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Changes to Social Security Claiming Strategies

The Bipartisan Budget Act of 2015 included a section titled "Closure of Unintended Loopholes" that ends two Social Security claiming strategies that have become increasingly popular over the last several years. These two strategies, known as "file and suspend" and "restricted application" for a spousal benefit, have often been used to optimize Social Security income for married couples.

If you have not yet filed for Social Security, it's important to understand how these new rules could affect your retirement strategy. Depending on your age, you may still be able to take advantage of the expiring claiming options. The changes should not affect current Social Security beneficiaries and do not apply to survivor benefits.

File and suspend

Under the previous rules, an individual who had reached full retirement age could file for retired worker benefits--typically to enable a spouse to file for spousal benefits--and then suspend his or her benefit. By doing so, the individual would earn delayed retirement credits (up to 8% annually) and claim a higher worker benefit at a later date, up to age 70. Meanwhile, his or her spouse could be receiving spousal benefits. For some married couples, especially those with dual incomes, this strategy increased their total combined lifetime benefits.

Under the new rules, which are effective as of April 30, 2016, a worker who reaches full retirement age can still file and suspend, but no one can collect benefits on the worker's earnings record during the suspension period. This strategy effectively ends the file-and-suspend strategy for couples and families.

The new rules also mean that a worker cannot later request a retroactive lump-sum payment for the entire period during which benefits were suspended. (This previously available claiming option was helpful to someone who faced a change of circumstances, such as a serious illness.)

Tip: *If you are age 66 or older before the new rules take effect, you may still be able to take advantage of the combined file-and-suspend and spousal/dependent filing strategy.*

Restricted application

Under the previous rules, a married person who had reached full retirement age could file a "restricted application" for spousal benefits after the other spouse had filed for Social Security worker benefits. This allowed the individual to collect spousal benefits while earning delayed retirement credits on his or her own work record. In combination with the file-and-suspend option, this enabled both spouses to earn delayed retirement credits while one spouse received a spousal benefit, a type of "double dipping" that was not intended by the original legislation.

Under the new rules, an individual eligible for both a spousal benefit and a worker benefit will be "deemed" to be filing for whichever benefit is higher and will not be able to change from one to the other later.

Tip: *If you reached age 62 before the end of December 2015, you are grandfathered under the old rules. If your spouse has filed for Social Security worker benefits, you can still file a restricted application for spouse-only benefits at full retirement age and claim your own worker benefit at a later date.*

Basic Social Security claiming options remain unchanged. You can file for a permanently reduced benefit starting at age 62, receive your full benefit at full retirement age, or postpone filing for benefits and earn delayed retirement credits, up to age 70.

Although some claiming options are going away, plenty of planning opportunities remain, and you may benefit from taking the time to make an informed decision about when to file for Social Security.

Are There Gaps in Your Insurance Coverage?

If you own a condo, your association's property insurance may leave gaps in coverage. For example, most association insurance doesn't cover your furniture, wall coverings, electronics, interior walls, and structural improvements made to the interior of your unit. Review your condo documents, particularly the association's master deed, its by-laws, rules and regulations, which may describe those parts of your unit the association insurance covers, and which parts you may need to insure.

Buying insurance is about sharing or shifting risk. For example, health insurance will cover some of the cost of medical care. Homeowners insurance will assume some of the risk of loss in the event your home is damaged or destroyed. But oftentimes we think we're covered for specific losses when, in fact, we're not. Here are some common coverage gaps to consider when reviewing your own insurance coverage.

Life insurance

In general, you want to have enough life insurance coverage (when coupled with savings and income) to allow your family to continue living the lifestyle to which they're accustomed. But changing circumstances may leave a gap in your life insurance coverage.

For example, if you have life insurance through your employer, changing jobs could affect your insurance coverage. You may not have the same amount of insurance, or the policy provisions may differ. Whereas your prior employer may have provided permanent life insurance, now you may have term insurance that will expire on a predetermined date. Review your income, savings, and expenses annually and compare them to your insurance coverage, and be mindful that changing circumstances may require a change in the amount of insurance coverage.

Homeowners insurance

It's not always clear from reading your homeowners policy which perils are covered and how much damage will be paid for. It's important to know what your homeowners policy covers and, more important, what it doesn't cover.

You might think your insurer would pay the full cost to replace your home if it were destroyed by a covered occurrence. But many policies place a cap on replacement cost up to the face amount stated on the policy. You may want to check with a building contractor to get an idea of the replacement cost for your home, then compare it to your policy to be sure you have enough coverage.

Even if your policy states that "all perils" are covered, most policies carve out many exceptions or exclusions to this general provision. For example, damage caused by floods, earthquakes, and hurricanes may be covered only by special addendums to your policy, or in some cases by separate insurance policies altogether. Also, your insurer may not cover the extra cost of rebuilding attributable to more stringent building codes, or your policy may limit how much and how long it will pay for temporary housing while repairs are made.

To avoid these gaps in coverage, review your policy annually with your insurer. Also, pay attention to notices you may receive. What may look like boilerplate language could actually be significant changes to your coverage. Don't rely on your interpretations--seek an explanation from your insurer or agent.

Auto insurance

Which drivers and what vehicles are covered by your auto insurance? Most policies provide coverage for you and family members residing with you, but it's not always clear-cut. For instance, a child who is living in a college dorm is probably covered, but a child who lives in an off-campus apartment might be excluded from coverage. If you and your spouse divorce, which policy insures your children, particularly if they are living with each parent at different times of the year? Notify your insurer about any change in living arrangements to avoid a gap in coverage.

Other gaps include no coverage for damaged batteries, tires, and shocks. And you might not be covered for stolen or damaged cell phones or other electronic devices. Your policy may also limit the amount paid for a rental while your vehicle is being repaired.

In fact, insurance coverage for rental cars may also pose a problem. For instance, your own collision coverage may apply to the rental car you're driving, but it may not pay for all the damage alleged by a rental company, such as loss of use charges. If you're leasing a car long term, your policy may cover the replacement cost only if the car is a total loss or is stolen. But that amount may not be enough to pay for the outstanding balance of your lease. Gap insurance can cover any difference between what your insurer pays and the balance of your lease.

Policy terms and conditions aren't always easily understood, and you may not be sure what's covered until it's time to file a claim. So review your insurance policy to be sure you've filled all the gaps in your coverage.

Quiz: Which Birthdays Are Financial Milestones?

What is the birthday rule?

The birthday rule may be used by health insurers to coordinate benefits when a dependent child is covered by the health plans of both parents and the parents are married or living together. The plan of the parent whose birthday falls earlier in the calendar year is generally the primary plan, providing benefits and paying claims first, and the plan of the other parent provides secondary coverage. If the parents share the same birthday, primary coverage is provided by the plan that has covered one parent the longest.

Source: National Association of Insurance Commissioners, naic.org

When it comes to your finances, some birthdays are more important than others. Take this quiz to see if you can identify the ages that might trigger financial changes.

Questions

1. Eligibility for Medicare coverage begins at what age?

a. 62

b. 65

c. 66

2. A child can stay on a parent's health insurance plan until what age?

a. 18

b. 21

c. 26

3. At this age individuals who are making contributions to a traditional or Roth IRA or an employer-sponsored retirement plan can begin making "catch-up" contributions.

a. 50

b. 55

c. 60

d. 66

4. This age is most often associated with drops in auto insurance premiums.

a. 18

b. 25

c. 40

d. 50

5. Individuals who have contributed enough to Social Security to qualify for retirement benefits become eligible to begin collecting reduced benefits starting at what age?

a. 62

b. 65

c. 66

d. 70

6. To obtain a credit card, applicants under this age must demonstrate an independent ability to make account payments or have a cosigner.

a. 16

b. 18

c. 21

Answers

1. b. 65. Medicare eligibility begins at age 65, although people with certain conditions or disabilities may be able to enroll at a younger age. You'll be automatically enrolled in Medicare when you turn 65 if you're already receiving Social Security benefits, or you can sign up on your own if you meet eligibility requirements.

2. c. 26. Under the Affordable Care Act, a child may retain his or her status as a dependent on a parent's health insurance plan until age 26. If your child is covered by your employer-based plan, coverage will typically end during the month of your child's 26th birthday. Check with the plan or your employer to find out exactly when coverage ends.

3. a. 50. If you're 50 or older, you may be able to make contributions to your IRA or employer-sponsored retirement plan above the normal contribution limit. These "catch-up" contributions are designed to help you make up a retirement savings shortfall by bumping up the amount you can save in the years leading up to retirement. If you participate in an employer-sponsored retirement plan, check plan rules--not all plans allow catch-up contributions.

4. b. 25. By age 25, drivers generally see their premiums decrease because, statistically, drivers younger than this age have higher accident rates. Gaining experience and maintaining a clean driving record should lead to lower premiums over time. However, there's no age when auto insurance rates automatically drop because rates are based on many factors, including type of vehicle and claims history, and vary by state and insurer; each individual's situation is unique.

5. a. 62. You can begin receiving Social Security retirement benefits as early as age 62. However, your benefits will be reduced by as much as 30% below what you would have received if you had waited until your full retirement age (66 to 67, depending on your year of birth).

6. c. 21. As a result of the Credit Card Act of 2009, credit card companies cannot issue cards to those under age 21 unless they can show proof that they can repay the debt themselves or unless someone age 21 or older with the ability to make payments cosigns the credit card agreement.

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What are required minimum distributions (RMDs)?

Traditional IRAs and employer retirement plans such as 401(k)s and 403(b)s offer several tax advantages, including the ability to defer income taxes on both contributions and earnings until they're distributed from the plan.

But, unfortunately, you can't keep your money in these retirement accounts forever. The law requires that you begin taking distributions, called "required minimum distributions" or RMDs, when you reach age 70½ (or in some cases, when you retire), whether you need the money or not. (Minimum distributions are not required from Roth IRAs during your lifetime.)

Your IRA trustee or custodian must either tell you the required amount each year or offer to calculate it for you. For an employer plan, the plan administrator will generally calculate the RMD. But you're ultimately responsible for determining the correct amount. It's easy to do. The IRS, in Publication 590-B, provides a chart called the Uniform Lifetime Table. In most cases, you simply find the distribution period for your age and then divide your account balance as of the end of the prior year by the distribution period to arrive at your RMD for the year.

For example, if you turn 76 in 2016, your distribution period under the Uniform Lifetime Table is 22 years. You divide your account balance as of December 31, 2015, by 22 to arrive at your RMD for 2016.

The only exception is if you're married and your spouse is more than 10 years younger than you. If this special situation applies, use IRS Table II (also found in Publication 590-B) instead of the Uniform Lifetime Table. Table II provides a distribution period that's based on the joint life expectancy of you and your spouse.

If you have multiple IRAs, an RMD is calculated separately for each IRA. However, you can withdraw the required amount from any of your IRAs. Inherited IRAs aren't included with your own for this purpose. (Similar rules apply to Section 403(b) accounts.) If you participate in more than one employer retirement plan, your RMD is calculated separately for each plan and must be paid from that plan.

Remember, you can always withdraw more than the required amount, but if you withdraw less you will be hit with a penalty tax equal to 50% of the amount you failed to withdraw.

Should I delay taking my first RMD?

Your first RMD from a traditional IRA and an employer retirement plan must be taken for the calendar year in which you turn 70-1/2. However, if you're still working, you can delay RMDs from your current employer's plan until the year you retire (but only if allowed by the plan and you are not a 5% owner).

In general, you must take your RMDs no later than December 31 of each calendar year to avoid a serious tax penalty equal to 50% of the amount you failed to withdraw. However, a special rule applies to your first RMD. You have the option of delaying your first distribution until April 1 of the following calendar year.

You might delay taking your first distribution if you expect to be in a lower income tax bracket in the following year, perhaps because you're no longer working or will have less income from other sources. However, if you wait until the following year to take your first distribution, your second distribution must be made on or by December 31 of that same year.

For example, assume you have a traditional IRA and you turn 70½ in 2016. You can take your first RMD during 2016 or you can delay it until April 1, 2017. If you choose to delay your distribution until 2017, you will have to take two required distributions in that year, one for 2016 and one for 2017. This is because your distribution for 2017 cannot be delayed until the following year.

Receiving your first and second RMDs in the same year may not be in your best interest. Since this "double" distribution will increase your taxable income for the year, it will probably cause you to pay more in federal and state income taxes. It could even push you into a higher federal income tax bracket for the year.

In addition, the increased income may result in the loss of certain tax exemptions and deductions that might otherwise be available to you.

Obviously, the decision to delay your first required distribution can be important. Your tax professional can help you decide whether delaying the RMD makes sense for your personal tax situation.

Where the Jobs Are

Your daughter or grandson wants to get hired right out of college, without a lot of job hunting. So what degree should you recommend that they pursue?

Recently, the National Association of Colleges and Employers published a list of the top ten degrees for getting hired in this new year—that is, the degrees that make a young person most desirable to employers. The NACE links college career placement offices with employers, so it's in a unique position to measure the desirability of different types of college training.

At the top of the list were accounting and computer science degrees; 98% and 97% of large companies are interested in hiring people with those credentials. Next came finance (91%), followed by business administration/management (86%), mechanical engineering (83%), information sciences and systems (75%), management information systems (73%), electrical engineering (71%), logistics and supply chain programs (67%), economics (64%) and marketing (64%).

Notice that social sciences and humanities are not at the top of this list. The report showed that just 20% of the employers plan to hire communications majors, and 16% will hire economics majors and English literature. But the report also noted that these "soft science" graduates, plus psychology and law majors, tend to progress toward management levels as fast or faster than the specialized computer/engineering students.

Meanwhile, Forbes magazine recently asked companies to reveal the toughest jobs to fill in this new year—which means areas where people with these skills are virtually certain to be hired. Top of the list: data scientists, who can take gigantic data sets and turn them into usable information.

Closely-related professions also made the list: information security analyst, electrical engineer and software engineer, followed by marketing manager and operations manager.

Also on the list were health care-related jobs: home health aide, medical services manager, physical therapist and registered nurse.

- Source:
  - http://www.forbes.com/sites/susanadams/2015/11/25/top-degrees-for-getting-hired-in-2016/?utm_campaign=Forbes&utm_source=TWITTER&utm_medium=social&utm_channel=Leadership&linkId=19841205
  - http://www.forbes.com/sites/susanadams/2015/09/24/the-10-toughest-jobs-to-fill-in-2016/?utm_campaign=Forbes&utm_source=TWITTER&utm_medium=social&utm_channel=Leadership&linkId=19841547

Global Financial Literacy: The Haves and Have-Nots

A new survey by the S&P organization—the S&P Global FinLit Survey—measured financial literacy across a wide spectrum of countries around the world. More than 150,000 randomly selected individuals in 140 countries were asked to answer five multiple-choice questions regarding investment diversification, the ability of income to stay on par with spending (or vice versa), interest payments and compounding investment returns. If individuals could correctly answer three out of the five questions, they were deemed to be financially literate.

So how did we do? Only 57% of the Americans surveyed were able to correctly answer three out of the five questions. That puts the U.S. in the upper echelon of nations overall, ranking number 14 behind Finland (#10), Australia (#9), Germany (#8), the Netherlands (#7), the UK (#6), Canada (#5), Israel (#4) and the three top-scoring countries: Sweden, Denmark and Norway—all Scandinavian, which probably means they cheat by actually including financial literacy in their regulator educational curriculum.

Not surprisingly, poorer countries tended to be less financially literate, and the survey found wide discrepancies between adults living in the richest 60% of households in each country vs. those in the poorest 40%. For instance, the U.S. saw a disparity of 64% literate (wealthiest households) vs. 47% (poorest). The conclusion: financial ignorance can carry an invisible lifetime cost.

Does that mean that U.S. policymakers will add a financial literacy curriculum to our nation's high schools, as a way to increase the prosperity of our overall society? Let's not hold our breath.

- Sources:
  - http://www.forbes.com/sites/maggiemcgrath/2015/11/18/in-a-global-test-of-financial-literacy-the-u-s/?utm_campaign=Forbes&utm_source=TWITTER&utm_medium=social&utm_channel=Investing&linkId=19914106
  - https://www.mhfi.com/corporate-responsibility/global-financial-literacy-survey#keyfindings

The Future is Coming Faster Than You Think

You've probably seen at least a few episodes of Star Trek, the science fiction TV show that went through several iterations that included Mr. Spock and Mr. Data—and, more importantly, starships that travel around the galaxy in comfortable style. The show was set 300 years in the future, and included magical technology like the transporter that caused people to vanish from the ship and reappear on the planet's surface, and a replicator, which synthesized food and drink items without the need for a kitchen (or bartender).

