

## **The Financial Navigator – Blizzard Juno Newsletter**

Greeting from snowy New Hampshire, I hope those of you receiving this newsletter in the northeast survived the blizzard of the century, as one local scribe called it. Isn't interesting that now every storm has a name? I always thought naming storms was reserved for hurricanes, something of real significance. What's next, naming summer thunderstorms?

Perhaps a blizzard is the appropriate metaphor for the proposals, and the reaction to those proposals, coming out of Washington DC last week after the President's State of the Union speech. Part of that blizzard is outlined below as there is some good-bad news concerning 529 college savings plans. Following that update is an article from our friends at Dimensional Fund Advisors that reflects on the 2014 investment markets and compares the actual results to the 'experts' predictions; it provides some interesting food for thought when reading the latest experts' predictions for 2015.

You may know someone who has the same questions and concerns about the market and their portfolio. If you think it will help, feel free to forward this email and let me know if you have questions about a specific situation.

Sincerely,

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### **529 College Savings Plan Update**

First the good news, thanks to a new federal law you now may change the investment option on your 529 college savings account for the same beneficiary twice per year instead of once. Previously, the Internal Revenue Service allowed 529 account owners only a single investment option change per year for the same beneficiary. This caused quite a bit of angst and losses on paper in 529 plan balances during the 2008 bear market. While frequent trading in one's college savings plan isn't advisable, being allowed only one trade per year was too restrictive.

Now for the bad news-good news story. In his State of the Union address last week, President Obama proposed that community college should be free for all, and to pay for that withdrawals from 529 college savings plans would be taxed.

Currently funds located in 529 plans grow tax free and withdrawals are tax free if used to pay for college tuition, room & board. The President's proposal was that any gains over and above the original investment would be taxed at the student's tax rate, and would be considered income of the student. Theoretically this is a break as the student is likely in a lower tax bracket than his or her parents; however, due to the so called 'kiddie-tax' rule this theory is debatable. And, considering the income as the student's is about the worse place it can go from a financial aid perspective; about 50% of the withdrawal would reduce any potential financial aid. The proposal's supporters assured those listening, any current plan would be grandfathered; the tax would only apply to new money.

This proposal was a real win-win for those trying to save for their kid's college education; a higher tax bill when college comes around and less financial aid! Interestingly, according to the Wall Street Journal, when the Obamas filed their financial disclosures as required in 2007 when he was a Senator, it revealed that they had fully funded their daughters' 529 plans with over \$240,000. Wonder why the proposal contained a grandfather clause?

Many in DC justify this money grab by claiming that only the 'one-percenters' were utilizing 529 plans and college funding had to be fair for all. In reality, there are over 11.8 million 529 plan accounts, the average account size is \$20,671; hardly the realm of the one percent.

Well as you might expect the reaction was fast and furious from all, not just conservatives, and the proposal was pulled just as I am writing this newsletter.

You may ask, why waste space discussing a proposal that will never come to fruition. Because simply put, bad tax ideas emanating out of DC are like zombies. They don't die and go away until they are shot, beheaded and the corpse burned; and that hardly ever happens in DC. The zombie tax proposal just comes back in another bill, under a different name, with a different justification offered by another administration. This idea of taxing money that was previously promised to us to be tax free, i.e. 529 plans or maybe Roth IRAs, will rise from the grave whenever someone has a new program to fund.

### **2014: Patience Pays Off**

Westin Wellington, Vice President-Dimensional Fund Advisors.

The broad US stock market surprised many investors with above average returns in 2014. The S&P 500 Index rose 11.39%, and the total return with reinvested dividends was 13.69%. By comparison, the annualized (compound) return was 10.02% average for the 1926–2014 period.

Forecasters often cite a figure of 8%–10% as a likely outcome for stock market performance in the year ahead, and 2014 was no exception. As sensible as this may sound, it is worth pointing out that over the past 89 years, the S&P 500 Index and its predecessors have never delivered a total return between 8% and 10% in any single calendar year—in every case it has been higher or lower, often by a substantial amount. For example, starting in 1926, there have been 28 years with a gain or a loss in excess of 25%. Investors would do well to expect the unexpected every year.

Achieving the market rate of return in 2014 required a level of patience and equanimity that eluded many investors—individuals and professionals alike. After five years of positive equity returns, many investors were easily persuaded that stocks were dangerously overvalued and overdue for a “correction”—customarily defined as a decline of 10% or more from the previous peak.

