Market Review

Spring 2016

Predicting vs. Positioning

The year began with an encore roller coaster that followed the tumultuous ride of late 2015. Despite most global stock markets falling over 10% last February, most asset classes ended up between 2% and nearly 9% by the end of March. Old and new concerns surfaced — slowing global growth, China grappling with a painful transition from a manufacturing economy to a service-centered economy, European terrorism, and the continued migration crisis. Add in volatile oil prices with uncooperative oil-rich nations, and it almost seems like almost nothing is predictable in the world. *What is an investor to do?*

The answer lies in whether your investment focus is based upon ***predicting or positioning***. It is a lot more fun to invest based upon predictions. Jim Cramer and the pundits interviewed on CNBC are highly entertaining. They tell us with utmost certainty what will happen with a company, a sector, or an economy. And they know how to provoke our fear and greed so that we will keep watching.

Most everyday investors only know an investment world based on predictions. They may have heard about the mutual fund manager who finds undervalued companies by predicting cash flows, the Merrill Lynch broker who calls with his analyst's latest tip, Motley Fool newsletters, the UBS economist who predicts a drop in the U.S. dollar, and the super-smart options trader who knows how to hedge out risk in a portfolio. But many investors are still smarting over damaged portfolios from flawed predictions of the 2008 financial meltdown. And most investors who join **Rebalance IRA** previously have been burned by a "failsafe" strategy that should have seemed too good to be true.

Another group of investors; institutional investors such as pensions, endowments, and foundations, believe that predicting the future is at best informed fortune telling. After decades of research and experience, they have concluded that it is better to focus on making sure their portfolios are properly positioned, instead of attempting to predict what will happen in the world. They know there are risks that cannot be articulated or imagined, let alone predicted. So they endeavor to build portfolios to withstand the unexpected.

What can everyone learn from these institutional investors? They have assumed a high-stakes responsibility. Pension plans have to send checks to retirees every month. Managers at university endowments have to help pay scholarships and faculty salaries. So they have to "think differently." They need a portfolio that survives and prospers under any scenario. They reason through allocations to U.S. stocks, treasuries, foreign stocks, real estate, or commodities. When the world panics, investors flock to treasuries. When inflation worries are front and center, assets like real estate benefit at the expense of treasuries.

They debate these issues and end up with an investment policy that can only be changed by an investment committee. Once they agree on the policy, they look for the best ways to get exposure to each type of investing asset. Institutional investors focus on fees, and rarely hire managers because they know most cannot "outperform" the stock market, thus why they buy index funds. In fact, in recent months, large public pension funds in California, Illinois and New York City have taken steps to pull investments from hedge funds, which had previously been considered masters at outperforming the markets.

These investors don't care about Netflix or Apple; rather, they care about having the appropriate allocation of U.S. growth stocks. When the markets have big changes and the actual percentages differ from their recipe, they do not panic. They also do not change the policy, but rather rebalance back to the policy, by adding to their less successful assets. As panic around the fate of emerging markets drove prices down, these investors likely added to their holdings to keep their allocations intact.

There is a quiet but growing revolution going on in American retirement investing. A generation of investors over 45 has grown weary of expensive predictions; they want to be positioned.

Rebalance IRA clients have tuned out the soothsayers with crystal balls and now emulate the smartest investors in the world. Through the tumult of the first quarter of 2016, **Rebalance IRA** client portfolios remained well positioned and positive for the year.

Terrorist attacks, tsunamis, negative interest rates, falling oil, and revolts all become stress tests for how well a portfolio is positioned. Are you trying to predict what will happen next? Think about positioning, not predicting, and manage your family money like the smart guys.

The **Rebalance IRA** Investment Committee works with two broad asset classes for the basic building blocks of our client retirement portfolios: Growth and Income. During the first quarter of 2016, these asset classes performed as follows:

Growth Asset Classes*	Q1 2016 Returns
U.S. Total Market (VTI)	2.5%
U.S. Small Cap (IJR)	5.1%
Emerging Markets (VWO)	8.8%
Foreign Developed (VEA)	-0.8%
International Small Cap (VSS)	1.6%
U.S. Real Estate (VNQ)	7.6%

Income Asset Classes*	Q1 2016 Returns
High-Yield Dividend Equities (VYM)	5.4%
Government and Corporate Bonds (BND)	3.8%
High-Yield Corporate Bonds (HYG)	3.0%
Emerging Market Bonds (EMB)	5.3%

*Returns displayed representing the major asset classes of **Rebalance IRA** portfolios include dividends are measured using the ETFs shown in parenthesis.

