.

† Small-cap stocks and high-yield (lower rated) bonds pose more risk and price volatility than those of larger, established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

60-Day Rollovers: Just One per Year per Customer, Please.

Need a little cash from your Individual Retirement Account? Just a short-term need with the intent to replace the funds without triggering a taxable distribution? That's often referred to as a 60-day rollover – draw the funds to meet that short-term need, then return them to the IRA within 60 days, and there are no tax consequences.

For many years it was widely believed that one 60-day rollover was allowed from *each* IRA a taxpayer maintained. But earlier this year the U.S. Tax Court (see Bobrow v. Commissioner) scotched that idea, interpreting the applicable legislation as limiting a *taxpayer* to a single 60-day rollover within a 12-month period, regardless of how many IRAs he happens to hold.

Soon after that decision, the Internal Revenue Service announced its intention to start enforcing that more restrictive interpretation of the regulation governing IRA rollovers. And in an amusing twist, the IRS withdrew a proposed amendment to the IRA rollover rules it had sent to the Treasury Department in… 1981. That 33-year-old proposal would have enshrined the more liberal approach to 60-day rollovers that lots of taxpayers had long assumed to be the operative rule. But neither Treasury nor the Congress ever formally adopted the IRS proposal, and now the Tax Court has rendered it a "dead letter."

This simply points up the need for careful planning *prior to* any IRA withdrawal for which you may want to take advantage of a 60-day rollover. Direct IRA-to-IRA transfers (custodian-to-custodian) are *not* limited in terms of frequency or time period. So if that short-term need for funds is greater than the amount available in any one IRA, the first step may be to transfer assets from one or more *other* IRAs. Just a little extra care in the process. ■

Then There's the Other Kind of Rollover

Retirement is a pretty popular occupation – or at least *preoccupation* – these days. And it often presents decisions to be made about the assets accumulated in the retirement plan sponsored by a retiree's employer. One of the most basic decisions is whether to leave the assets in the employer's plan, assuming that's an option, or roll them to an individual retirement account (IRA). That can be an involved decision depending on a range of individual considerations and the choices available.

Age: Most employer plans allow penalty-free withdrawals for participants between the ages of 55 and 59½, while withdrawals from a traditional IRA during this period are usually subject to the 10% early withdrawal penalty. Those still employed after age 70½ usually can delay required minimum distributions from an employer's plan until they stop working, unlike with an IRA.

If plan assets are part of a divorce settlement or an inheritance, a divorced spouse or heir under age 59½ may want to keep funds in the plan if there is a chance they'll be needed before age 59½. An inheriting spouse under age 59½ can preserve penalty-free access by leaving the balance with the employer (if allowed) or rolling to an inherited IRA and taking the RMD *as an heir* until age 59½, then convert the inherited IRA to a spousal IRA and postpone future RMDs until age 70½.

Investment Choices and Costs: IRAs can offer a wide range of investments. But so do many employer plans these days, along with unique options such as stable value funds with attractive yields negotiated on behalf of participants. The underlying cost difference between the investment vehicles may not be a huge factor, but employer-sponsored plans – especially larger ones – may be using lower-expense fund shares than those available to retail IRA investors. In recent years plans have provided more detailed reporting to participants on underlying fees and expenses, so such comparisons have become a little easier.

Special Tax Situations: Tax-deferral generally can continue whether assets stay in a plan or roll to an IRA. But if one's plan balances include after-tax contributions, those funds may be able to roll to a Roth IRA without tax consequences. If the plan account holds stock of the employer with a low cost basis ("net unrealized appreciation"), there is a distribution strategy that *may* be more advantageous than rolling those assets to an IRA.

Protection from Creditors: Facts and circumstances will vary, but experts typically caution that assets in an employer-sponsored plan may enjoy a somewhat higher level of protection from creditors than balances in an IRA.

Personalized Advice: Rolling assets to an IRA may be part of receiving ongoing investment and financial planning advice from a qualified professional. Many employer plans offer extensive, web-based information and guidance, but this may be relatively impersonal and limited to the investment vehicles available to plan participants.

A decision to move funds from an employer's retirement plan is usually irrevocable. Careful consideration regarding the areas noted above should be part of the drill. ■

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consumer spending growth to be among the highest among Emerging Markets. That prospect is bolstered by a young population. According to United Nations data, nearly 50% of Saudis are less than 30 years old, while only about 3% are over 65.

All reforms are relative, and nobody would suggest a big portfolio bet on some "Saudi miracle." It's just interesting to note the evolution of different societies and global investment implications, all taken in rational measure. ■

The Rising Real Value of Basic Insurance

September is National Life Insurance Awareness Month. And to think you might have missed it. But seriously, a number of recent surveys suggest that lots of people – about 20% of American households in the 37-48-year-old group – don't bother with life insurance. That's kind of surprising when one considers the basic cost-versus-need equation.

For starters, the *nominal* cost for a dollar of basic death benefit protection has generally been falling for at least 20 years. A healthy, 35-year-old couple can insure *each* of their lives for $500,000 at a total premium cost of about $900 a year ($75-80 a month). We're talking about 20-year, level-premium term coverage – a million bucks worth – and that's only part of the picture.

Today's super thin interest rates mean that the basic *opportunity* cost of a premium outlay is low. And those skinny interest rates also imply a need for *more* coverage to replace a given level of lost earnings.

It's kind of a no-brainer, but young parents have lots of demands on the pocketbook. For example, that same $900 can buy the market's first power-folding baby stroller. It collapses with a push of a button (a sensor tracks when baby's in the seat), it has lights underneath for night strolling, and an LCD screen to show your speed, how far you've walked, and the temperature. Much neater than life insurance, right? ■

Bradley C. Fields, CFP®

Delta Financial Group

6600 SW 92nd Ave Suite 260

Portland, OR 97223-0704

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Cold *Data Provide Clues...*

precooked food dominate. Middle-income households have more indulgences such as alcoholic beverages, ice cream, and cheese. Rising affluence fosters a focus on health and is reflected by the appearance of such items as low-fat yogurt and 100% natural fruit juice.

In broad terms, Chinese consumers are considered to be in the *indulgence* phase, using a rise in real incomes for such products as beer, butter, and chocolate. This may tip analysts to anticipate more ancillary spending on movies and other casual entertainment, short, domestic vacations, etc. In India families are still acquiring refrigerators for efficiency items like milk, yogurt, and ready-made sauces. Brazil is farther along in the prevalence of high-end food producers with implications for rising sales of health and beauty products.

Refrigerators are also a key to reducing the demands of home labor, freeing women to generate income outside the home. Drawing inferences from refrigerator contents may not match the precision of some other *cold*, hard statistics, but it's still a *cool* way to gauge the rise in global living standards. ■

For information on our investment services, please contact:

Bradley C. Fields, CFP®

503-244-9215

503-828-0307 (fax)

brad@bcfields.com