A Wall Street Journal columnist warned in January, *“The US stock market is more overvalued than it was at the majority of the past century’s peaks, according to six well-known valuation ratios.”*<sup>1</sup> Money magazine chimed in, observing that *“stock prices by at least one measure are among the frothiest in history.”*<sup>2</sup>

Stock prices fell sharply in January, with the S&P 500 Index sliding 3.56% and the Dow Jones Industrial Average dropping 5.30%. Followers of the so-called January Indicator were quick to point out that a rocky first month often signals poor performance for the remainder of the year. The market’s weak performance in January appeared to justify the concern that stock prices were out of whack with business conditions. On February 5, a Wall Street Journal reporter observed, “Increasingly, however, it looks like stock markets are off to a terrible start mainly because hopes for economic growth and the profits that go with it got too high.”<sup>3</sup> As it turned out, stock prices had already touched their low for the year two days earlier, and the S&P 500 Index was destined to rise over 19% from February 3 through December 31.

In recent years, a number of market commentators have argued that low interest rates allegedly engineered by the Federal Reserve and the European Central Bank have artificially boosted share prices to unsustainable levels. These experts say stocks are likely to fall decisively when interest rates begin to rise again. We will defer comment on the contentious issue of asset-price manipulation for another day, but we can file away 2014 as another example of the challenges facing those who claim to have the expertise to predict market behavior. To an overwhelming degree, professional investors were confident that interest rates would rise in 2014, but the yield on 10-year US Treasury notes instead fell sharply from 3.03% at year-end 2013 to 2.19%.<sup>4</sup>

If we could measure collective investor anxiety, it would likely have reached its peak for the year in mid-October. On October 15, the Dow Jones Industrial Average plunged as much as 460 points during the day before rallying to close with a loss of 173 points. At

that point, the Dow was down 2.6% for the year while the S&P 500 clung to a slim gain of 0.76%. The selloff was front-page news the following day in the New York Times, which observed, *“The party is over. Waves of nervous selling buffeted the stock market in the United States on Wednesday, after a steep selloff in Europe. ... Since their peak a month ago, American stocks have lost over \$2 trillion in value, losses that may ripple through the wider economy. ... The faltering global recovery after the 2008 financial crisis may now be in jeopardy, particularly in Europe.”*<sup>5</sup> What caused such a fierce selling squall? Market commentators cited selling by momentum-oriented hedge funds, fears of a weakening global economy, and gloom associated with another reported US case of the Ebola virus. Many investors braced themselves for a continuing slide in stock prices that never occurred. Year-to-date stock returns were back in the plus column the following day and kept rising through December.

While many Wall Street experts fretted all year over monetary policy and valuation ratios, companies on Main Street plodded along, generally selling more goods and services, earning larger profits, and sending bigger dividend checks to shareholders. Twenty-eight of the 30 firms in the Dow Jones Industrial Average paid a higher dividend at year-end 2014 compared to the previous year, with an average increase of 11.65%.

Stock returns in non-US markets were generally positive in 2014 but with a wide range of results. Among 45 developed and emerging markets tracked by MSCI, total return expressed in local currency ranged from 38.66% in Israel to -31.59% in Greece. Thirty-five non-US markets had positive returns, including 17 with higher returns than the US. With so many pessimistic discussions of the European economy in recent months, many investors might be surprised to learn that stocks in Belgium, Denmark, Finland, Ireland, and Sweden outperformed US stocks when expressed in local currency. Appreciation of the US dollar relative to every major currency significantly penalized net results for US investors. Even the Swiss franc, long associated with fiscal rectitude, slumped relative to the US dollar. Total return for the MSCI World ex USA Index (gross dividends) was 6.80% in local currency but -3.88% in US dollar terms.

The recent strength of the US dollar stands in stark contrast to the gloomy predictions we heard from some quarters just a few years ago. For example, in the book *Aftershock*, published in 2011, the authors argued that the financial crisis of 2008–2009 was *“relatively small compared to the coming dollar crisis”* and predicted that this *“unsustainable currency bubble”*<sup>6</sup> was destined to burst with disastrous consequences.

Exchange rates fluctuate in unpredictable ways, and it would not surprise us to see such arguments resurface in a few years, particularly after a prolonged period of dollar weakness.

The year 2014 was a challenging one in many respects, but perhaps the biggest challenge was to resist the urge to dip and dart in response to the cascade of news events and opinions that suggested action of some sort was imperative for financial success.

#### **References**

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6. David Wiedemer, Robert A. Wiedemer, and Cindy Spitzer, Aftershock (New Jersey: John Wiley & Sons, 2011).