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Dear Client,

This letter contains news and views that I feel will be of interest to you. As always, please call me at your convenience to set up your quarterly meeting.

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Going, Sebastien, Fisher & Le Bouef, LLP News:

- Through Friday, January 8, 2016 the DJIA and S&P 500 lost 6.13% and 5.91%, respectively year to date. A 10% drop is considered a “correction.” More stock market volatility may occur into the future, feel free to contact Darren or Craig for a review of your portfolio asset allocation or market insights to determine if your diversification fits your risk tolerance.

Investment Views:

- ***Morningstar Data - Through December 31, 2015 - Year-to-date returns -*** S&P 500 1.38%, Dow Jones Industrial Average 0.21%, NASDAQ Composite (dollars) 5.73%, Russell 2000 - -4.41%, MSCI EAFE (dollars) -0.82%, and the Barclays U.S. Aggregate Bond Index 0.55%.

- ***Lowry Research Corporation – January 6, 2016 –*** Business Week has published a graph of the S&P 500 yearly return following a decline of more than 1% on the first day trading day of the year. These statistics date back to the 1930s and there were fourteen instances when the S&P 500 lost more than 1% on the first day of trading of the year. Of these 14 cases, 6 were followed by a losing year, with the losses ranging from 8.47% to 37.68%.

- ***Bureau of Economic Analysis – December 22, 2015 -*** Real Gross Domestic Product (GDP) – the value of goods and services produced by the nation’s economy less the value of the goods and services used up in production increased at an annual rate of 2.0% in the third quarter of

2015 as compared to a 3.9% increase in the second quarter 2015. Personal Income increased 0.3% in November as compared to 0.4% in October.

- ***Bureau of Labor Statistics – December 15, 2015 –*** On a seasonally adjusted basis, the Consumer Price Index for All Urban Consumers was unchanged in November, and over the last 12 months the all items index rose 0.5% before seasonal adjustment. The index for all items less food and energy rose 0.2% in November, the same increase as in September and October.

Craig's Thoughts and Views:

Reinsurance Attributes in a Portfolio

As a refresher to my July 13, 2015 newsletter covering Insurance-Linked Securities (ILS), these contracts are issued by reinsurers and insurers (property and casualty insurance companies primarily) as a way to partner with capital markets investors to more efficiently and strategically support the risks they underwrite. Types of contracts that are included in ILS are catastrophe bonds ("cat bonds"), quota share transactions, and excess of loss ("XOL") transactions. Cat bonds are the most liquid of the ILS and have historically delivered excess returns similar to the equity risk premium, while exhibiting low volatility, low external correlation to traditional asset classes (equity and fixed income), and low internal correlation with each other. Compared with cat bonds, quota share and XOL transactions allow access to broader classes of reinsurance risks and the opportunity for higher returns, but with less liquidity. Reinsurance risks can diversify a traditional fixed income portfolio while offering potentially higher returns with similar or lower risk. An investment in the fund involves risk. The reinsurance-related securities in which these funds invest are considered "high-yield" or "junk bonds" by ratings agencies (S&P, Moodys, and Fitch). They are rated junk by the ratings agencies not because of the financial health of the insurer or reinsurer (capital is held by an outside trustee), but because a large single catastrophic event (think Hurricane Katrina) can cause the investor to lose principal.

Investing in ILS also provides diversification away from U.S. risk peril. The typical ILS cat bond fund will have about 77% in U.S risks and about 23% in non-U.S. risk as a percentage of expected total loss, while the typical quota/XOL fund will offer a reduced 33% in U.S. risks and 67% in non-U.S risks as a percentage of expected total loss. Typical peak perils in these ILS are U.S. hurricane, earthquake, tornado; Europe windstorm, earthquake, and flood; Australia earthquake, bushfire, hail, and windstorm; and Asia earthquake and windstorm.

Now, let's look at reinsurance in a portfolio context, meaning how we should think about reinsurance as an addition to a typical balanced portfolio. Research done by *Bloomberg* showed how an allocation to the Swiss Re Catastrophe Bond Index would have improved the returns of a generic 60/40 portfolio (60% S&P 500 and 40% Barclays U.S. Aggregate Bond Index). The scenarios examined were to allocate to reinsurance pro rata, graphing the outperformance of a 5%, 10%, and 20% allocation. The analysis assumed that the portfolios were rebalanced each quarter to reset the allocations to the original targets. Insights taken away from the research: 1. An allocation to reinsurance would have improved returns; 2. Allocate enough to reinsurance to make an impact.