Will humans ever actually see those technologies? Surprisingly, many of them are starting to manifest a few centuries earlier than expected. Futurist Vivek Wadhwa offers a tour of the gadgets on the Starship Enterprise, and then points to similar innovations that are already happening right here on old-fashioned 21st Century Earth.

Such as? Consider the communicators that the crew carried around with them. When the first version of Star Trek appeared on TV, the audience primarily communicated via land-line phones, while Captain Kirk and his crew talked on modified flip phones. Today, we think of those flip phones as outmoded technology—devices you merely talked into, without the email, music, web access and the ability to ask for directions to your destination. The Enterprise's communications devices didn't even have cameras!

In the starship's medical center, the ship's doctor would aim a "tricorder" at patients and quickly diagnose what was wrong with them. Today, doctors can point a device called GENE-Radar at the patient and identify a range of illnesses, including AIDS, malaria, tuberculosis and cancer. Meanwhile, smart phones and even smart clothing are being developed which will constantly monitor our heart rate (and health), temperature, oxygenation and other vital signs, check for early signs of illness, and report all this information in real time to artificial intelligence systems on the web, which will notify us if/when we need to head for the hospital for a checkup. That technology will quickly be replaced by chips embedded unobtrusively in our bodies, which will monitor just about everything. The tricorder will look outmoded compared to a system where the ship's computer knows what's wrong with every crew member in real time.

Okay, but surely that replicator thing is centuries down the road. Not so fast. Today's 3D printing devices are already able to create objects in plastic, metal, glass and titanium. They are even creating human cells and organs. Yes, today it takes hours to "print" a finished product, but it's not hard to imagine the devices becoming much faster as the technology improves. Remember how long color printers took to finish a page 20 years ago?

Finally, Captain Kirk used a universal translator when he wanted to communicate with alien warlords. Today, Google Translate is capable of translating pages of text from one human language to another. Microsoft recently demonstrated a real-time, voice-based language interpreter that works on Skype. A commercially-available real-time translator is years—not centuries or even decades—away.

It may be a few more years before somebody recreates faster-than-light transportation to the stars, but it's useful to realize how much of the Star Trek technology seemed impossible 30 years ago, and now seems mundane. Who knows what the next 30 years will bring?

Welcome To 2016

Well, it's all over the news. The stock market has had a very rough start to 2016. Through January 20th, the stock market has lost -9% of its value. In fact, the stock market has not had a worse start to a calendar year. It seems appropriate to put things into context.

What's Going On?

While no one knows for certain, the common reasons for the decline have been the continual decline in oil prices, slowing growth in China, and the strong U.S. dollar. It's also worth noting that the stock market's valuation has been on the high side for a while. This leaves it more vulnerable to a correction on any hint of bad news.

Oil prices are down to levels not seen since 2003, and could go lower, which is not terrific news for oil companies and oil services companies. There is legitimate concern about repayment of high-yield bond debt among some higher-risk energy companies. Politically, the energy price collapse is also a challenge for certain countries that heavily rely on oil revenue (Brazil, Russia for example). But cheaper energy **is** good news for manufacturers and consumers -- which is sometimes forgotten in the gloomy forecasts.

Chinese stocks and the Chinese economy are showing more signs of weakness. The confidence in the ability of the Chinese authorities to "manage" their economy is eroding. China has a significant amount of debt and appears to have created too much productive capacity. They do have significant monetary reserves, which will probably give them some time. Nevertheless, a significant currency adjustment is a real possibility as well as additional fallout.

Is this 2008-2009 Again?

While the correction may or may not get worse, we do not believe another "2008" is around the corner for the following reasons:

- U.S. and European banks are much healthier today than they were in 2007.
- There hasn't been a big credit boom in the U.S. and Europe like there was during the housing bubble. Some of the energy companies may have borrowed too much, but they are nowhere near the economic size of the housing bubble that occurred.
- Consumer balance sheets are much healthier today than they were in 2007.
- Even if China is a financial house of cards their financial system isn't interlinked to the U.S. and Europe in the same way that the U.S. and Europe are interlinked.

We believe the majority of evidence suggests that a recession is not imminent – or even likely to soon occur. But, this does not mean the stock market cannot go down further – it certainly can.

Putting Corrections Into Historical Context

Let's put this -9% intra-year decline into a historical framework. The chart on page 3 shows the intra-year decline in stock prices since 1980, as well as the full calendar-year return.

The median intra-year decline in stock prices since 1980 has been -10.5%. An intra-year decline of -10% or more has occurred in 20 out of the 36 calendar-year periods (or 56%). So a -10% intra-year decline is not particularly uncommon. A -15% decline has occurred less frequently (13 of the 36 periods or 36%), but still more than once every three years.

Since 1980, 28 years (or 78%) had positive stock market returns. Interestingly, of the 20 years that had an intra-year stock decline of -10% or more, 13 had positive returns for the full calendar year. So, historically speaking, it is not uncommon (although by no means a certainty) for the market to be able to "digest" even a -10% intra-year decline and still have a full-year positive return.

Lastly, it is important for any stock investor to realize that stock prices can decline at any time, with no warning whatsoever. This is why investors in common stocks need a longer time horizon – probably a minimum of five years, and preferably longer.

The chart on page 4 shows the frequency of a below zero returns for a 50% stock / 50% bond or 100% stock portfolio. Historically, the S&P 500 has produced a negative one-year calendar return 27% of the time. That probability declines to 14% over a five-year timeframe, 5% over 10 years, and 0% over a 20-year holding period.

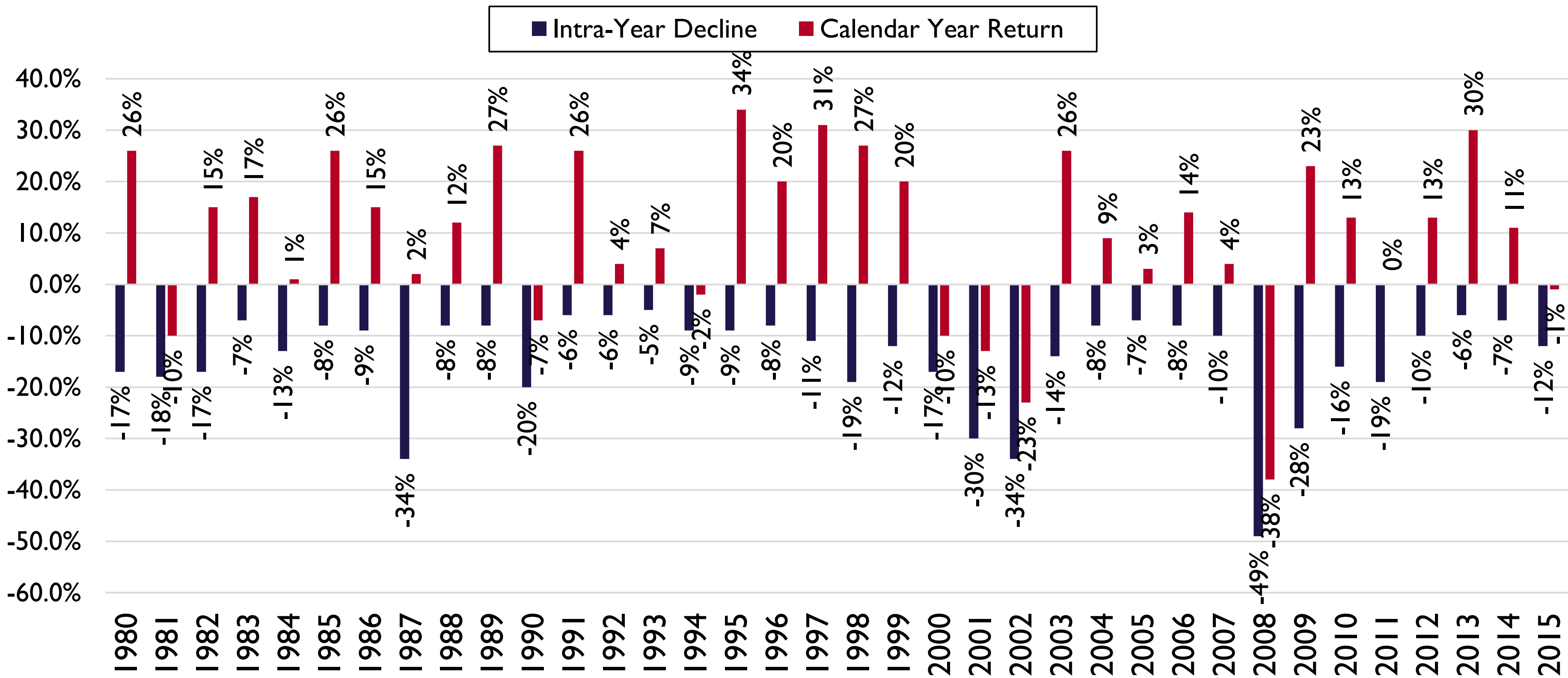
The investor with a 50% bond portfolio has had a 20% frequency of a negative one-year return, but less than a 6% chance of a negative return for holding periods of 3 years or longer.

Please note that these type of statistics are only designed to provide historical context. The future may be significantly different than the past.

Conclusion

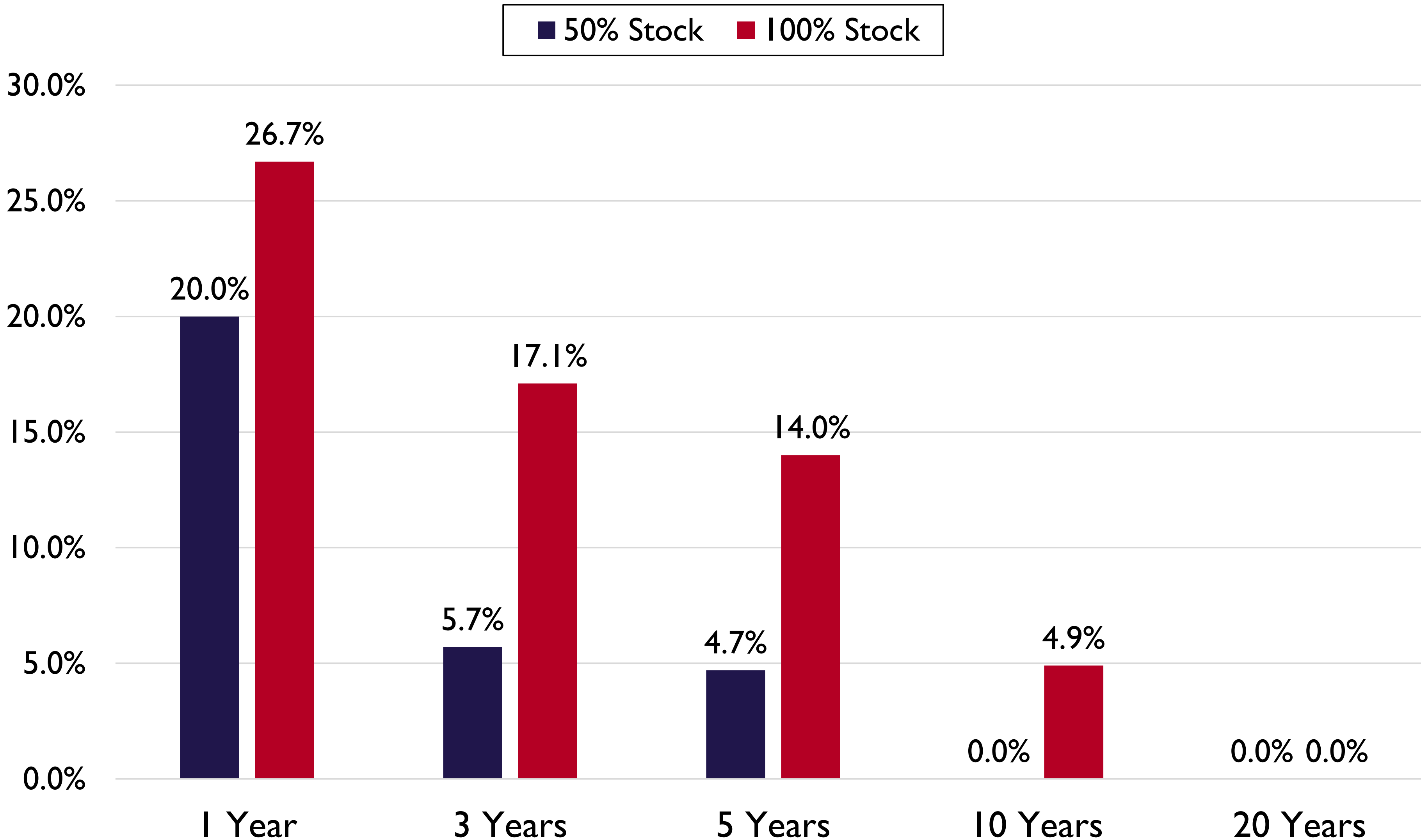
Whether this will be a -10%, -20%, or worse correction, only time will tell. But it is worth noting that, in the past, every one of these drawdowns eventually ended with an even greater upturn and markets testing new record highs.

S&P 500: Intra-Year Stock Market Decline vs. Calendar Year Returns
Price Change Only (Excludes Dividends)



- There has been an intra-year decline in the S&P 500 every year since 1980. The average / median decline has been -14.2% and -10.5% respectively. The maximum intra-year decline has been -49% while the minimum has been -3%.
- An intra-year decline of at least -10% has happened 56% of the calendar years since 1980. A -15% decline or -20% has occurred 36% and 17% of the calendar years, respectively.
- Since 1980, there have been 8 calendar years (22%) where the S&P 500 produced a negative calendar-year return.
- Even though intra-year declines of -10% are pretty common, the market has generally rebounded to produce a positive calendar-year return (at least 78% of the time since 1980).

Historical Frequency of Negative Returns
50% Stock and 100% Stock Portfolios
90 Years of Data From 1926 to 2015



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Capital Market Review and Outlook

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Executive Summary

Capital Market Returns

- For U.S. investors, 2015 capital market returns were disappointing. Domestic stocks and bonds returned 0.5% and 0.6%, respectively.
- However, the rather boring market return masks significant volatility in various stock / bond market segments. For example, large stocks significantly outperformed mid- and small-company stocks, growth outperformed value, and there was wide discrepancy within sector returns.
- Commodifies (not just energy) had a terrible year (again) with a return of -24.7%.

Economic Conditions

- Most indications are that the economy will continue to grow slowly. Consumers appear to be in pretty good shape, but businesses may have hit a slower-growth period.
- The unemployment rate is near a ten-year low. Demand for workers appears strong yet hiring could be stronger. Wages appear to be growing at a modest level.
- Real estate conditions appear good (sales, prices, construction have been increasing in combination with low interest rates).
- Inflation remains below the FED's target. Future interest rate increases appear to be "data dependent" but the market expects four increases during 2016. We do not expect that many.

