On the Horizon

Summer 2015

HORIZON
ADVISORS

Horizon Notes

We are pleased to have Houston Rutherford working with us as an intern this summer. Houston is in his final year in the financial planning program at Texas Tech University in Lubbock. Texas Tech has one of the premier financial planning programs in the country and Houston is proving to be a valuable resource to us and a big help this summer.

Caution: Rising Interest Rates Ahead

The Federal Reserve Board met recently (June 17th) and yet again declined to raise the fed funds rate. It has been nine years since the Fed last raised the benchmark rate and we've now had six years of "ZIRP" or "Zero Interest Rate Policy."

In the (now distant) past, the Fed would allow interest rates to rise as economic activity accelerated, but our current recovery has been so lethargic that they have continued their accommodative interest rate policy in the hopes of spurring a faster recovery. While the lowering of interest rates arguably helped avoid a worse recession, the policy of keeping rates lower longer hasn't been the expected catalyst for faster economic growth as it has been in the past. We could devote a great deal of time to discussing the pros and cons of their policy, but our intent is to simply set the stage for what may happen when the Fed eventually acts and interest rates begin their inevitable cyclical rise.

We have spent many years preparing for interest rates to begin to rise again. It's a certainty that rising interest rates will result in a decline in bond values, which will contribute to losses in investors' bond portfolios. (It's just how the math works.) We will be leaving behind a very long period of declining interest rates, which provided a tailwind for bond investors. If there is a sharp and sudden rise in interest rates, investors may be surprised and could overreact when bond values decline, despite repeated warnings.

JP Morgan's Bill Egan, who manages a well regarded bond fund, says there are three reasons investors own bonds: income, capital preservation, and diversification. He believes that in the current low (and possibly rising) interest rate environment, investors may miss out on all three.

Faced with the possibility of rising rates, you may wonder how bad a bear market in bonds could be. To give you a sense of the possibilities, the largest peak to trough declines in bond prices since 1965, according to the Barclay's Aggregate Bond Index are as follows:

April 1981	-7.7%
September 2008	-8.6%
July 2003	-8.8%
October 1979	-8.9%
March 2009	-9.5%

While these declines are nothing to sneeze at, they still compare very favorably with declines in the S&P 500 Index during the same period when the largest 5 declines ranged from -26.8% ending in December 1987 to -50.8% ending in March 2009. Still, it is difficult to get very excited when your bond portfolio declines by only 7.7 to 9.5%!

From this vantage, identifying the risk of rising interest rates is simple enough, but acting on this knowledge creates a real timing problem. We have been positioned for rising interest rates for some time now and are still patiently waiting for the turn. Given the uncertainty over timing, we've chosen to tilt our clients' portfolios away from this risk without overcommitting. Our fixed income positioning is as follows:

40% Short Duration Bonds – As the name indicates, these bonds have short maturities and should not be greatly affected by increases in rates, although the tradeoff is somewhat lower income.

30% Core Bonds – This is a broader selection of bonds, generally government or investment grade corporate bonds with a wider mandate. Bond duration is controlled by the managers we have selected.

20% Strategic Bonds – For this allocation, we use a go-anywhere fund with a sizable allocation to high yield bonds, which should have higher current returns as well as a somewhat lower exposure to the effects of rising interest rates.

10% International Bonds – Here, we invest primarily in foreign government bonds. This part of our portfolio currently has a low duration by manager positioning to guard against rising rates.

As we've said, rising interest rates are a near-certainty. We look forward to a time in the future when bonds once again provide income, capital preservation, and diversification. But until we see rates returning to more normal levels, we intend to retain our current defensive fixed income allocation.

We invite you to reach out to us if you would like to further discuss our thoughts and outlook, or if you would like us to review your portfolio and your current positioning.

Questions, We Get Questions!

When people learn that you are in the wealth management business, they inevitably ask questions. Sometimes they ask about social security, or how to provide for their children or grandchildren's education, or some arcane estate planning technique, but most often, they want to know "What investment do you recommend today?" or "Where should I put my money?"