Reinsurance is often appreciated primarily for its low correlation with other traditional asset classes. Therefore, including reinsurance in a portfolio should improve its characteristics by lowering risk. Published data on the Swiss Re Cat Bond Index from January 4, 2002 to December 11, 2015 shows the annualized return was 8.1%, while the S&P 500 returned 6.1% and the Barclays Aggregate Bond Index returned 4.8%. The research done by *Bloomberg* on the generic 60/40 portfolio for the 2002 through 2015 time period revealed that allocating reinsurance to the portfolio would have resulted in cumulative outperformance: +3.8% for a 5% allocation; +7.4% for a 10% allocation, and a +14.7% for a 20% allocation. In addition, average volatility of 10% for the 60/40 portfolio would have been reduced with allocation to reinsurance: -4% for a 5% allocation; -10% for a 10% allocation; and -20% for a 20% allocation.

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Based on the limited research (limited because about 14 years) done by *Bloomberg*, the larger the allocation to reinsurance, the more meaningful the impact. However, we do not know what the future holds, and 1 in 100 year events could negatively affect a portfolio with an allocation to ILS. But the research above for the representative approximate 14 year period does show convincing outperformance from allocating none of one's portfolio to reinsurance to 5%, 10% and 20% with a corresponding reduction in risk (volatility).

Reinsurance mutual fund investing involves risk and principal loss is possible. Event-linked, catastrophe bonds, and reinsurance related securities carry large uncertainties and significant risk exposures to adverse climate and other conditions.

Anxiety of Investing in High Yield Bonds

To summarize, high yield bonds are also called "junk bonds" and are more volatile than investment grade corporate bonds. These bonds have ratings of BA1(Moody's), BB+ (Standard & Poor's), and BB+ (Fitch) as set by these ratings agencies who analyze corporate bonds. Therefore, these bonds may be unsuitable for some or many household investors because they are loans to companies with dubious credit quality.

These bonds have traditionally had higher default risk as compared to other bonds and have therefore offered higher yields. As many investors have chased "yield" over the past 7+ years because of near zero percent short-term interest rates, for some, caution may have been thrown to the wind for these higher yields.

For investors in these securities or mutual funds and ETFs who own these bonds, the volatility in these securities were experienced first-hand in December when a junk bond mutual fund, Third Avenue Focused Credit, halted investor redemptions in order to facilitate an orderly sale of its assets. This subsequently led to an even sharper sell-off in junk bonds that pushed the prices of the bonds themselves, as well as many closed-end funds that own them, to prices that may not reflect their intrinsic value. Compounding the slide in this asset class were two high-yield hedge funds managed by Stone Lion Capital Partners ($400 million) and Lucidus Capital Partners ($900 million) who announced their liquidation.

In both the Third Avenue Focused Credit and Stone Lion Capital Partners liquidations, these funds announced that they would liquidate and would "gate" their funds, which means that investors would not be able to receive their money until the assets were sold at a later date. Why this type of move? This was necessitated by the fact that the funds (down 27%+ in 2015) owned many low-quality and illiquid high yield bonds that they were unable to sell. To accomplish the fund liquidation, the funds had to sell their assets into a liquidating trust and deemed the sale a redemption from the fund that met its obligation to redeem shares without asking the Securities and Exchange Commission for prior approval to freeze withdrawals.

For those investors seeking income, welcome to the downside of the Federal Reserve's invitation to reach for yield!

Since July 1983 (the longest time period for which data was available), investment grade bonds have served well as a source of stability that can offset the volatility inherent in common stocks. Compared with U.S. stocks these higher quality corporate bonds provided lower nominal returns (8.1% versus 10.6%), but these returns were more stable. As the table below shows, investment grade corporate bonds offered comparable returns with less risk for the period examined.

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July 1983 through November 2015

Asset Class	Annualized Return(%)	Annualized Volatility (Standard Deviation %)
U.S High Yield	8.9	8.4
U.S. Stocks	10.6	15.3
U.S. Investment Grade	8.1	5.5

The above data suggests that junk bonds lie somewhere between investment grade bonds and stocks on the risk/return spectrum. Based on that, it might appear that a reasonable investor would include junk bonds as part of a well-diversified bond portfolio. However, investors should offset the volatility of stocks with assets that have returns not highly correlated with those stocks. However, research has shown that investment grade bonds' correlation coefficient with stocks is 0.26 as compared to that of junk bonds of 0.60. Junk bonds have in fact been more highly correlated with stocks than with investment grade bonds (0.60 versus 0.51). That same research showed there were periods of several years when junk bonds were strongly correlated with stocks, such as the 1990s and early 2000s. Keep in mind that past performance does not guarantee the same future returns.

It is impossible to predict when junk bond returns will act more like a bond or a stock. During financial crises, when stability is needed most, there is no guarantee that junk bonds will provide the necessary stability as compared to other fixed income securities. During the stock market collapse between July 2007 and March 2009, U.S. stocks provided a total return of -43.8% while high-yield bonds tumbled -22.5%. Investment grade corporate bonds on the other hand were about flat, returning -0.70%.