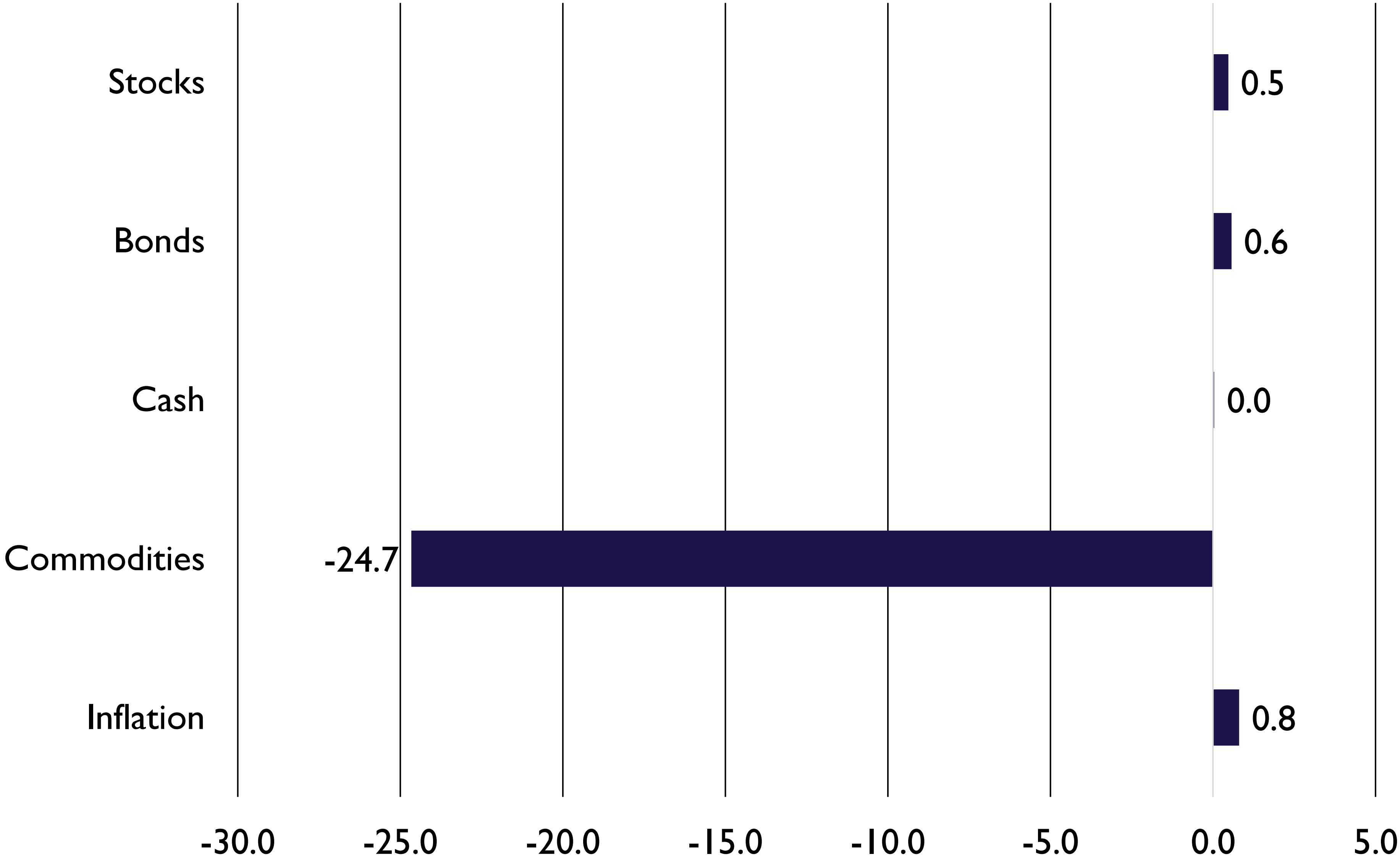
Stock Market

- During 2015, returns were concentrated in a few large-company stocks that did very well. For the broad market (including small company stocks), the average stock lost -3.5% and eight of the 12 sectors had negative returns. Within the S&P 500, five of ten sector returns were negative.
- Large U.S. stocks performed the best. Mid- and small-company stocks, developed international, and emerging market stocks all had negative returns. Emerging market stocks were particularly poor performers.
- Valuations remain elevated. For the past several years stock market volatility has been modest. We expect a higher level of volatility during 2016.
- While valuation is a poor short-term predicator, it does seem to provide insights on longer-term expectations. Current valuation levels suggest more modest future stock returns.

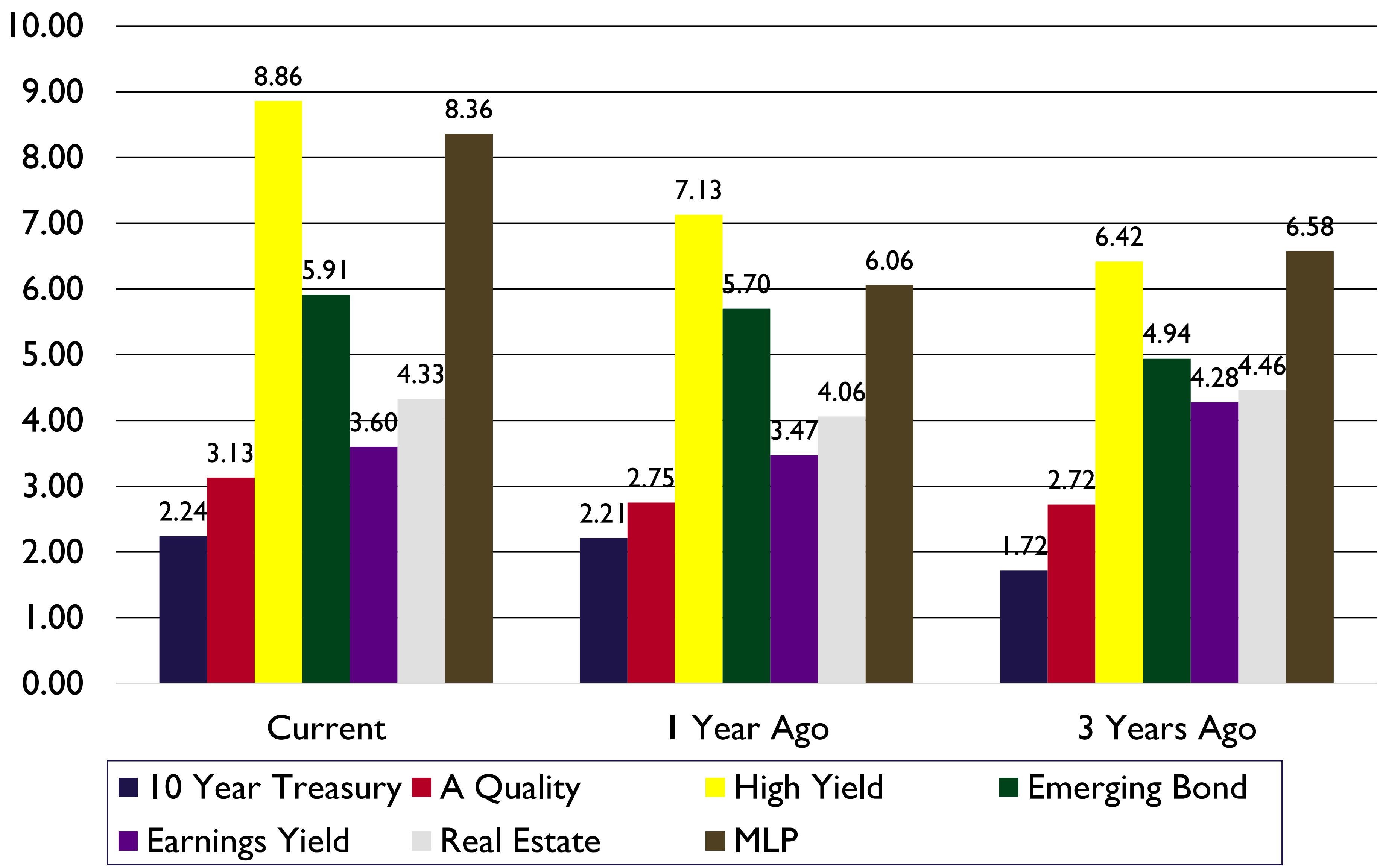
Bond Market

- The Federal Reserve increased short-term interest rates for the first time in nearly a decade. The market currently expects four interest rate increases during 2016. We are skeptical there will be this many interest rate increases.
- Tax-free bonds outperformed taxable bonds. Mortgage bonds were the best performing sector. High yield bonds performed poorly.
- Expect low bond returns (similar to their yields). Investment grade corporate and high yield bonds are more interesting now.

2015 Asset Class Returns



Asset Class Yield Comparisons

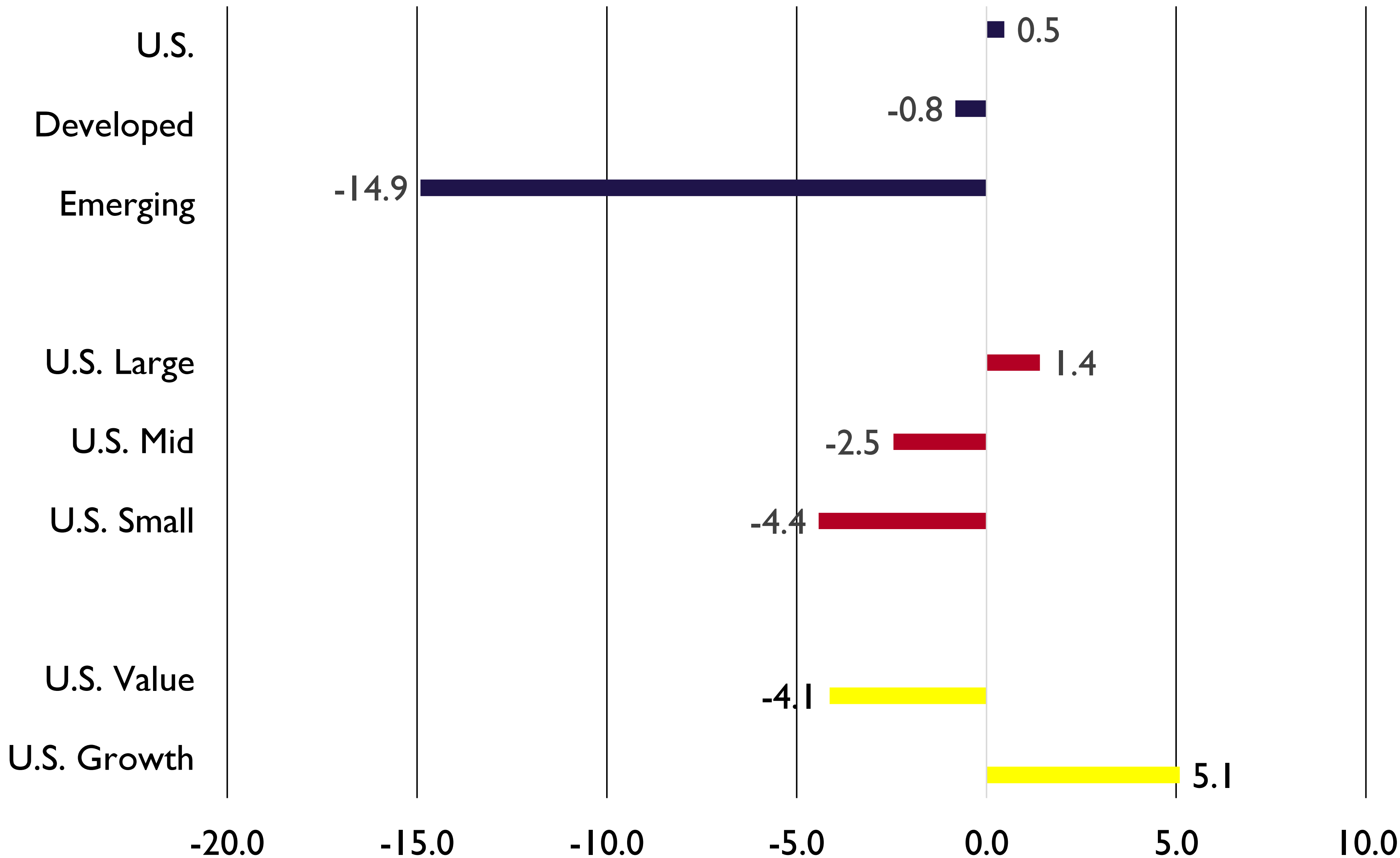


Stock Market

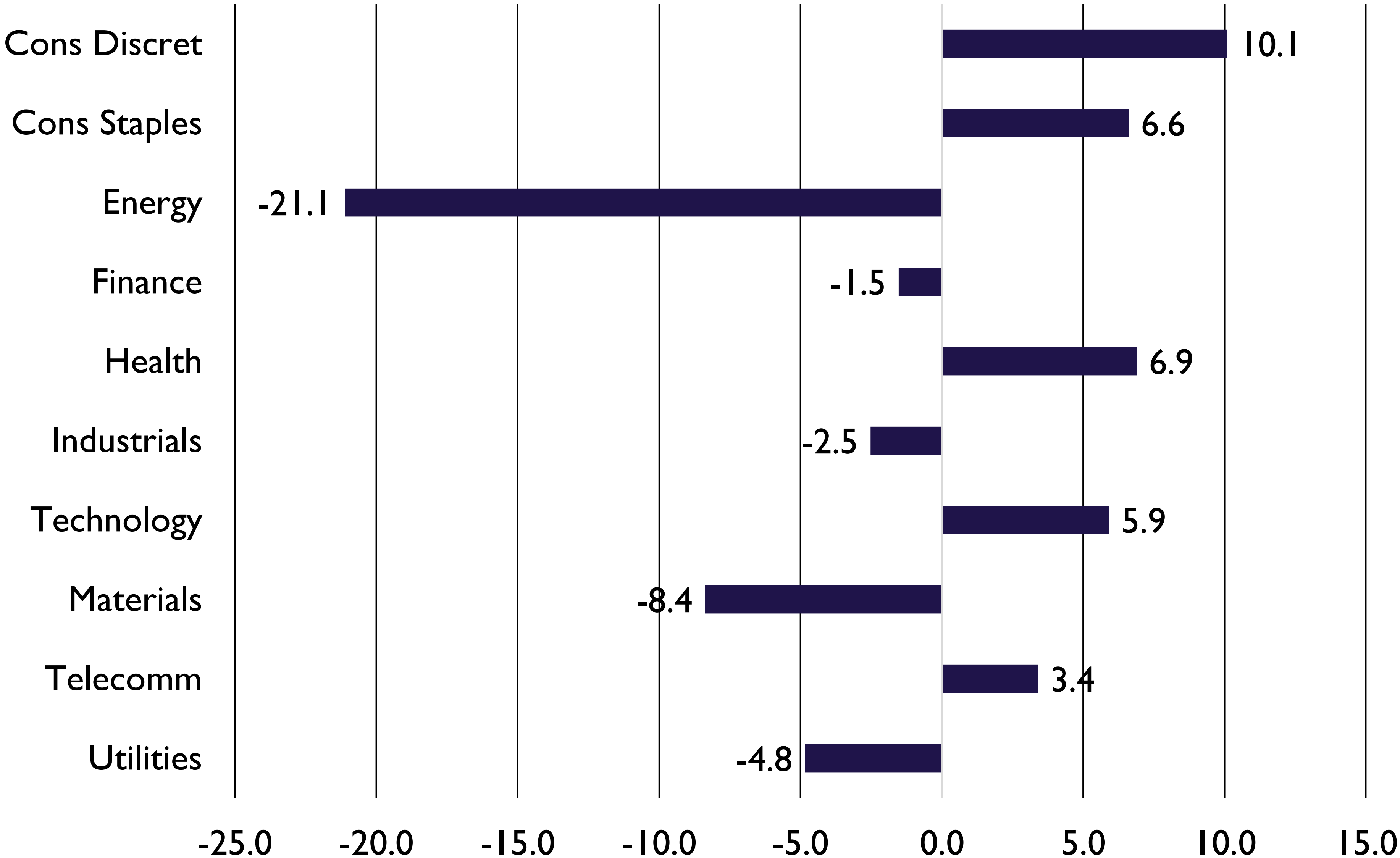
Observations

- During 2015, U.S. stocks were essentially flat with a return of 0.5%. Developed international and emerging market stocks returned -0.8% and -14.9%, respectively. Large company stocks returned 1.4%, outperforming the mid- and small-company stock returns of -2.5% and -4.4%, respectively. By investment approach, growth stocks return of 5.1% was significantly ahead of the value stock return of -4.1%.
- While the U.S. stock market had a positive return, that is really the result of a few very large companies (Facebook, Amazon, Netflix, and Google) doing very well. The broader stock market was much less healthy. Overall, 56% of stocks declined during 2015 with an average decline of -3.5%. Of the 12 economic sectors examined, only Consumer Non-Cyclical, Finance, Healthcare, and Technology had more stocks with a positive return. The other 8 sectors had more stocks with a negative return. For example, the Basic Materials, Energy, and Transportation sectors had 76%, 86%, and 72% of stocks within their respective sectors decline. The average 2015 stock return in those sectors was -18%, -35%, and -18%, respectively.
- Emerging market stocks were negatively impacted by the collapse in commodity prices as well as more sluggish growth in China. For countries that are highly dependent on oil revenue (Brazil, Russia), the fall in oil prices will likely lead to additional budget / debt / currency issues. This has the potential to be a significant economic event.
- The dramatic decline in Energy prices has negatively impacted some of the fundamental characteristics of the S&P 500. For example, for the one-year period ending September, sales and operating growth has been negative. However, the median economic sector operating income growth was 3.2% -- so fundamental characteristics may not be as bad as the "headline" number (when energy is excluded).
- Valuations remain on the high side. At the end of the year, the Price / Operating Earnings ratio was 18.1x (compared to 16.9x a year ago and 14.4 five years ago). Price to book value is also significantly higher than five years ago.
- Using normalized earnings (averaged over a 10-year period), valuation is near a 10-year high. However, when comparing the stock earnings yield to that of a 10-year Treasury, stocks look somewhat more attractive.
- Analysts expect bottom-up earnings growth for large-company stocks to be 16.6% in 2016 and 13.7% in 2017. Given the broad macro-economic environment, we find these estimates essentially meaningless. Mid- and small-company expected earnings growth are even higher (and more meaningless). JIC believes large-company stocks will continue to outperform mid- and small company stocks.
- For the past few years, volatility has generally been low. But, we are seeing more frequent spikes -- in October and now in January. In addition, we are seeing certain stock market sentiment indicators flash some warning signs. We believe 2016 will be a much more volatile year for the stock market compared to the past few years.
- Future stock returns are comprised of essentially three things: dividend yields, future earnings growth, and changes in valuation multiples. Given relatively high valuation levels and lower expected earnings growth, we believe investors should moderate their stock market return expectations.

