FINANCIAL SYNERGIES®
ASSET MANAGEMENT

Q4 2014

INSIDE THIS ISSUE

Economic Forecasters & The Weatherman

By **Mike Booker, CFP®, ChFC, CFS®, *Board Certified in Asset Allocation***

I have always found it fascinating that Economic Forecasters never use a probability approach with their prognostications. The Weatherman uses this approach very effectively, however. So, when the Weatherman predicts a 30% chance of rain, and it doesn't rain as precicted, we forgive him because 30% was a low probability and, so what if it didn't rain? When the Weatherman says the high temperature for today was supposed to be 60 degrees and it only gets to 52, we gripe about it, but excuse him, even if we didn't prepare for it and pack a coat.

We all know the weather is tough to forecast. In light of that, I think the financial gurus should consider taking a page from the Weatherman's playbook and start handicapping their predictions by using percents. That way, when they get it wrong we might more readily forgive them as we do the Weatherman.

Instead, we dutifully hang on every word the "consensus forecast" says about what is to come in the economy and financial markets, and then we are disillusioned when their predictions do not pan out (as they often do). It looks like 2014 would have been a perfect year for the financial experts to the change to a percentage system.

For example, at the beginning of 2014 a wise Economic Forecaster might have said "There is a 50% chance that oil prices will continue to rise in 2014". Or, "There is a 60% chance that interest rates will rise dramatically in 2014". Speaking for myself, I think I could forgive a missed forecast if it had a low enough percent attached to it. But, because Economic Forecasters drink their own Kool Aid, they apparently have no need for percents.

Maybe it's time to rethink this strategy because wow, did they have an off year last year:

- **Monthly change in payroll growth:**
  Economist's consensus: 200,000
  2014 Actual: 241,000

- **Interest Rates (10 year treasury):**
  Economist's consensus: 3.52%
  2014 Actual: 2.17%

  - In the realm of interest rate predictions, this was WAY off the mark for one of the world's most important rate measurements.

- **Oil Prices:**
  Economist's consensus: \$94.65 / barrel
  2014 Actual: \$53.27 / barrel

  - Maybe the worst prediction miscue of all and has been especially painful for many of us in Texas. It caught all the experts flat-footed.

- **Inflation Rates:**
  Economist's consensus: 1.9%
  2014 Actual: 1.3%

  - Same problem as with the above interest rate prediction - every .01% counts. Big.

(All above percents, WSJ 12.31.14)

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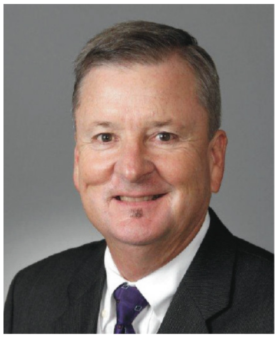
FORECASTERS, Continued...

People in glass houses should not throw stones; if asked to make the same predictions they did, I'm certain that I would have been even further off the mark than they were. But, that's the point - studies continue to show that economic predictions of any kind are incorrect over 70% of the time (Burton Malkiel, *A Random Walk Down Wall Street, 4th Edition*).

No one knows what the future has in store for us. Markets cannot be predicted. That's why, at FSAM, we don't invest your money by employing dubious predictive powers that seemingly no one, least of all, me, possesses.



We diversify. We allocate across many asset classes, so as to not have too much of one asset class at a time, which protects you from downside risk. Likewise, if an asset class decides to soar, we will trim it back a bit because we cannot predict when it will experience a downturn.

This conservative strategy can lead to pretty boring returns from time to time (witness 2014). As the old saying goes, "diversification works whether you want it to or not". Investing one's money in a strategy based on "accurate prediction" of a future that is completely unknown seems more than just silly; it seems irrational.

Thank you for your continued trust and confidence. Happy New Year from all of us at Financial Synergies. ■

A Christmas Story

By **Heath Hightower CFP®**

One of the most rewarding aspects of being a financial advisor comes from the close relationships that we build with clients as we work with them. Perhaps my favorite part is listening to client's stories and learning about their families. In the spirit of swapping stories, here is a quick story about my family's Christmas this year that you might appreciate.

Every Christmas Morgan and I take the kids to West Texas to visit family. As tradition has it, the routine is about the same every year: we exchange gifts, we overeat, we watch football, and then we take naps.

This Christmas was a little different; it came in with an ice storm that left our entire family without electricity for almost 2 days. No phones, no internet, no lights, no gas, and most importantly, no heat! Chaos ensued as we all bumped into one another searching for candles and flashlights. Looking back on it, it was quite a spectacle.

As the night went on it began to get cold so Papa, my wife's grandfather (and the patriarch of the family) asked me to fetch him some of the frozen firewood that was stacked outside. Papa is a man of few words so I didn't ask any questions. I did as he asked, but I couldn't help but shake my head and wonder how he would start a fire with frozen firewood (and no kindling I might add). Nevertheless, he asked me to stack the frozen logs in the fireplace. Once again, I did as he asked. Papa then shuffled out to the shed and then returned with a device called "the flame thrower". As he hooked the "flame thrower" up to a propane tank I looked over at my wife as if to say, "Has Papa finally lost his mind?"