Investors willing to accept higher risk in pursuit of higher expected returns can do so with other asset classes in addition to high yield bonds. Liquidity (the ability to convert a security to cash relatively quickly at a reasonable price) is an important consideration when it comes to bonds, and many high-yield bonds are considered illiquid.

IRA Review

If you are the owner of an IRA, there are some issues that you should be aware of. We assist our clients in avoiding these pitfalls, so they can maximize the use of their IRAs. Each IRA owner has different circumstances and these issues may impact individuals differently. Below are some areas that IRA owners should give attention to.

- First and foremost, it is important to review the current beneficiary of your IRA on at least an annual basis, especially if you have recently experienced an event such as a birth, death, marriage, or divorce. You should also make sure to list a contingent beneficiary or beneficiaries in the event the primary beneficiary predeceases the IRA owner or disclaims some or all of the IRA assets.

- Exercise caution before listing the estate or a trust as the beneficiary of your IRA. These can cause unnecessary required accelerated distribution methods that may be undesirable.

- When taking traditional IRA distributions, attempt to do so in a manner that does not cause IRS penalties. For example, traditional IRA distributions prior to the owner reaching age 59 ½ are subject to a 10% IRS "early withdrawal" penalty. Exceptions to this penalty as defined under the Internal Revenue Code Section 72(t) may be for the following distributions:
    - that are part of a series of substantially equal periodic payments
    - made due to total and permanent disability
    - made due to death
    - to the extent the individual's unreimbursed medical expenses exceed 10% (7.5% if taxpayer or spouse age 65 or older) of adjusted gross income

- to pay for health insurance premiums for certain unemployed individuals
- for qualified higher education expenses of taxpayer, spouse, child, or grandchild
- for first-time home purchases ($10,000 limit lifetime and no home ownership in prior 2 years)
- due to an IRS levy on an IRA
- to reservists while serving on active duty for at least 180 days

In addition, traditional IRA owners must begin taking required minimum withdrawals from their IRAs after the owner reaches age 70 ½. A penalty of 50% may be assessed on any shortfall below the required minimum distribution amount.

- Effective for years 2010 and beyond, there is no adjusted gross income (AGI) limit for Roth conversions and married filing separate (MFS) taxpayers can make Roth conversions.

- A 2014 Tax Court decision concluded that the one-IRA-rollover-per-year limitation applies globally to all traditional IRAs owned by an individual rather than on an account-by-account basis. However, there are no limitations on direct rollovers (trustee-to-trustee).

GSF&L, LLP Registered Investment Advisors:

We can never know what the future holds, but we can make informed decisions regarding investment strategies and portfolio allocations. We (GSF&L) make changes based on our perception of opportunities in the capital markets. We assimilate fundamental, technical, and economic information to make informed decisions. Of course it is important to have long-term focus on portfolio management, but with a critical analysis of intermediate strategies.

Managing risks and opportunities are important to portfolios and reaching one's financial needs and goals. Having a complimentary understanding of investment horizon and attitude toward risk are equally important. Markets and economies do not always behave as we expect them to. That is the problem with investing! There is no luck to professional investing. You can no more have a successful, disciplined approach by luck or accident than you can win a chess tournament by luck or accident.

If you know of someone who may fit our financial and investment planning philosophy, please mention our name. We are a small organization and intend to remain so. A solid organization makes it possible for us to spend our time managing our business rather than each other. Because everyone has so much to do, much gets done. We will forego any growth opportunity that may detract from our ability to serve our clients as they have become accustomed to. We never expect to be among the biggest, but our attention to be among the best is not subject to compromise.

Regards,

Craig

Craig C. Le Bouef, MBA, CPA/PFS, CFP®

NASDAQ composite measures the performance of all issues listed in the NASDAQ Stock Market, except for rights, warrants, units, and convertible debentures. The S&P 500 is made up of 500 common stocks representing major U.S. industry sectors. The Dow Jones Industrial Average contains 30 stocks that trade on the New York Stock Exchange (NYSE) which reflect the performance of 30 large American companies. The Morgan Stanley Capital International Europe, Australia, and Far East Index (MSCI EAFE) is a market-weighted aggregate of 20 individual country indexes that collectively represent many of the major markets of the world, excluding Canada and the U.S. The Lehman Brothers U.S. Aggregate Bond Index tracks performance of debt instruments issued by corporations and the U.S. Government and its agencies. The returns for this index are total returns, which includes reinvestment of dividends. The Russell 2000 Index measures the performance of the 2,000 smallest companies in the Russell 3000 index, which represents approximately 8% of the total market capitalization of the Russell 3000 index.

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All indices are unmanaged. It is not possible to invest in an index.

Past performance is no guarantee of future results.

Diversification does not assure against market loss.

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