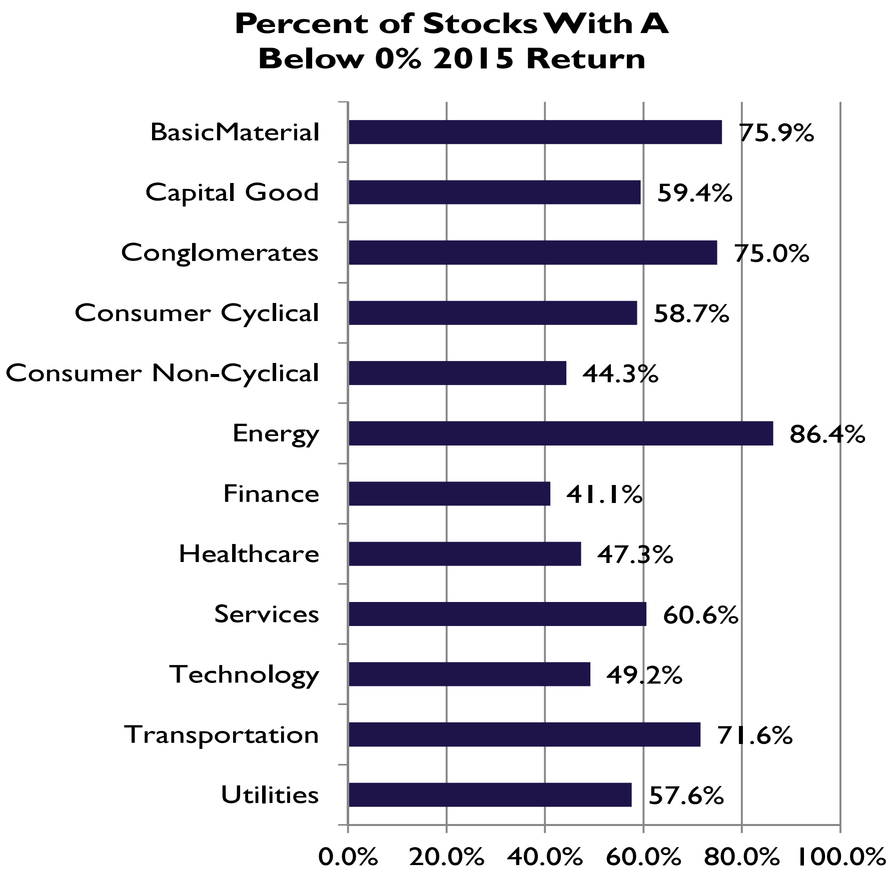
2015 Stock Market Returns

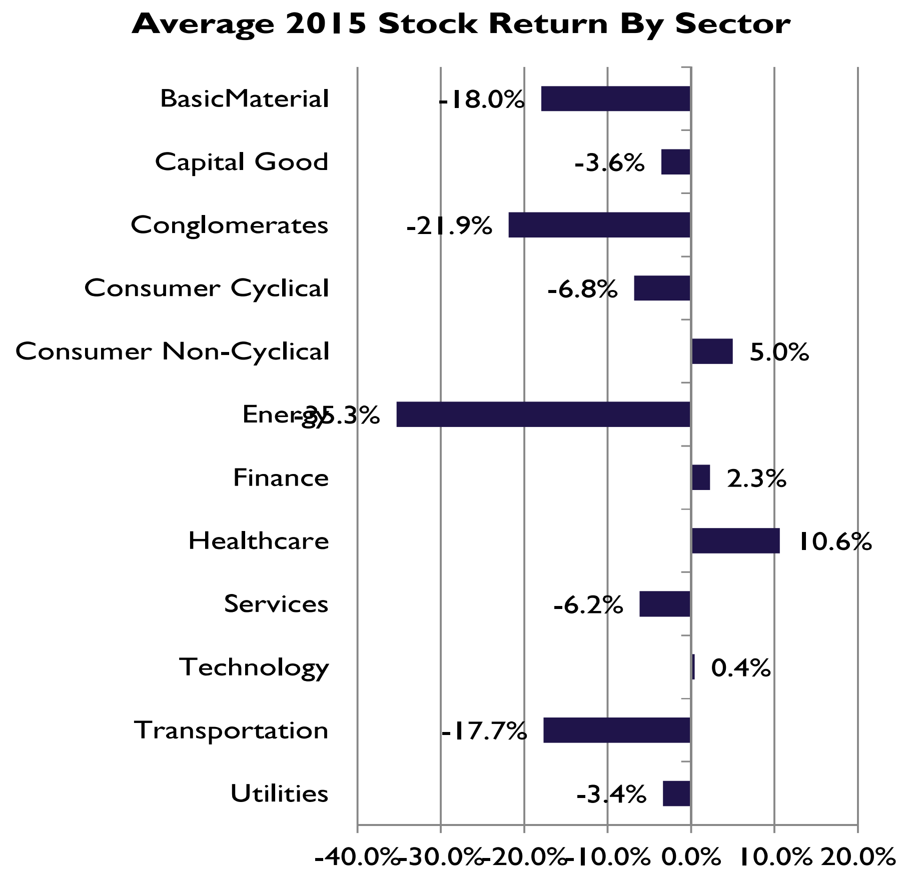


2015 S&P 500 Sector Returns



2015 Stock Returns By Sector

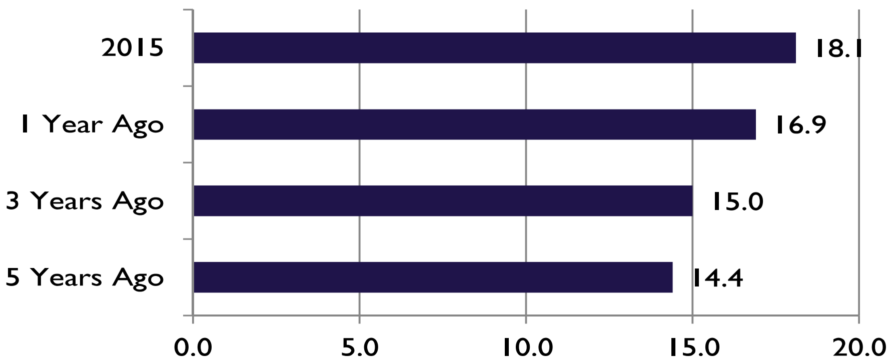




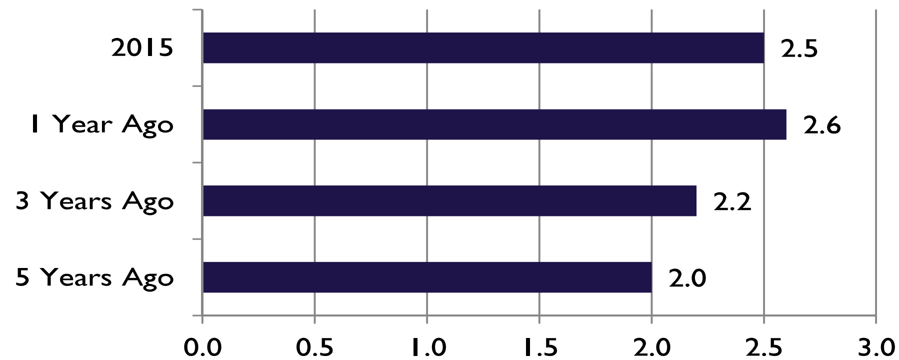
- For the broad stock market most stocks did not perform well during 2015. In only four of the twelve sectors did the average stock have a positive 2015 return. Losses in certain sectors were very significant (Basic Materials, Energy, Transportation).

SP 500 Index: Fundamental Characteristics

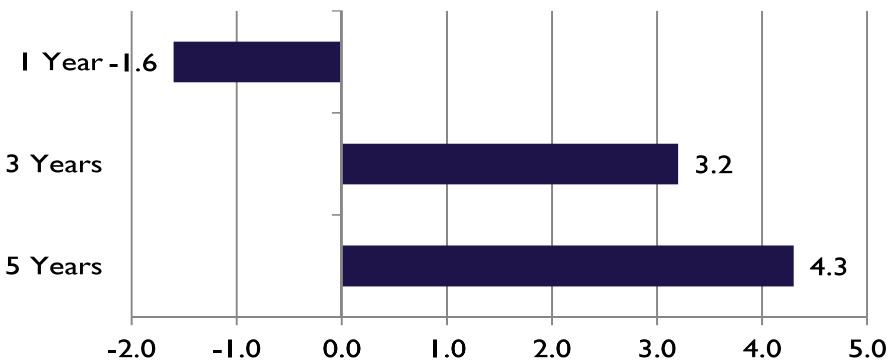
Price to Operating Earnings



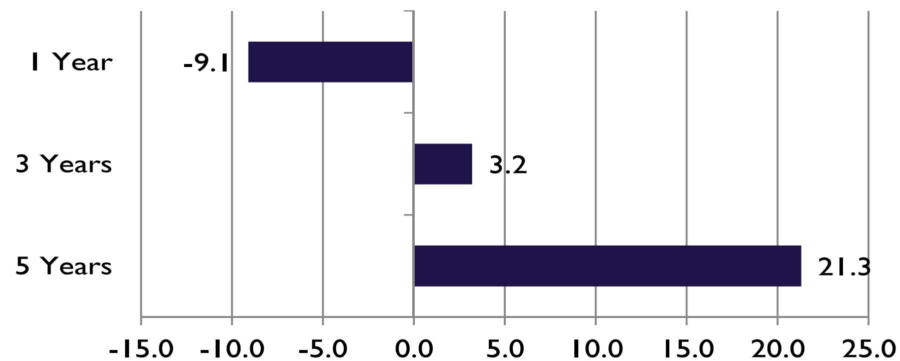
Price to Book Value



Sales Growth

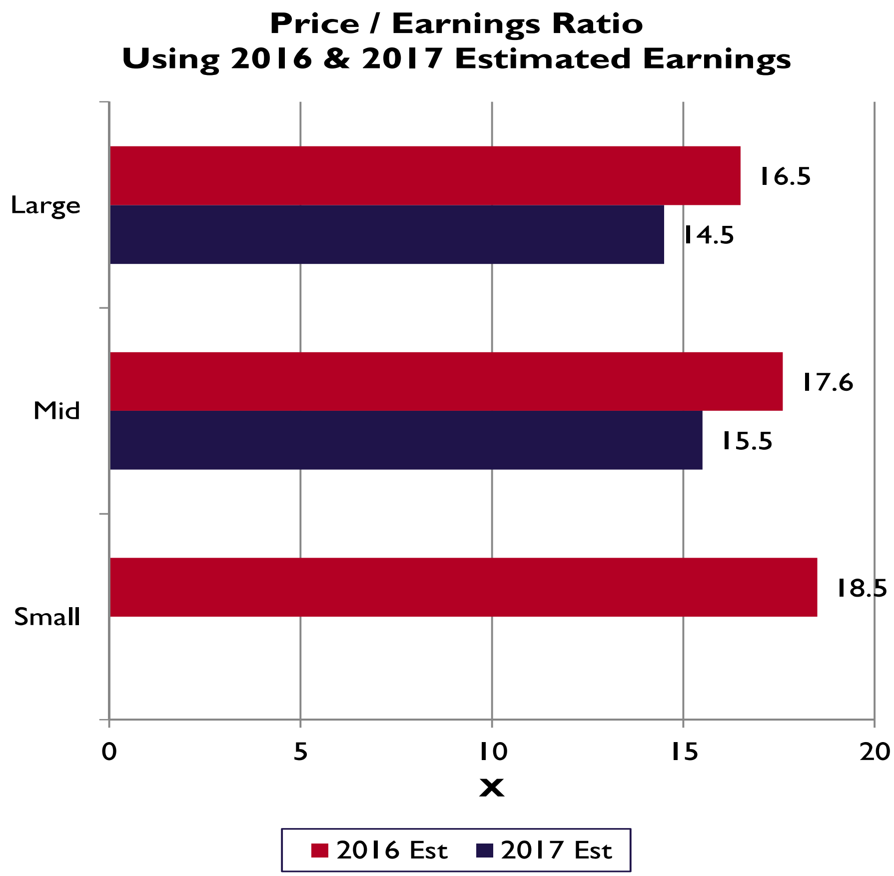


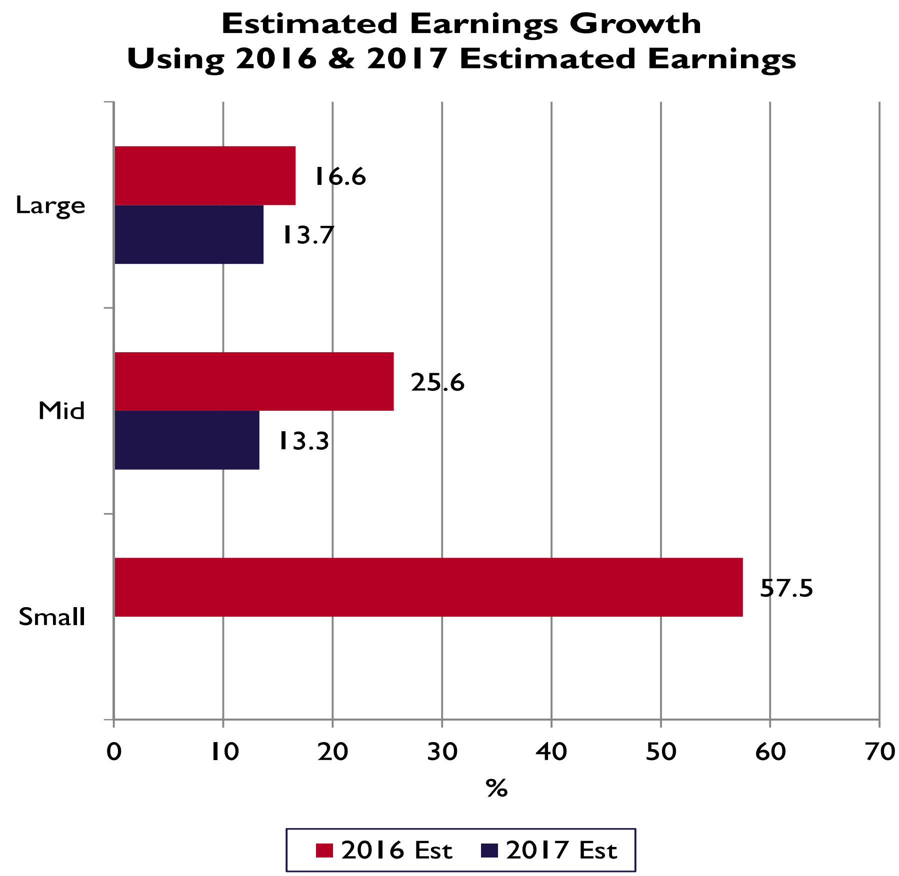
Operating Income Growth



- JIC believes it is difficult to make the case that the current stock market is significantly undervalued. In addition, JIC believes continued stock market multiple expansion is less likely.