The best way to answer these types of questions from our perspective is to ask a question back. That question is broadly stated, where do you want to go and what are you trying to accomplish? We're not trying to overcomplicate things by being nosey, but if you want the right solution, it's vitally important that we understand the context before we provide an answer.

We tend to agree with humorist/economist Ben Stein, who says, "The first step to getting the things you want out of life is this: Decide what you want."

Alternatively, you can be like Alice, who asked directions from the Cheshire cat…

One day Alice came to a fork in the road and saw a Cheshire cat in a tree.
"Which road do I take?" she asked.
His response was a question: "Where do you want to go?"
"I don't know," Alice answered.
"Then," said the cat, "it doesn't matter."

Just like you wouldn't want your doctor prescribing medicine without making a diagnosis, we think it's financial malpractice to suggest a solution before we know all of the facts. So, we want to know as much as we can about you and your goals before we advise.

On the other hand, the financial media will be happy to give you tips or reveal the secrets to savvy investing. They make it sound so easy. Always using 20:20 hindsight, they will tell you why you should follow the herd and invest in the ideas that worked for the past few days, months, or years. Just remember that it's easy picking the winners once they've passed the finish line and all the horses look fine when they're in the barn. You can always follow Will Rogers' advice on how to make money in the market, "Don't gamble. Buy some good stock and hold it 'til it goes up, then sell it. If it don't go up, don't buy it." Wouldn't it be great if things were this easy?

At Horizon, our approach to advising our clients can be distilled into three words: understand, organize, and manage.

Understand. We want our clients to first, understand the essentials – what is important to you and your family? Articulate why you are planning so that you can begin with the end in mind. Knowing what's essential provides context and clarity for decision-making.

Organize. Second, we think it is important to organize the details – what, specifically is your situation? What are your circumstances? What do you own and what do you owe? Who are your family members and what are their needs? We want to develop a view of how all of the pieces fit together. This helps to focus our attention on your most important priorities.

Manage. Finally, we want to help you to manage the process of traveling from where you are now to where you want to be in the future. Our job is helping you bridge the gap between your current position and your ideal future, making necessary course corrections as life unfolds.

Then, repeat as necessary. Understanding, organizing, and managing is not a one-time, "set it and forget it" process; it is ongoing. Since the future is unknowable, we have to periodically return to the beginning of the process, understanding how things have changed and reorganizing so that our clients can continue successfully along their way.

COLLECTED THOUGHTS

"A majority of our life's errors come about when one forgets what one is really trying to do."
- Warren Buffett

Making Cents

One of the components of our regular meetings with our clients is a review of the provisions in their estate planning documents such as wills and powers of appointment. This review is intended to revisit the appointments which are made in these documents. For wills, these appointments are the people who have been designated to serve as executor(s) or trustee(s) to administer the estate or any trusts created under the will. With powers of appointment, the appointees may be in charge of a person's medical care or their financial assets in the event that they cannot make decisions for themselves.

All of these appointments are important and require a lot of thought. These are the people or institutions that will be in charge of your financial affairs and medical care in the event that you are unable to do it yourself, either temporarily or permanently. The attorney who prepares your documents will always discuss this during their engagement; however, thoughtful decisions made when you initially execute these documents may not be so optimal after the passage of years (or people!). It is very easy to overlook the time that passes and how things may have changed.

For example, we often find that parents who had younger children at the time that their planning documents were prepared appointed friends or relatives to handle their affairs and to take care of their children. If it has been many years since they executed their documents and their children are now older and more responsible, it may make more sense for the children to be appointed to these responsibilities. This may be particularly true with medical powers. We have found that most people with adult children prefer their children to be in charge of making medical decisions for them.

To summarize, having a will and other planning documents in place is very important, but having outdated documents can derail your plans and make a difficult situation worse than you intended. So, if you haven't looked at your will lately, dust it off and review it. If you have a recent will (or you're still happy with the old one) schedule periodic reviews in the future to make sure that you have the right people in the right places at the right time. If you have questions, we will be glad to help answer them and we know a number of very competent attorneys and are happy to make a recommendation if you would like one.

2603 Augusta Drive, Suite 1400
Houston, Texas 77057

713.748.7000

horizon-advisors.com

HORIZON ADVISORS

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