As it turns out, Papa, a farmer and electrician by trade, had just the tool to burn frozen wood, and burn frozen wood he did. At last, we had a fire and Christmas was saved.

Papa, you're the man.

Happy new year everyone! ■

2014 Hits and Misses

By **Bryan Zschiesche, CFP®, MS, MBA**

As with almost every year, 2014 saw a wide range of returns from the many asset classes we use. This wide range means that some funds enhanced returns for our portfolios ("The Hits") and some funds detracted from returns in our portfolios ("The Misses"). Here's a recap of the Hits and Misses from 2014:

The Hits

U.S. Real Estate: Amazingly, the commercial real estate category posted its 6th consecutive calendar year of positive returns. Our Cohen & Steers Institutional Realty Shares posted an eye-popping 30.18% return for the year. The fund invests in publicly traded Real Estate Investment Trust (REIT) securities, which hold properties such as regional malls, office buildings, industrial properties and apartments. Virtually all of these sectors saw gains in 2014.

U.S. Large Cap Stocks: This is the category you typically see when you turn on the evening news or log in to a finance app on your mobile phone. After enduring a 7% decline from mid-September to mid-October, the S&P 500 Index finished the year up 13.69%. Our large cap value position, T. Rowe Price Institutional Large Cap Value, kept pace earning 13.13% in 2014. Our large cap growth position, Aston Montag & Caldwell Growth, lagged a bit, posting a return of 7.59% (not bad on an absolute basis). Much of the growth in large cap stocks was attributable to the strengthening U.S. economy and strong corporate earnings.

Bonds: Yes, you read that correctly. Bonds generally enhanced returns in 2014. Many pundits suggested that investors eliminate or dramatically reduce their bond positions as interest rates are expected to rise. Financial Synergies continues to maintain that bonds still belong in your portfolio. For example, PIMCO Income, a new addition to our portfolios back in 2013, earned 7.18% last year, and Metropolitan West Total Return (which we acquired this Fall after jettisoning PIMCO Total Return) earned 5.99% on the year. BlackRock Strategic Income (up 3.89%) and JPMorgan Strategic Income (up 0.13%) weren't quite as impressive.

The Misses

Commodities: Anyone living in Houston (or paying attention to prices at the pump) knows that the price of oil has declined dramatically in 2014. As prices have tumbled, PIMCO CommoditiesPLUS was directly impacted and declined 24.83% in 2014. The $64,000 questions are, "How low will oil prices fall?" and "How long will they stay at those lower levels?" Admittedly, we don't know the answers to those questions. (We don't believe anyone really does.) So we take these declines as an opportunity to add to our exposure at lower prices.

Foreign Stocks: Almost perfectly offsetting the gains from the US stock market, foreign stocks across nearly every category were down in 2014. Oakmark International Small Cap declined 7.72%, Harbor International lost 6.81% and Lazard Emerging Markets Equity Blend gave back 4.16%. The economic recoveries overseas have generally lagged that of the United States, which is partly responsible for the short-term underperformance. Foreign stocks have historically been great contributors to long term performance, and we expect that to remain true going forward.

Global Macro: Another fund which detracted from returns was PIMCO All Asset All Authority. The fund was down a comparatively modest 2.35% for the year. This position holds a place in our portfolios 1) as a diversifier for stocks and bonds and 2) as an inflation hedge. Since stocks and bonds performed relatively well in 2014 and fears of near-term inflation are low, it isn't surprising that this diversifying position had a soft year. As with commodities and foreign stocks, this decline provides opportunities to buy shares at lower prices.

Diversification Cuts Both Ways

In the end, positive and negative performance in our diversified portfolios resulted in generally muted performance overall. As Mike Booker noted, "Diversification works whether you want it to or not." During downturns, we benefit from the offsetting effects of diversifiers in our portfolios, but when U.S. stocks perform well, that same diversified approach has the potential to work against us. That was certainly true in 2014 with commodities, foreign stocks and, to a lesser degree, global macro.

Investors who have seen the recent outperformance of the US stock market may be tempted to overweight the S&P 500, but they would do well to remember that all of these asset classes experience up and down periods. From January 1, 2000 – December 31, 2009 (also known as the "Lost Decade") those same large cap stocks lost a total of 9.1%. Over the same period, diversifying positions boosted portfolio returns. Small cap stocks (measured by Russell 2000) earned 41.3%, emerging markets stocks (measured by MSCI Emerging Markets) earned 162.0%, and commodities (measured by Dow Jones Commodity index) earned 184.9%.