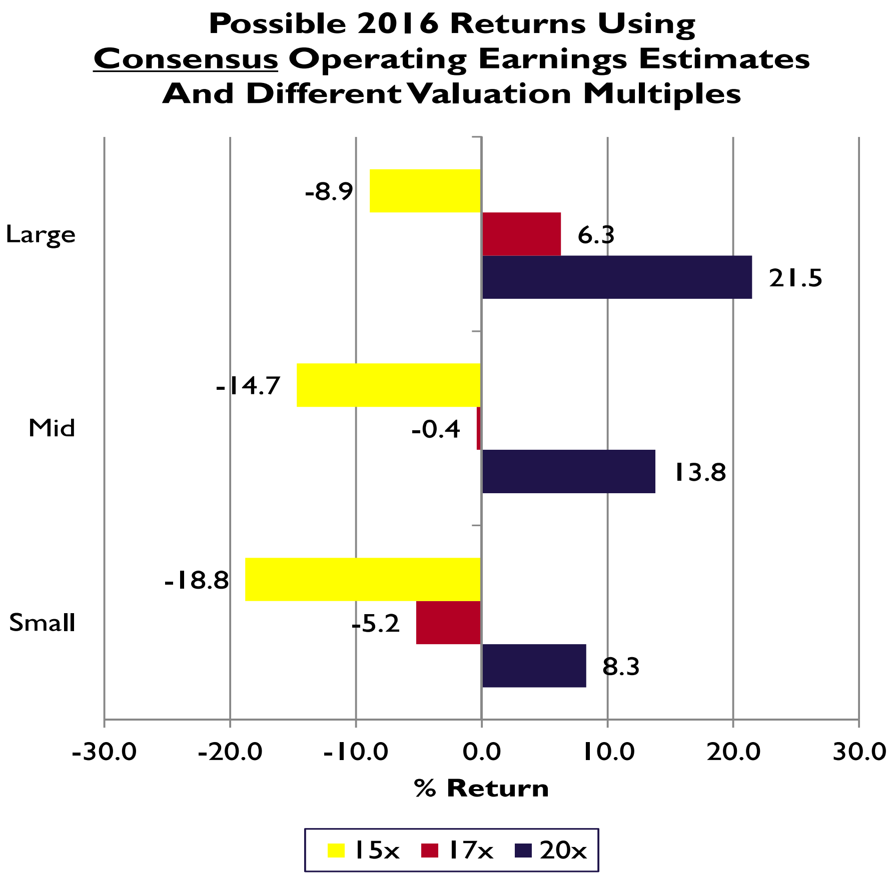
Price / Earning Multiples & Expected Earnings Growth By Company Size

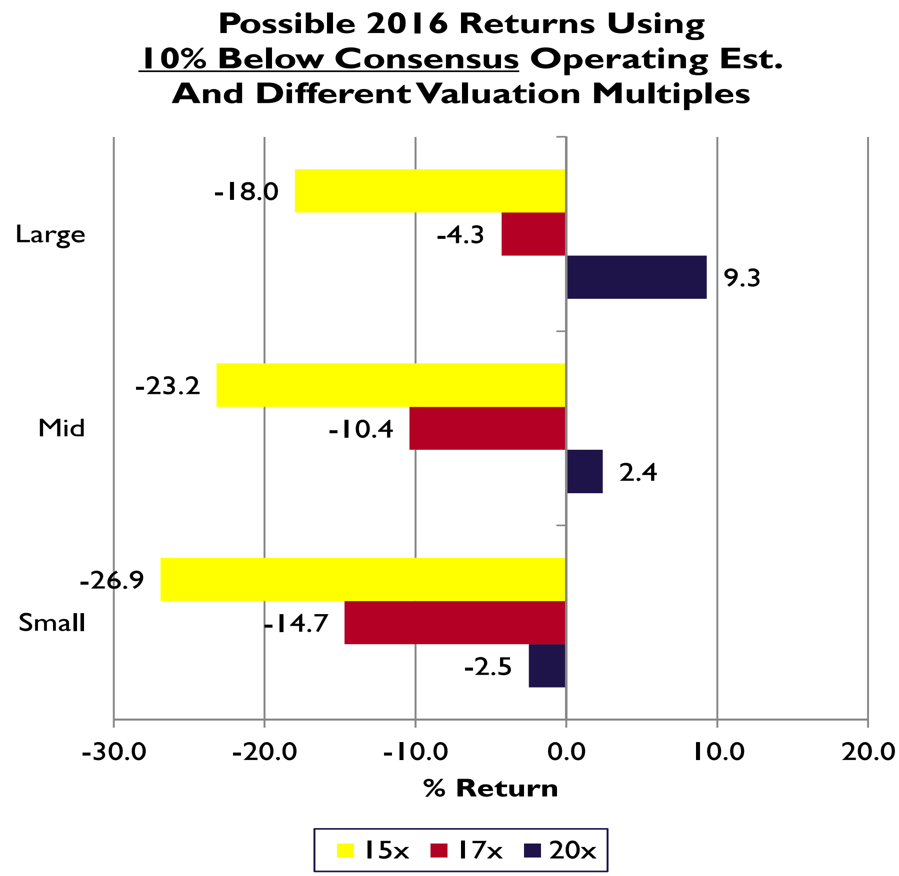




- We believe analyst earnings growth expectations are way too optimistic and do not reflect the broad macro-economic environment.

Possible 2016 Stock Returns By Company Size (Consensus & 10% Below Consensus Estimates)

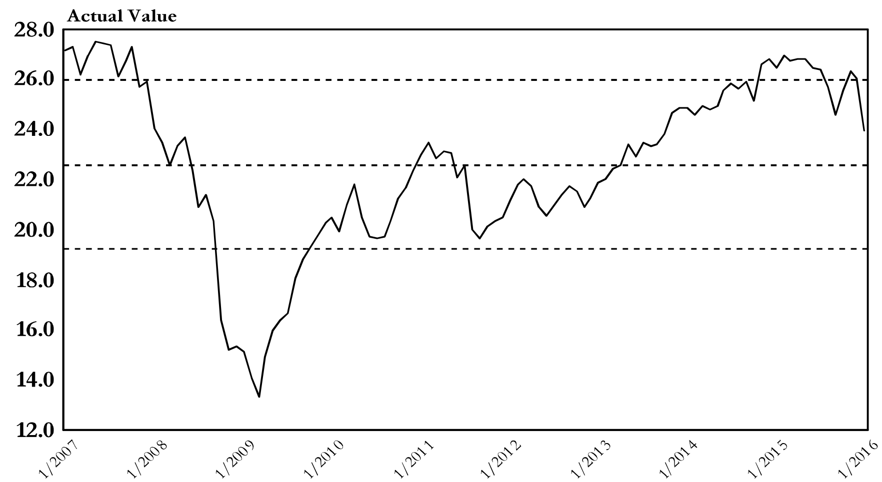




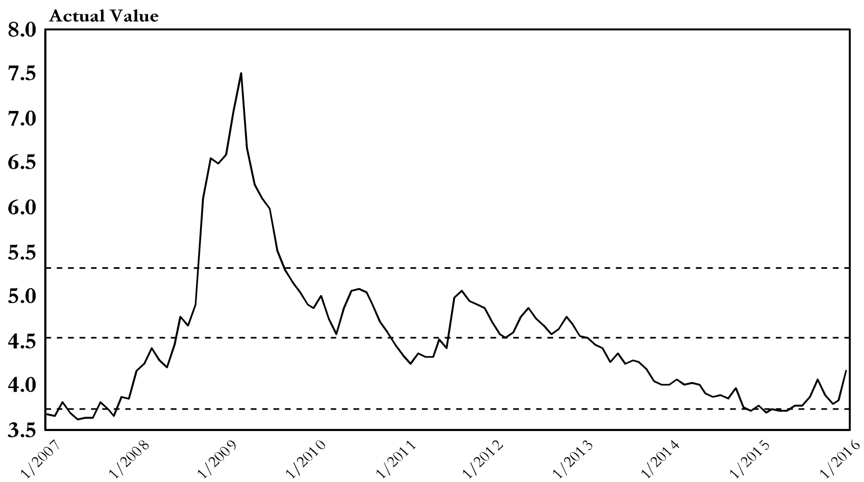
- Often times, as the year progresses, earnings estimates are reduced. If 2016 consensus earnings were reduced by 10%, it will be extremely difficult for stocks to produce a positive return (without multiple expansion).

Valuation Using 10-Year Average Earnings

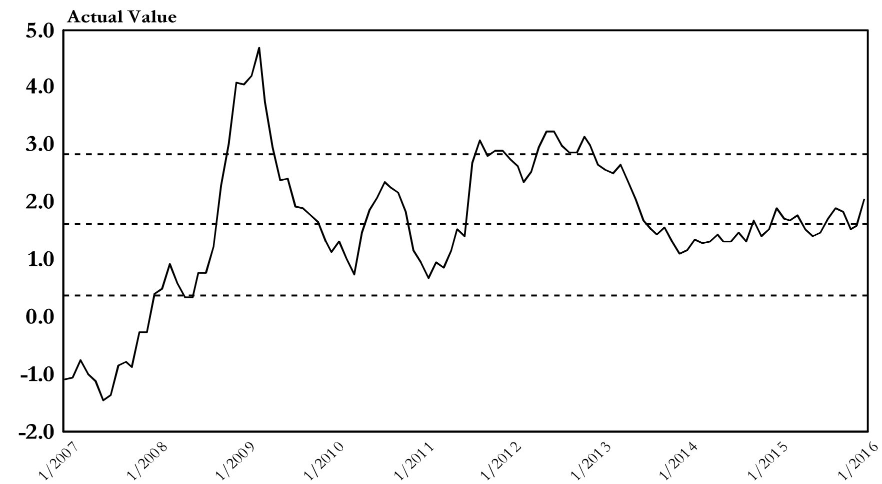
S&P 500 PE Using 10-Year Average Real Earnings



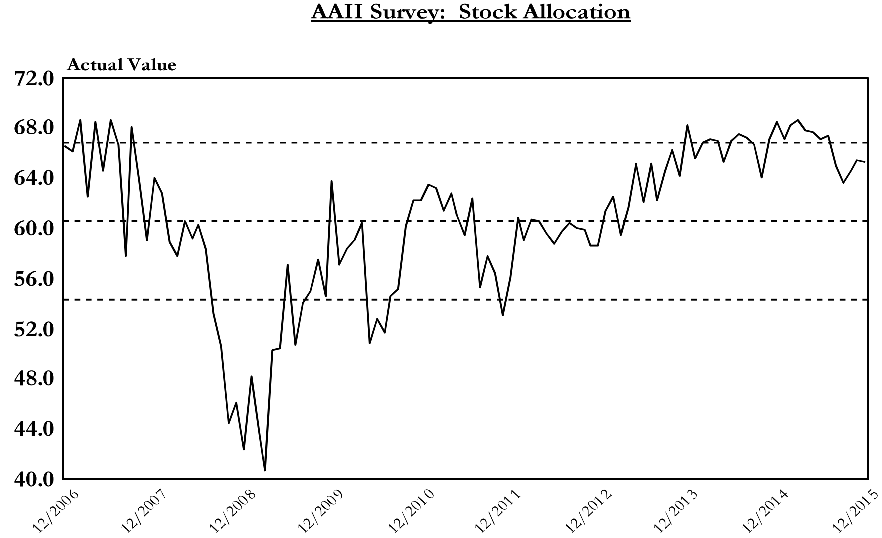
S&P 500 Earnings Yield Using 10-Year Average Real Earnings

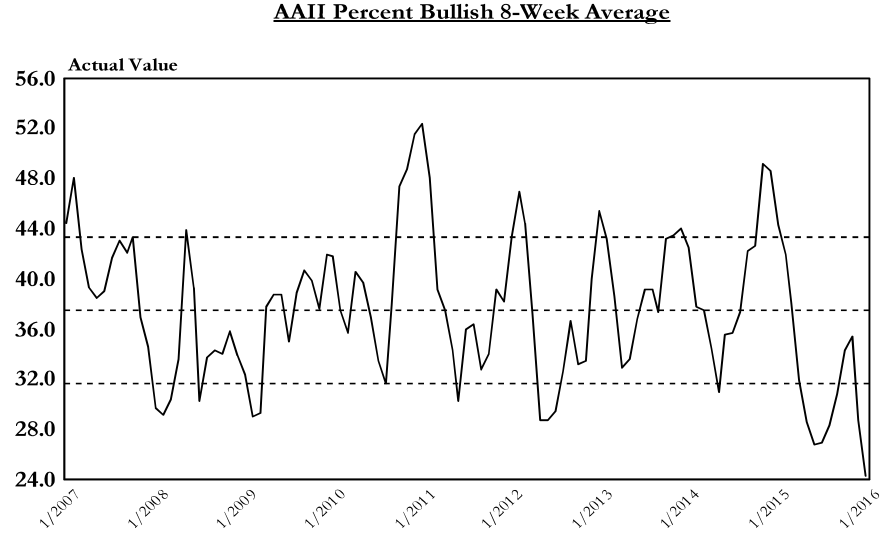


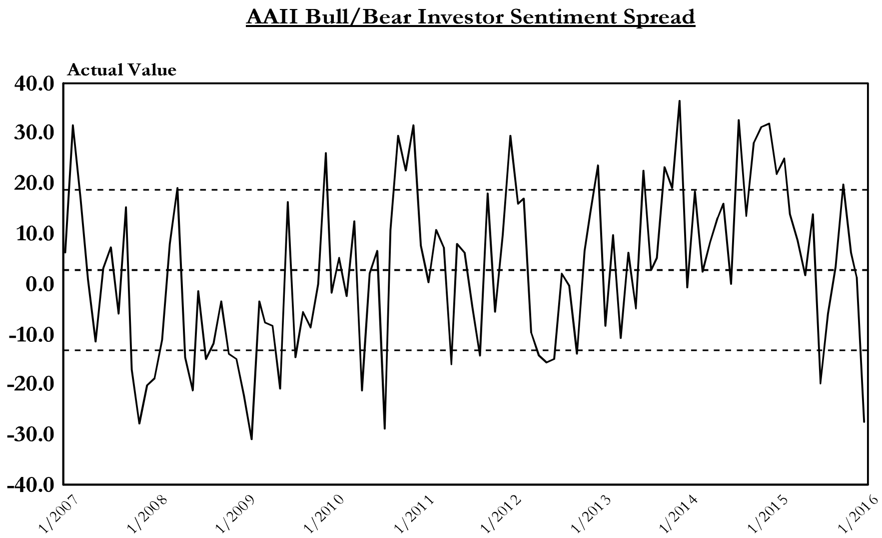
' 500 Earnings Yield Using 10-Year Average Real Earnings Less 10-Year Trea:

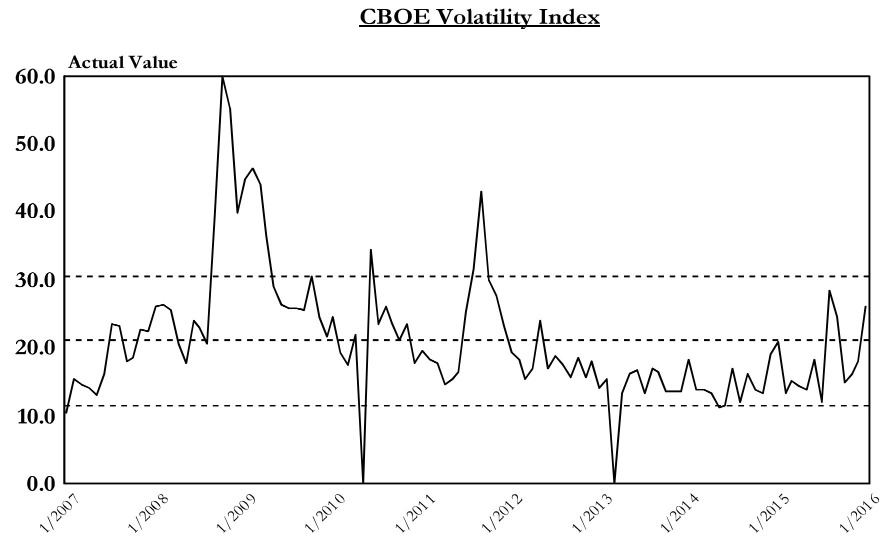


Stock Market Sentiment









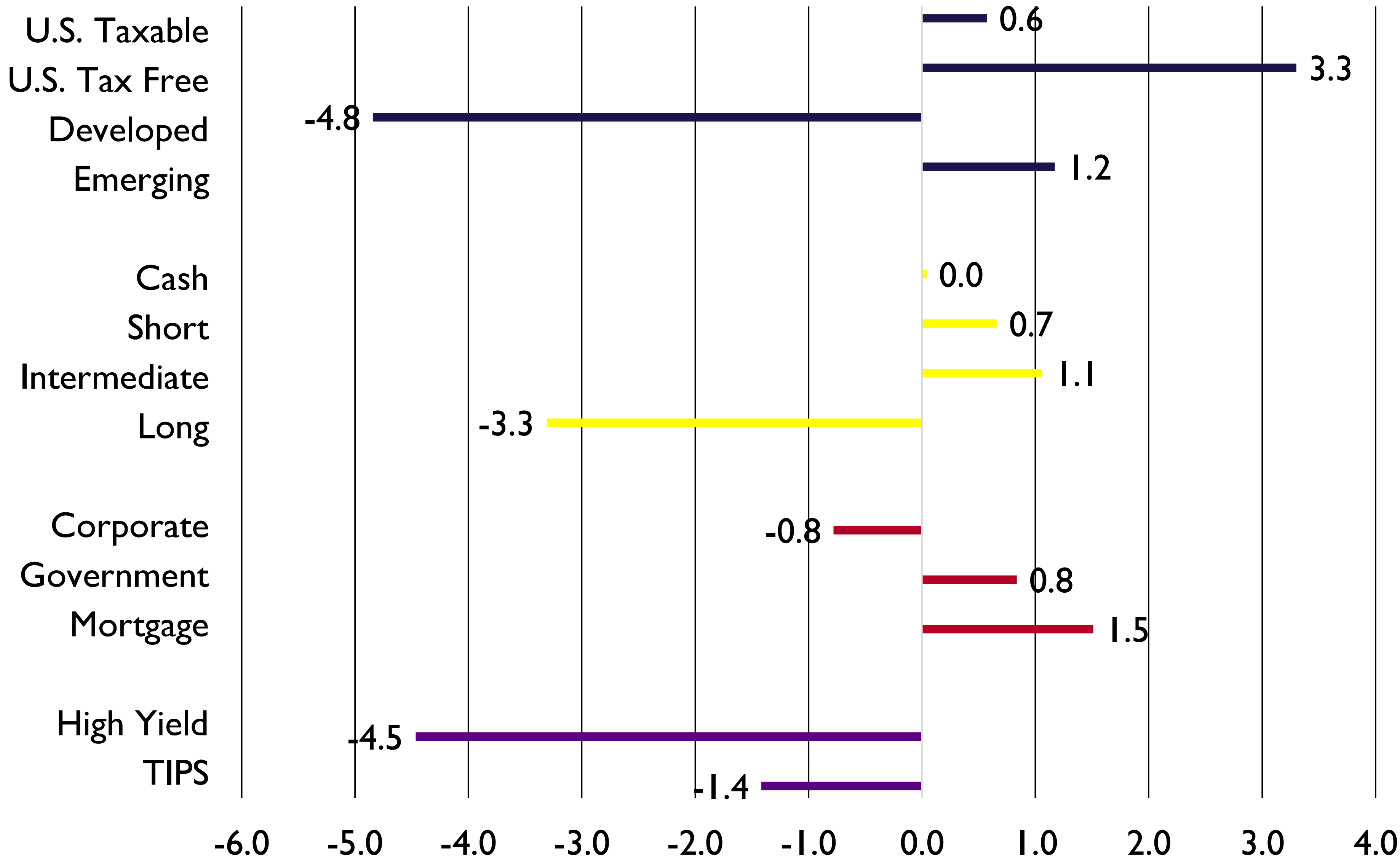
- There has been a recent change (likely due to the October correction) in stock investor "bullishness". Investors appear to be much more skeptical on the outlook for the stock market.
- For the past several years, the volatility index has been quite low. However, in October, during the correction, we saw it spike significantly. We expect the volatility index to generally increase from recent-year levels.