Growth Asset Classes

U.S. Stocks. Shares in U.S. corporations ended the quarter up about 2.5%, a clear signal that selling during the first few months of the year was out of touch with the value represented by owning large American companies. Low energy costs and the prospect of a slower rise in interest rates gave the markets enough buoyancy to offset terror attacks in Europe and a slowing economy in China. Steady reinvestment of dividends helped **Rebalance IRA** clients capture this downward move in big blue-chips and positioned our clients for better long-term performance.

Small-cap stocks. As the more volatile cousin of the large-cap stock portion, swings in investor sentiment often are exaggerated in the small-cap sector. Smaller companies had twice the performance of the bigger stocks in the first quarter. Last quarter's lower prices attracted investors who feared they might be "late to the party."

Real Estate Stocks. Real estate had a stronger quarter due in part to the continuing snapback of the commercial and residential building markets. The U.S. economy overall has continued to grow while the lack of available new housing has pushed existing home prices higher. A potentially slower path upward for interest rates has kept mortgage financing cheap while the jobless rate remains well under what most economists consider full employment. All of this bodes well for real estate stock valuations.

Large European, Japanese & Asian Stocks. Weakening inflation and poor business sentiment typically weigh heavy on the stocks of large companies outside the United States, yet the steady hands of foreign central bankers are now long-practiced in staving off disaster. The European Central Bank, for instance, moved quickly to reduce the benchmark interest rate, while Japan's new budget included extra stimulus spending. Both Europe and Japan face major problems with aging populaces and costly entitlement spending, not to mention renewed terror attacks in Brussels. However, investors are giving foreign shares the benefit of the doubt for now.

Emerging Market Stocks. Battered emerging country stocks are turning out to be the better performers in the first quarter of the year and a prime example of why rebalancing is crucial to long-term portfolio returns. While the prices of emerging market shares were in the dumps over the past several quarters, **Rebalance IRA** investors were buying into those markets, thanks to the judicious efforts of our Firm's Investment Committee. In time, even volatile spots across the globe bounce back, with gains that investors enjoy more fully if they buy them during down cycles.

Income Asset Class

US Corporate Bonds. A slower-moving Federal Reserve gave corporate borrowers a boost as companies took advantage of low-cost money while balance sheets reassured lenders. The United States continues to walk a tightrope between bad news abroad and not-bad news at home, which suggests that if no recession appears on the horizon, lending to U.S. blue-chip firms is still a good investment.

High Yield Corporate Bonds. After sliding for most of 2015, so-called "junk" bonds found their footing in the middle of the first quarter and staged a strong comeback. That long-delayed return to life leveled off in March, but the yield on our ETF holdings remains at over 6%, a welcome addition to return in any market. Concerns remain about the bonds issued by smaller energy companies in this index, but they remain a small part of the overall index.

Emerging Market Bonds. Emerging markets staged a strong run in the first quarter after many consecutive months in the doghouse. While protests in Brazil suggest that the good times could be cut short, the diversification of our clients' holdings in this asset class provided plenty of protection from single-country unrest. Importantly, **Rebalance IRA** investors were buyers of emerging debt when few investors wanted it, thanks to disciplined rebalancing.

High-Yield Dividend Equities. Dividend payers outperformed the broader market as stocks rebounded and their higher dividends added to total return. An expected exodus from dividend stocks was dampened, too, by news of a slower path upward for U.S. interest rates. Investors are expected to switch out from dividend stocks to bonds, but that day of reckoning has been postponed once again by the Federal Reserve, which saw risks to U.S. growth coming from the slowdown abroad.

The Rebalance IRA Investment Process

Rebalance IRA portfolios are diversified into thousands of stocks and bonds in the United States and over 45 foreign countries. Market cycles will continue. Research going back decades, much of it done by members of the **Rebalance IRA** Investment Committee, shows that using market cycles in a prudent manner is the most effective long-term strategy for retirement investing.

By systematically rebalancing our clients' portfolios, we are able to take advantage of market gyrations. Trimming what has gotten rich and adding to what has soured enables us to take advantage of market ups and downs, rather than become paralyzed by it. **Rebalance IRA** proprietary portfolios rely on multiple ways to deliver returns to our clients that are commensurate with the risk taken.