As the famed investor Peter Lynch once said, "Know what you own, and know why you own it." Be assured that every investment in your portfolio has a specific role to play. Over the long run, patience with each investment is a major determinant of success. ■

The Addition of ETFs to Your Portfolio

By **Mike Minter CFP®, CFS®**

I hope everyone is enjoying a Happy New Year as we leave 2014 behind and look forward to, hopefully, a fantastic 2015.

I want to take this opportunity to touch on some portfolio changes that we are in the process of implementing. This is just an overview of the changes - I will be following up with a more detailed white paper in the coming weeks.

We are adding some ETFs (exchange-traded funds) to the U.S. equity and foreign equity side of the portfolios. ETFs are nothing new to the investing landscape, and they have many of the same characteristics as mutual funds. You can expect the same liquidity, transparency and professional management that you've become accustomed to with traditional mutual funds.

We will be trimming some positions to allow for these new additions to the portfolio. These changes may not happen simultaneously in taxable accounts. We will be looking at each situation to determine the most tax-efficient way to reallocate those portfolios.

These ETF positions will help us build a better "core" equity portfolio going forward and will complement our active equity managers well. In addition to enhancing portfolio construction, ETFs will help lower the overall expense of the portfolio and could significantly increase tax efficiency.

In my next white paper, I will explain in detail what ETFs are, and the specific objectives of these new funds.

Stay tuned for much more detail in my next article... ■

There is Still Time to Make an IRA Contribution

By **Marie Villard**

Even though 2014 has come to an end, there is still time to save for retirement while possibly qualifying for a tax deduction. Both traditional IRA and Roth IRA contributions for tax year 2014 can be made up until the personal filing deadline of April 15, and could be beneficial to you depending on your tax and retirement savings position.

For year 2014, the total amount you can contribute to either a traditional IRA or a Roth IRA is $5,500, and up to $6,500 if you are age 50 or older. Contributions made can be partial or up to the full amount allowed for your age, from your or your spouse's earned income.

Traditional IRA contributions are considered pre-tax dollars, which means that you have the ability to deduct a certain amount of the contribution from your taxes in the year it is made. There are some limitations with tax-deductibility, however, depending on a variety of factors including whether you or your spouse is covered by a work retirement plan, your annual income, and your tax-filing status. The earnings in a traditional IRA grow tax-deferred until you begin taking distributions (after age 59 ½ without penalty), at which point you are then taxed on the distributions as well as the earnings.

Roth IRAs work a bit differently, where the contributions made are considered after-tax dollars and are not tax-deductible. The funds in these accounts grow tax-free, and the withdrawals made at retirement age are also tax-free, if the distribution is qualified. There are income requirements set out to qualify for contributing to a Roth, depending on whether you are single or married, and your tax-filing status.

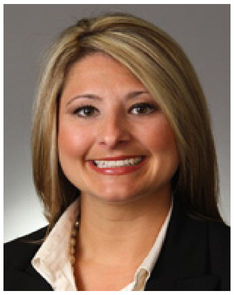
The above is a brief overview and reminder that you can make a contribution up until the tax-filing deadline of April 15, 2015 for tax-year 2014. There are many advantages and disadvantages to opening and making contributions to either a traditional IRA, or a Roth IRA. It is best to work with your advisor when making a contribution to maximize your tax and savings opportunities. ■

Announcements

As we begin the New Year, we are excited to tell you about two new additions to the Financial Synergies team beginning January 5th. It is our pleasure to introduce Will Goodson, CFP® and Candace Cunningham.

Will Goodson, CFP® has joined Financial Synergies as a Financial Planning Associate. Will's primary role will be to assist our Advisors with creating and presenting financial plans. He attended Rice University's CFP® Graduate Certificate Program and earned his CFP® designation in October 2013. Will grew up in Beaumont, where he earned the rank of Eagle Scout, and attended the University of Texas for his undergraduate degree.

Candace Cunningham has joined Financial Synergies as our new Office Manager and Receptionist. Candace will be the new face and voice of Financial Synergies and will ensure that our office operates smoothly so we can focus our attention on providing our clients the best service possible. Candace grew up in El Campo and is a graduate of Texas A&M University.



Some of you may be wondering about our previous Office Manager, **Nikki Anderson**.

Fear not! Nikki has been promoted to the role of Operations Associate, and she will be working closely with our Director of Operations, Marie Villard. Over the past several years, Nikki has demonstrated the ability to manage a number of complex operational systems we use. More importantly, she cares about our clients and the service experience they receive, and those qualities led us to offer Nikki this promotion.

We are excited about Will and Candace joining us and about Nikki's promotion to a more technical role, all to assist in the achievement of your financial planning and investment goals. As our firm continues to grow, we will continue to add to our talented, dedicated staff to better serve you.

Interested in eDelivery or Access to our Online Portal?

Did you know that you can receive your quarterly statement electronically?

You can also see all of the accounts in your Household, your account's holdings, transactions, and respective asset allocation through our online portal.

If you're interested in enabling eDelivery or the online portal feature, or would like to know more about it, please call us at 713-623-6600 or email mvillard@finsyn.com.