Bond Market

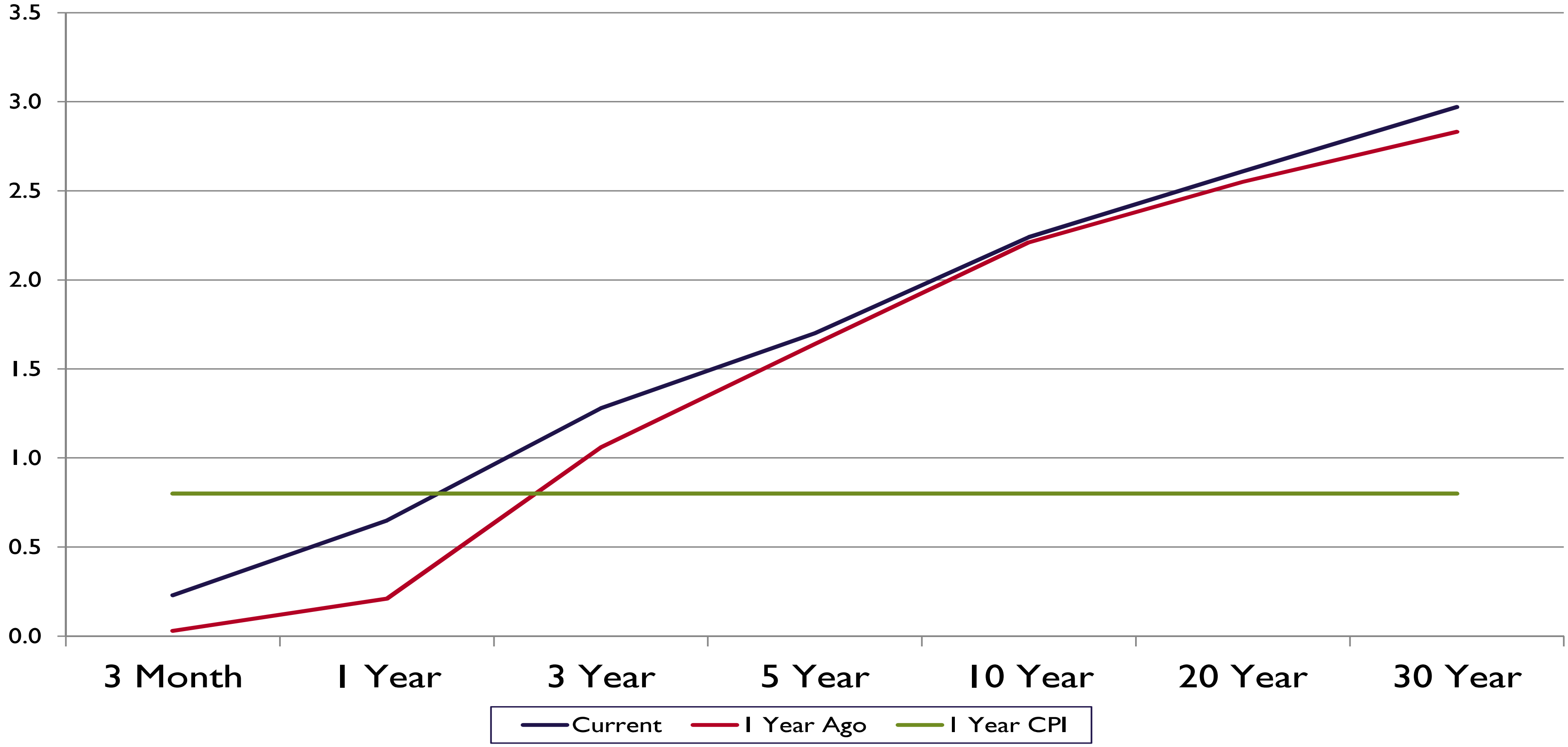
Observations

- Municipal bonds were the best performing bond segment during 2015 with a return of 3.3%. The broad U.S. bond market returned a disappointing 0.6%. Developed bonds returned -4.8% (due to U.S. dollar appreciation) and emerging market bonds (dollar denominated) returned 1.2%. High yield bonds, in part reflecting quality concerns among energy companies, returned -4.5%.
- The intermediate segment was the best performing maturity range with mortgages being the best performing sector. Corporate bonds were the worst performing bond sector.
- For the first time in nearly a decade, the Federal Reserve increased short-term interest rates by 0.25%. Going into 2016, market expectations are for perhaps up to four additional interest rate increases in 2016. While future interest rate increases are perhaps likely, we expect fewer increases -- unless the economic data improves. If there are future increases, we believe most of them will be in the second half of the year.
- Headline inflation (including energy) has been too low (below 1% for 2015). Excluding energy inflation still remains "well contained" and has generally been below 2%. The FED would probably like to see somewhat higher inflation.
- During 2015, interest rates rose in the short-maturity segment of the yield curve. The intermediate maturity segment saw very little yield change.
- The maturity spread (difference between 10-year and 1-year Treasury yields) is essentially at its longer-term historical average. Relative to its ten-year history, Treasury yields provide a below-average yield premium over inflation-protected securities. This is the result of low inflation expectations. If one believes inflation could rise, inflation protected securities offer some value.
- For the past several years, municipal bond yields have been higher than taxable bond yields. This is not a "normal" long-term condition and reflects the fragility of state / local governments budgets as well as the FED's influence on short-term interest rates. In today's environment, there is very little yield difference between taxable and tax-free bonds. Nevertheless, for taxable accounts, tax-free bonds remain somewhat more attractive.
- Corporate bond yields increased across the quality spectrum during 2015. The increase was particularly significant in the lower quality bond segments. High-yield bonds saw an over two percentage point increase in their yields. The quality spread (high yield less ten year Treasury yields) is now above it ten-year average. High yield bonds currently offer more value than at any time over the past several years. We will likely begin to re-establish small positions.

2015 Bond Market Returns

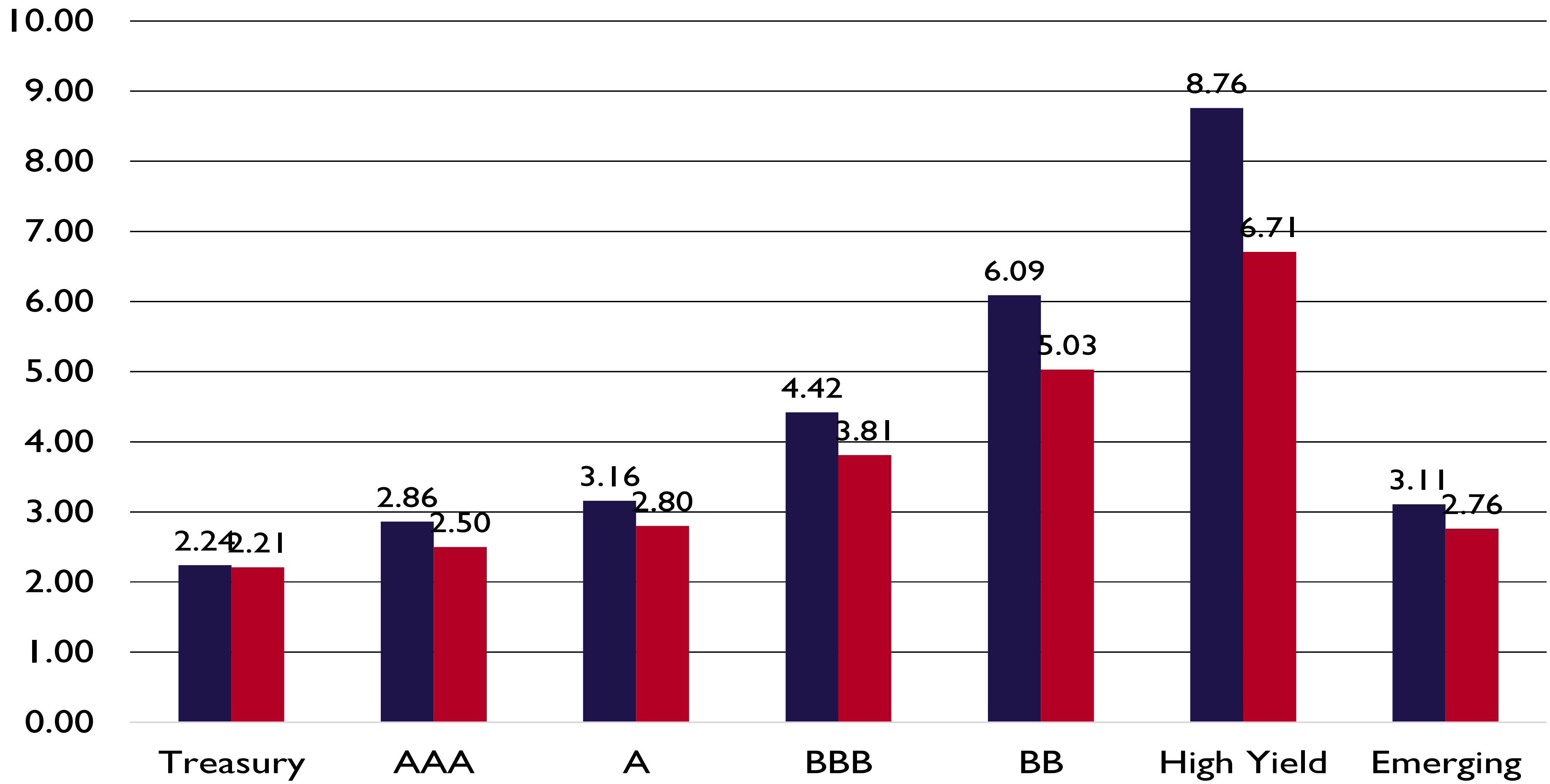


Treasury Yield Curve



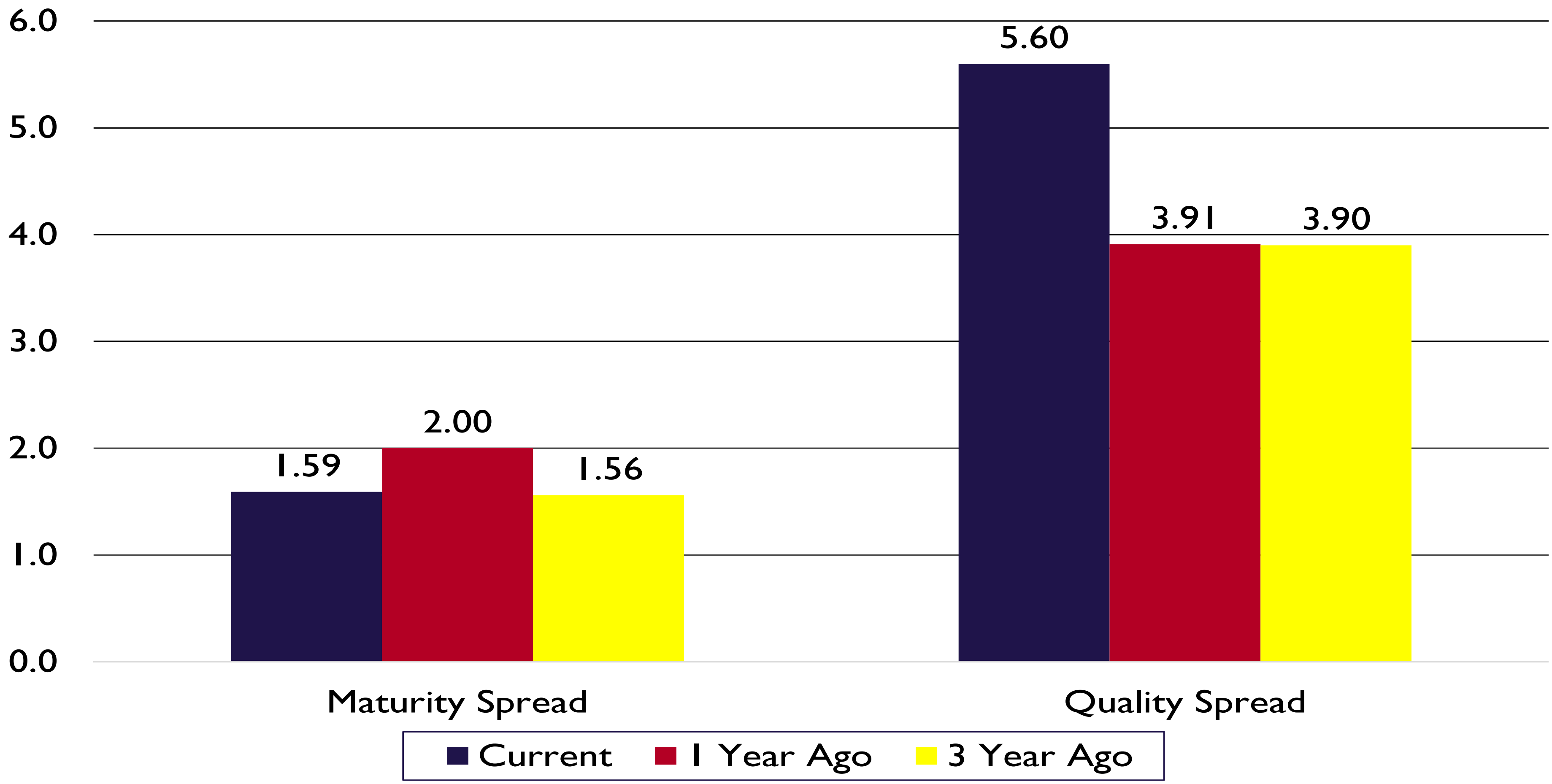
- Compared to a year ago, Treasury interest rates increased at the short-end of the curve with very little change in the intermediate section of the yield curve.