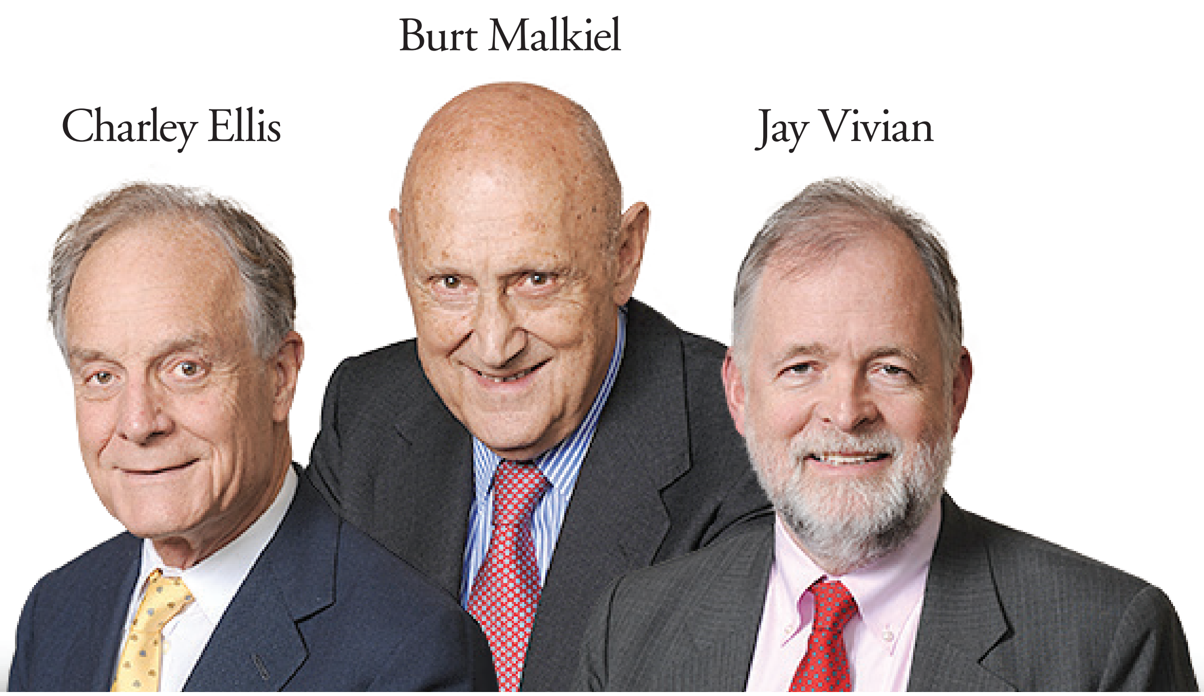
The **Rebalance IRA** Investment Committee has created a vigilant and disciplined rebalancing process that assures our client portfolios are managed using the best practices of sophisticated endowments and pension funds. The Firm will alert you when we are about to trim winning asset classes, and buy more of the losing asset classes, so that you can better understand how we are managing your money.

Your portfolio is premised on the dialogue that we have with you to understand your situation, risk tolerance and liquidity needs. Our goal: to help you reach your retirement investing goals with the lowest assumed risk possible.

We value your trust and look forward to many years of prudent and profitable investing. And, if at any time you would like to talk, please feel free to send us an email or give us a phone call.

Very truly yours,

Your **Rebalance IRA** Team



The Rebalance IRA Investment Committee

Burton Malkiel, Charles Ellis and Jay Vivian comprise the **Rebalance IRA** Investment Committee. They are renowned for creating and implementing sophisticated investment methods used today by elite pensions and endowments. The Investment Committee actively develops, oversees and sets policies for the portfolios offered to **Rebalance IRA** clients. Their core ideas include diversification across multiple types of assets on a global basis and disciplined portfolio rebalancing. They also advocate techniques for keeping investment fees low.

Professor Malkiel is an emeritus Princeton University economics professor, a former board member of The Vanguard Group, and author of the investment classic, *A Random Walk Down Wall Street*.

For three decades, Dr. Ellis was the managing partner of Greenwich Associates, the leading investment advisor to large pools of institutional capital around the world. He was Chairman of the Investment Committee of the famed Yale Endowment, and he has served on the governing boards of The Vanguard Group, Yale, Harvard, NYU Stern, Exeter, the Whitehead Institute, and the Robert Wood Johnson Foundation.

Jay Vivian is the former Managing Director of the IBM Retirement Funds, responsible for over $100 billion in IBM investment funds for more than 400,000 employees worldwide.