Ferguson | Johnson Wealth Management

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Quarterly Report

John Ferguson, Principal

"If the risk is fully aligned with your purpose and mission, then it's worth considering."

-Peter Diamandis

The main goal of allocating assets is to manage risk. This goal of asset allocation does not maximize return, but provides a return commensurate with the risk one is willing to take.

In evaluating the allocation process, we have an enormous amount of data at our fingertips to review and analyze. Dr. Harry Markowitz won his Nobel Prize for Modern Portfolio Theory. One of the core principles of Modern Portfolio Theory is the selection of the portfolio that we expect to give us the greatest return for an expected degree of risk[1]. As individuals, we ask ourselves what it is we are willing to risk. As your wealth manager, the most important question we can ask you is, "what is your tolerance for risk?" In conversations with our clients we find wide ranges of answers to this question.

Unfortunately, the risk tolerance of some of our clients is a shifting one. When the markets are moving higher we say we want the returns and will take more risk, but the moment a turn is in the wind the mood changes. This vacillation does not lend itself to a sound long-term investment approach. There is no risk to stay in a harbor in a storm, but we cannot reach our financial goals without venturing out.

Notice the breadth of returns for the following:

Dimensional Fund Returns for 2013 and 2014 (not compounded):

Fund	2013	2014	Average
DFA International Value (DFIVX)	22.72%	-6.99%	7.87%
DFA Real Estate (DFREX)	11.39%	31.11%	21.25%
DFA Global 60/40 Allocation (DGSIX)	15.97%	3.71%	9.84%
DFA US Micro Cap (DFSCX)	45.06%	2.92%	23.99%
DFA Inflation Protected Securities (DIPSX)	-9.27%	3.37%	-2.95%

Performance Data; Source: Dimensional Funds as of 12/31/14

We don't know of any tool that allows anyone to successfully or consistently predict the markets or asset classes. Until such a time comes, we will continue to allocate your monies across a number of asset classes in order to manage your risk and achieve appropriate diversification. If your tolerance for risk changes or you find that we are more cautious or more aggressive than you desire, then please let us know and we will reposition your assets accordingly.

Potpourri

2015 is a big year for the baby boomers. There are over 78 million of us born between 1946 and 1964, but the big numbers were born in the 1950s. Yep, 41 million boomers[2] in that decade and guess what, they start turning 65 this year, the magic retirement number!

No matter how you slice it, overall this group isn't poor. They have homes, savings, pensions, minimal debt, and decent retirement plans and income. Just think of the things you and your parents are doing as we age. Countless times I've read that 60, or even 70, is the new 40. We have drugs to control our blood pressure, our cholesterol, and so many ailments and aches and pains that we just keep on acting anything but our age. From the stock markets long term perspective we are all positive contributors to its continued growth.

The January issue of Fortune has an article about *The Fund That Was Too Good to Be True* which discussed the fund F-Squared. According to the article, "much of F-Squared's amazing early track record was faked, either a product of a hypothetical backtest or just an outright fraud."[3]

The article mentions that the F-Squared funds are sold and used by financial advisers around the country for tens of thousands of individual investors. We are not one of them. We continue to look for ways to enhance your returns, but we don't jump into the gimmick fund of the day. Due diligence is not an easy task and it is one we take very seriously.

The first five trading days of the year are considered by some to be a harbinger of things to come. When the Standard & Poor's 500 index has risen in those first five days of a new year, the market has closed out the year on the positive side 85% of the time.[4]

How did we do this year? Well, we just barely edged out a positive return. The index was up 0.16%.[5] Obviously, this wasn't quite a home run, but still, it was a positive first five days!

The fallout from the Great Recession left 24% of homeowner mortgages underwater in early 2010[6]. Today that figure, according to CoreLogic, is 10.3%[7]. Rising home prices, foreclosures, re-sales, and refinancing have all contributed to this improvement and the trend is generally positive.

Here's wishing for a prosperous 2015. Please give us a call, even just to chat. We'd love to hear from you.

John, Derek, Jon, Christina, & Angela

[1] Mangram, Myles, "A Simplified Perspective Of The Markowitz Portfolio Theory," Global Journal of Business Research, Volume 7, Number 1, 2013.
[2] Alva, Marilyn, "Homebuilders Bet On Baby Boomer Wave," Investor's Business Daily, January 9, 2015.
[3] Stephen Gandel, "The fund that was too good to be true," Fortune, December 22, 2014.
[4] Hirsch, Jeffery, "$SPY First Five Days Liberates Market from Santa Claus Rally Hiatal Damnation", Stock Trader's Almanac, January 8, 2015.
[5] Performance data; Source: Morningstar as of 1/8/15
[6] "First American Core Logic Negative Equity Report," CoreLogic, First Quarter 2010.
[7] "Equity Report Third Quarter 2014," CoreLogic