Bond Yields By Quality



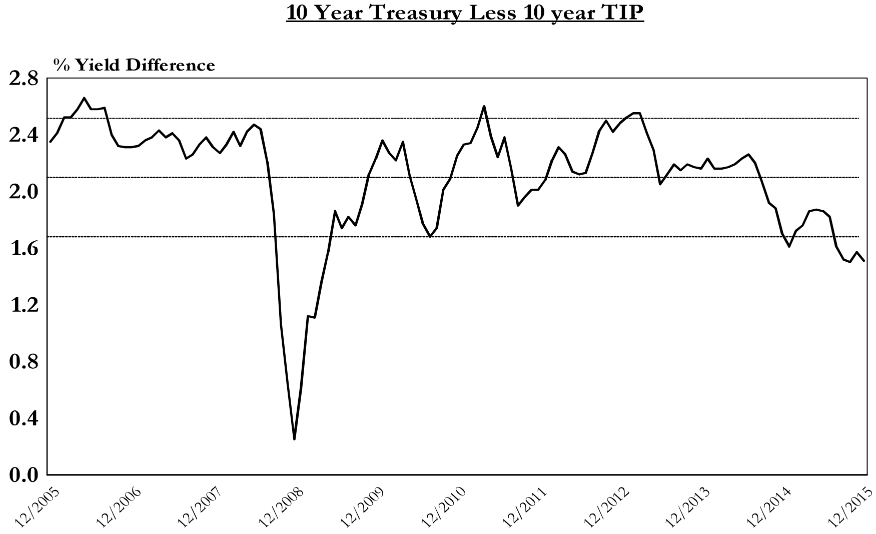
- Corporate bond yields increased, regardless of quality during 2015. The increase was higher in the lower-quality segments.

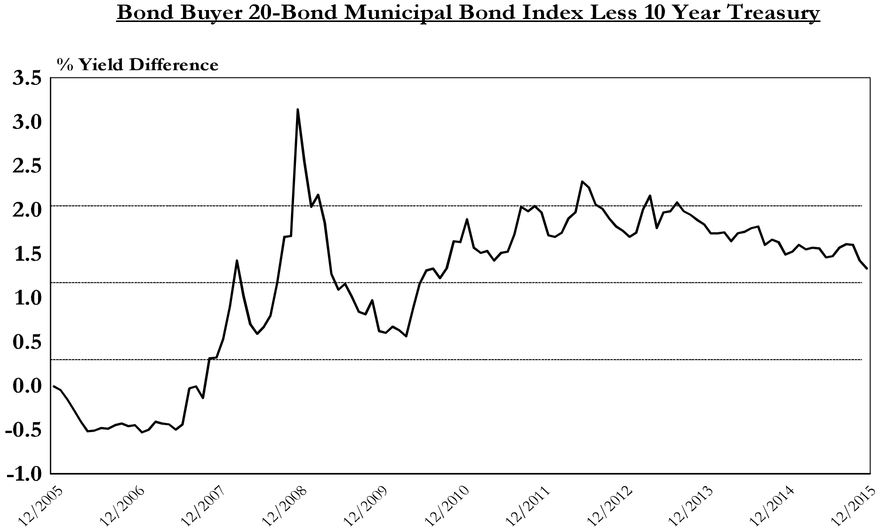
Quality & Maturity Spread

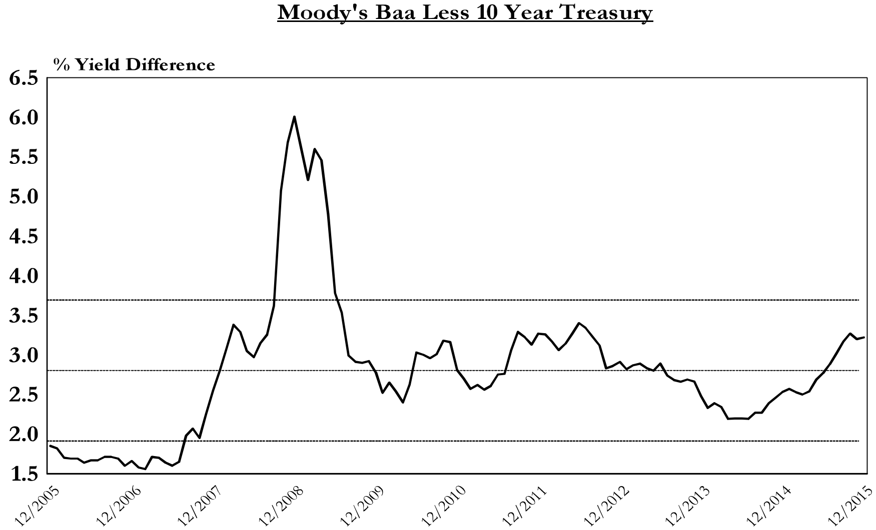


- The maturity spread narrowed during the past year, but is similarly to the spread of three years ago. At the margin, shorter-term bonds may be somewhat more attractive.
- The quality spread has significantly increased during the past year making high yield bonds more interesting.

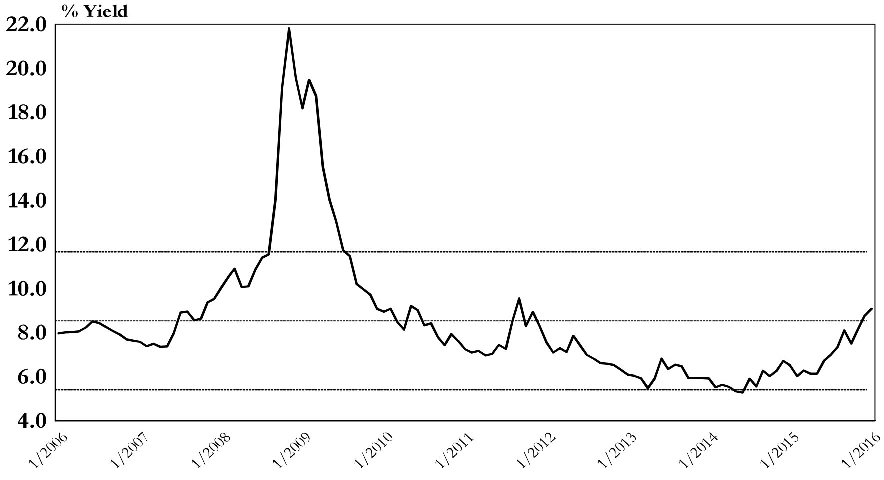

10 Year Treasury Less 1 Year Treasury
% Yield Difference
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
12/2005
12/2006
12/2007
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015


10 Year Treasury Less 10 year TIP
% Yield Difference
2.8
2.4
2.0
1.6
1.2
0.8
0.4
0.0
12/2005
12/2006
12/2007
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015

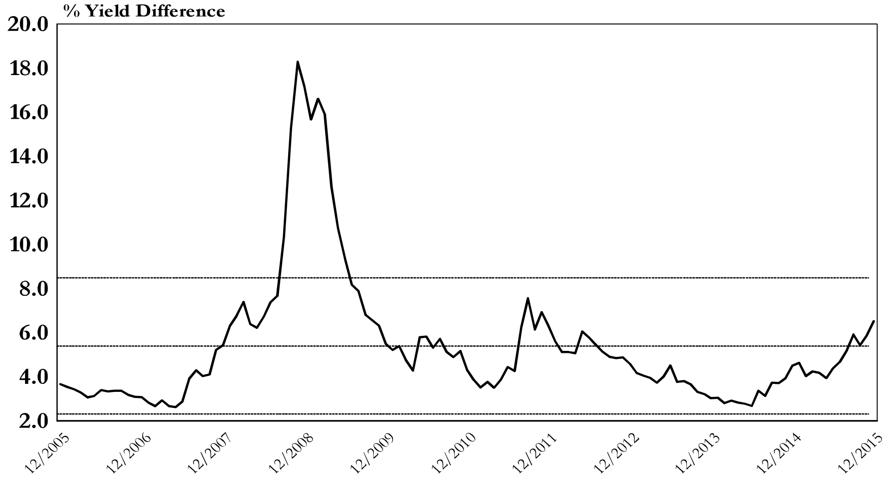

Bond Buyer 20-Bond Municipal Bond Index Less 10 Year Treasury
% Yield Difference
3.5
3.0
2.5
2.0
1.5
1.0
0.5
0.0
-0.5
-1.0
12/2005
12/2006
12/2007
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015


Moody's Baa Less 10 Year Treasury
% Yield Difference
6.5
6.0
5.5
5.0
4.5
4.0
3.5
3.0
2.5
2.0
1.5
12/2005
12/2006
12/2007
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015

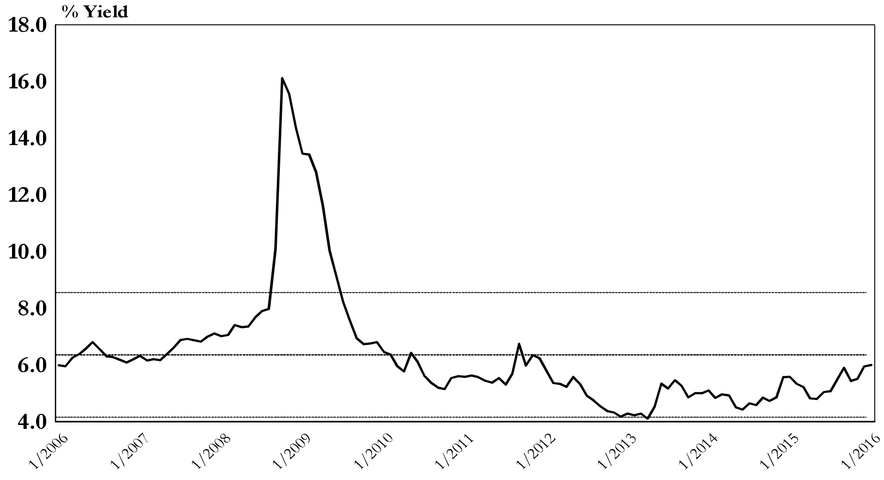
ML High Yield



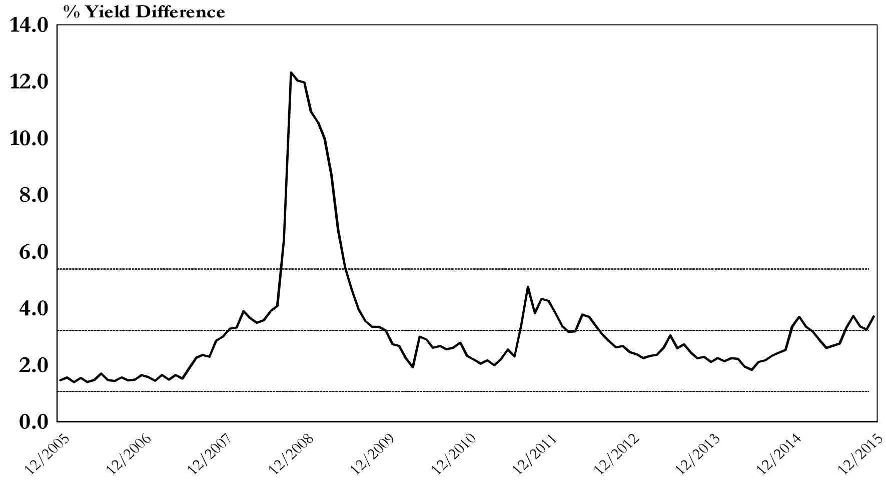
ML High Yield Less 10 Year Treasury



ML Emerging Market Corporate



ML Emerging Market Corporate Less 10 Year Treasury



Economic Conditions

General Economy & Financial Conditions

- The U.S. economy continues to grow modestly. We do not foresee dramatically higher growth than current levels. Recent indicators of future economic activity have suggested a potential slowdown in growth. This does not mean a recession is imminent -- just slower growth.

Consumer

- The consumer appears to be in relatively good shape. Durable goods growth, while lower, remains positive. Disposable personal income is growing slightly higher than it ten-year average. Consumer sentiment is pretty high. Inflation is under control.

Business

- Business growth seems to have stagnated. The growth in industrial production is declining and manufacturing and non-manufacturing purchasing managers clearly have less-robust outlooks. There is less optimism with respect to future new orders.

Labor

- The labor market has seen improvement. The unemployment rate has fallen dramatically. In addition employers appear to be interested in hiring additional workers. However, actual new hires, while growing, are not as robust.

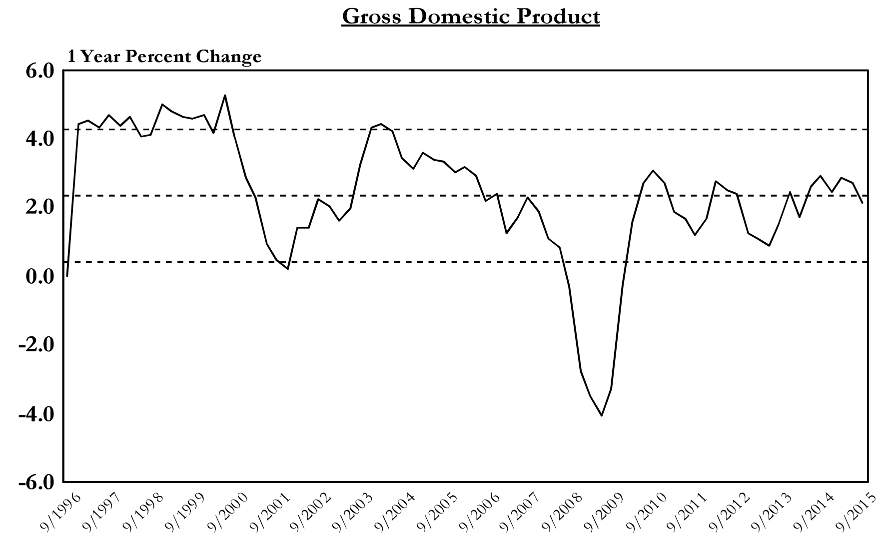
Real Estate

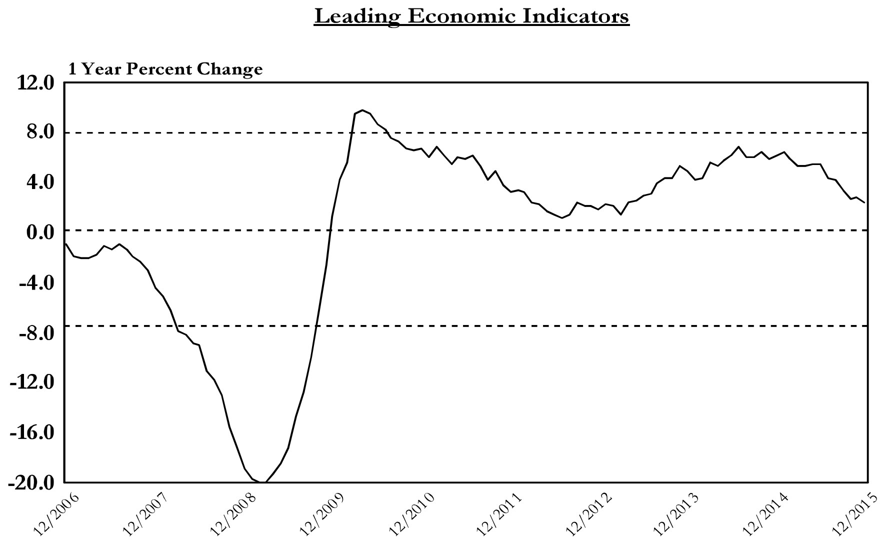
- Real estate activity appears pretty strong as sales, prices, and housing starts are all increasing. The number of months a house is for sale as declined to near ten-year lows.

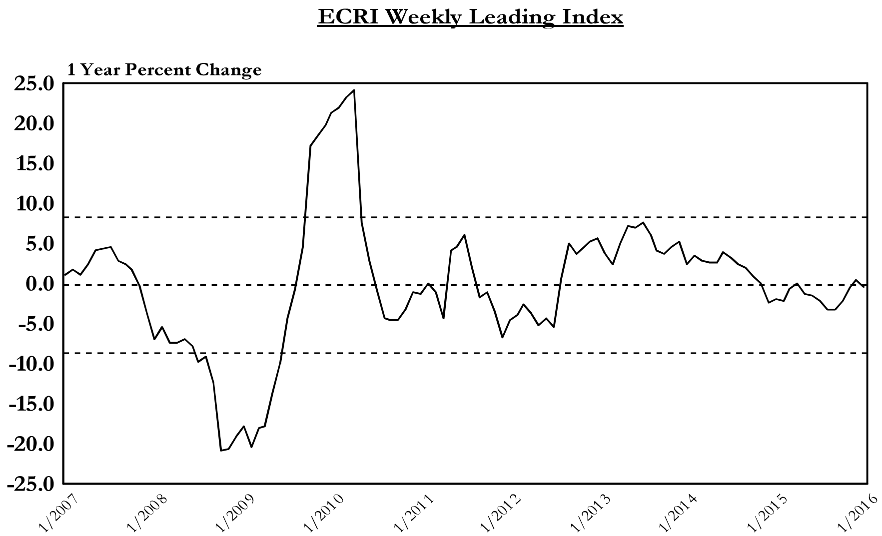
Summary

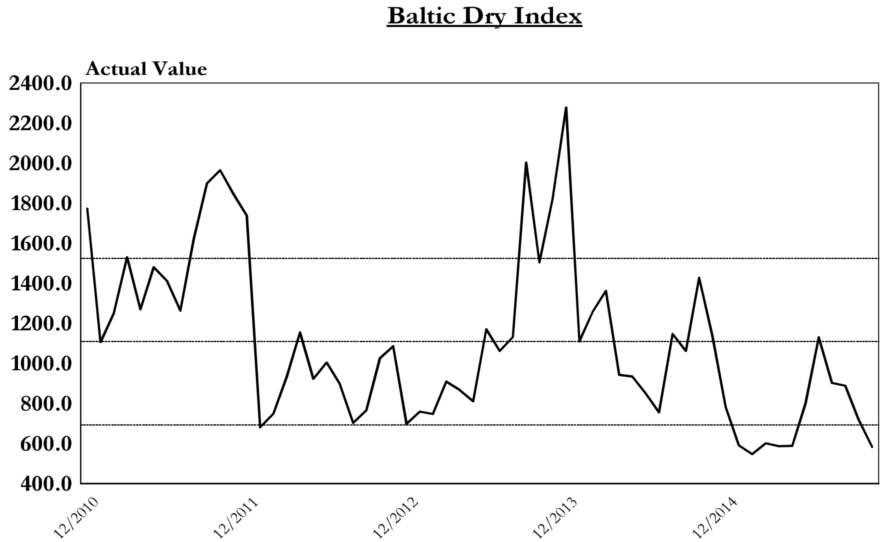
- The economy has been improving. But, it appears that in certain segments (business) we are / will be going through a slower-growth period. We expect consumers, given the dramatic decline in energy prices, to pick up some of the slack. Perhaps a recovering Europe could help. But demand from the emerging markets will clearly be a negative. It appears that modest economic growth is what should be expected.
- Given the levels of economic activity, it appears the FED believes inflation may become a concern and have hinted at additional interest rate increases. However, while the unemployment rate is low, wage growth (so far) has been moderate. Inflation continues to be below the FED's target rate. In this environment, we believe there will be more modest interest rate increases.

Economic Conditions: General Economy



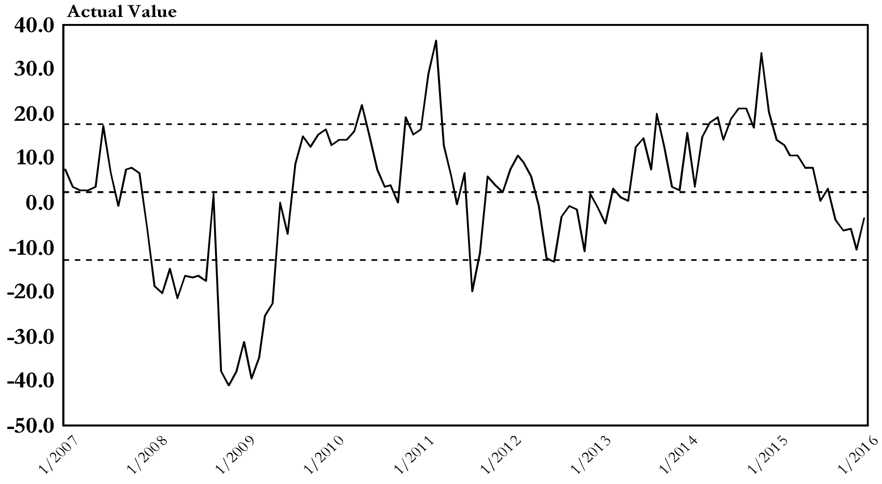




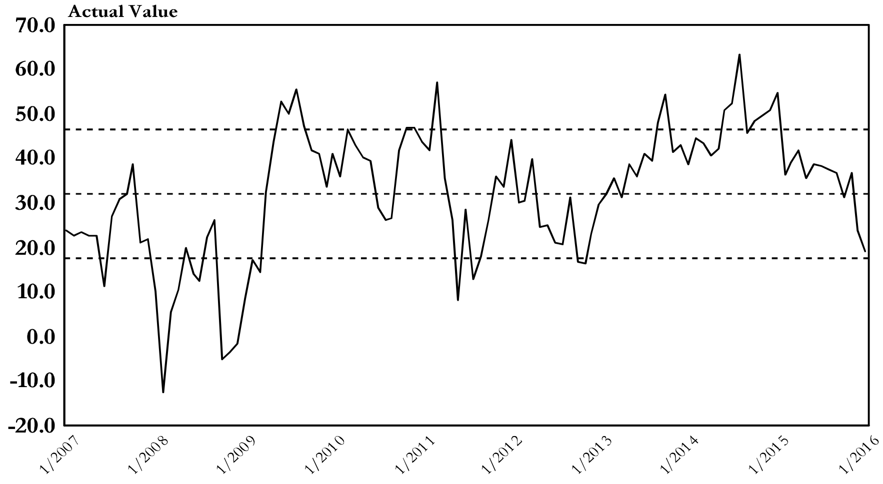


Economic Conditions: General Economy / Consumer

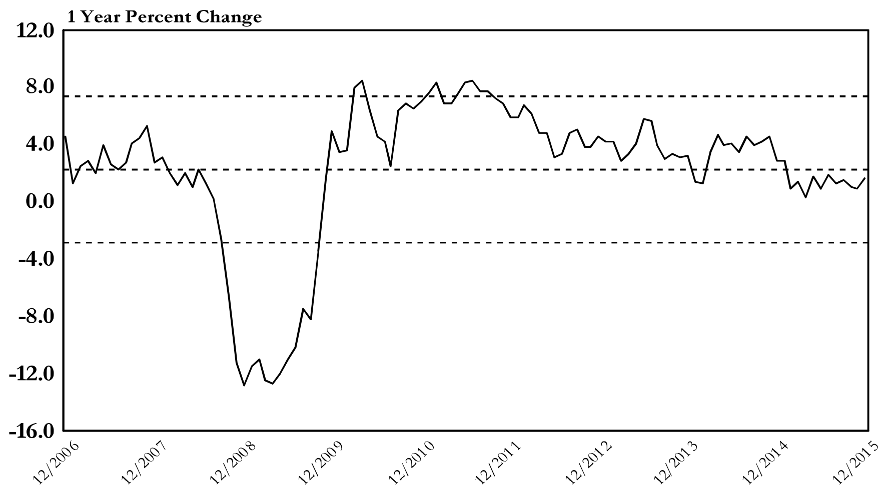
Phili Fed: General Activity - vs. Prior Month (Diffusion)



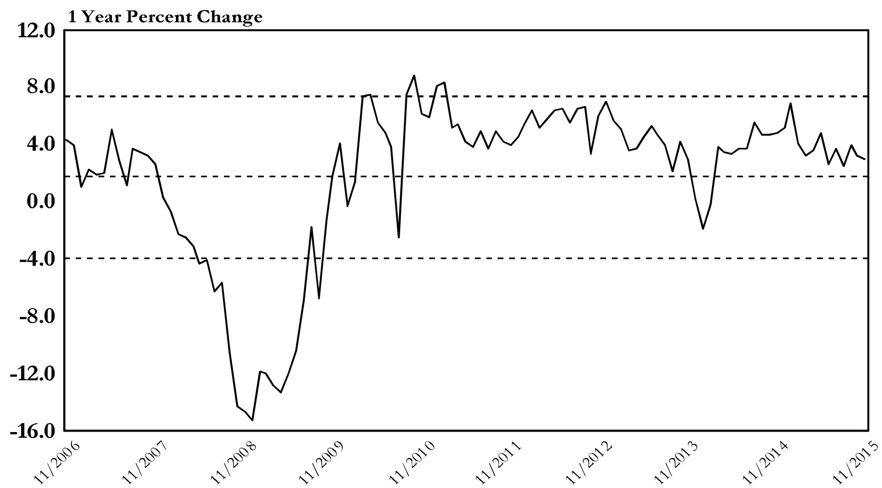
Phili Fed: General Activity - 6 Months Ahead (Diffusion)



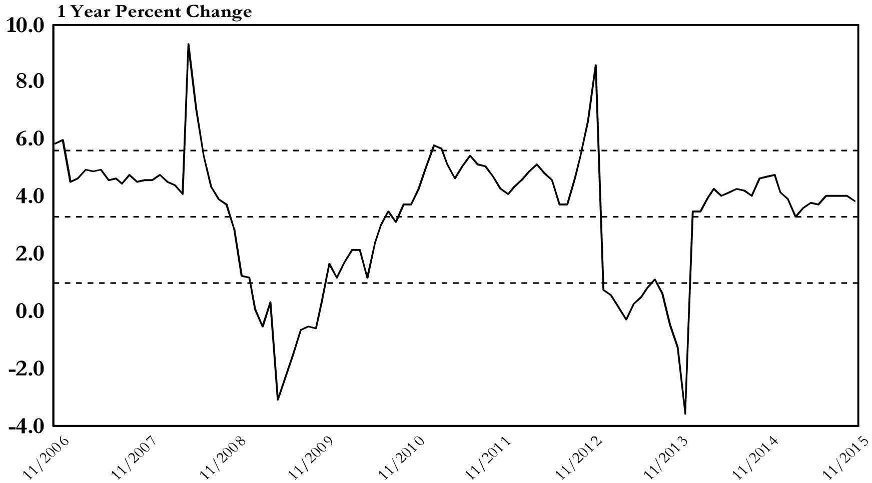
Retail Sales



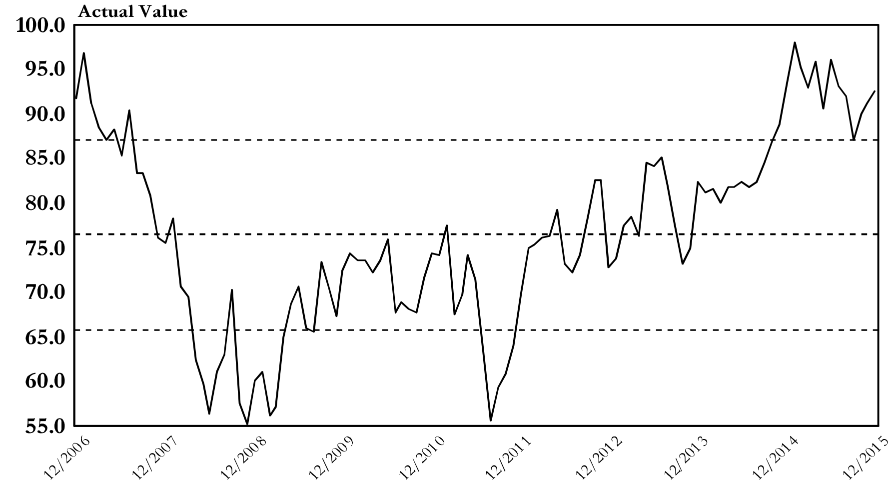
Personal Consumption Expenditures: Durable Goods



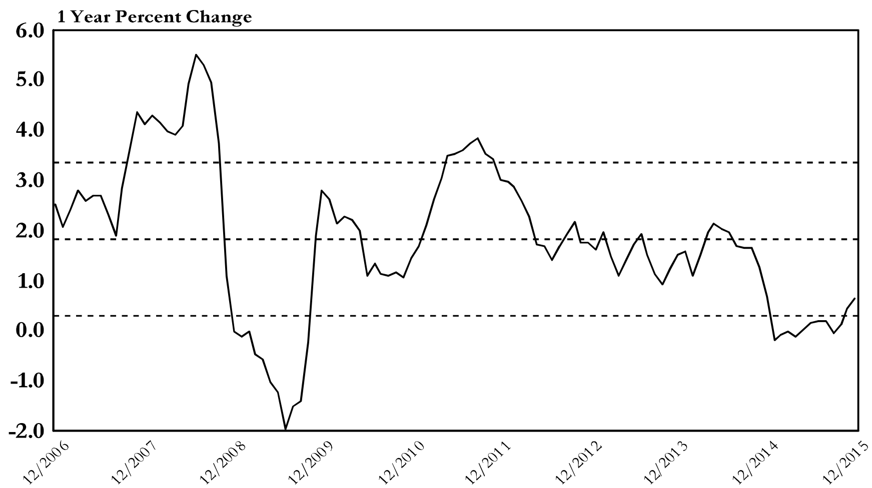
Disposable Personal Income



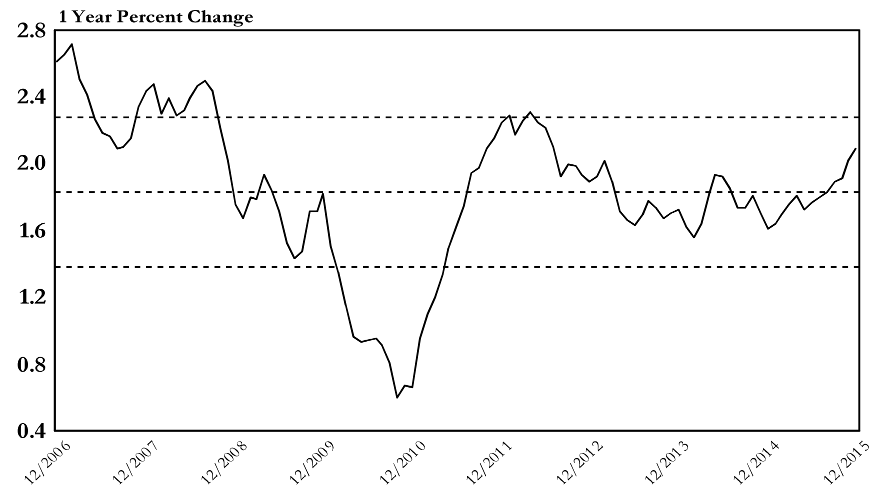
Consumer Sentiment

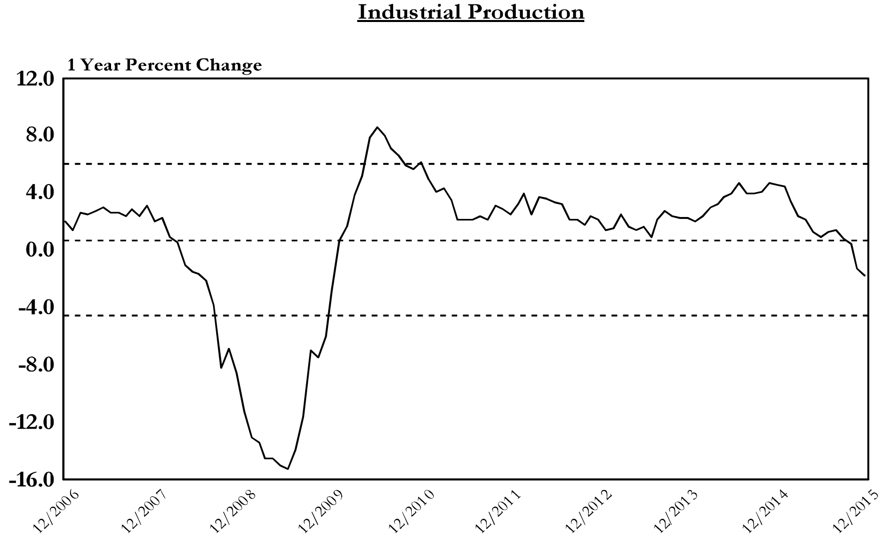


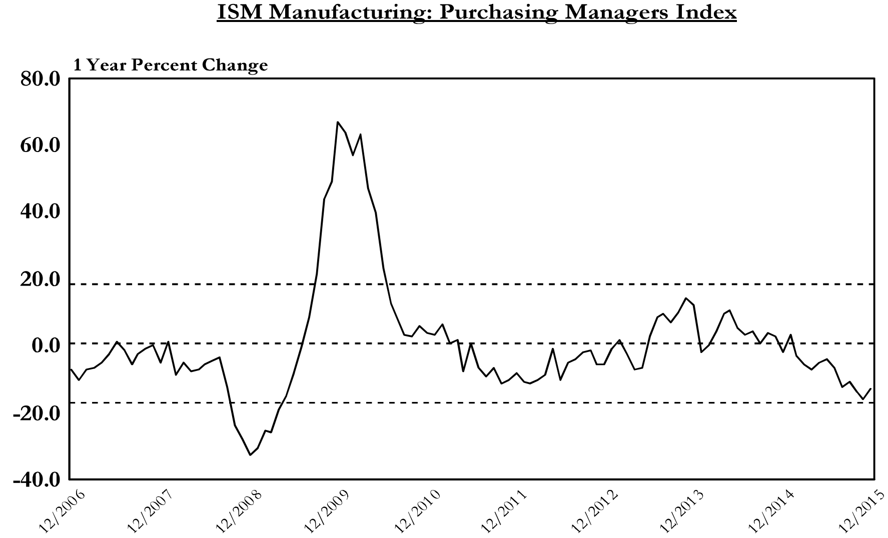
Consumer Price Index

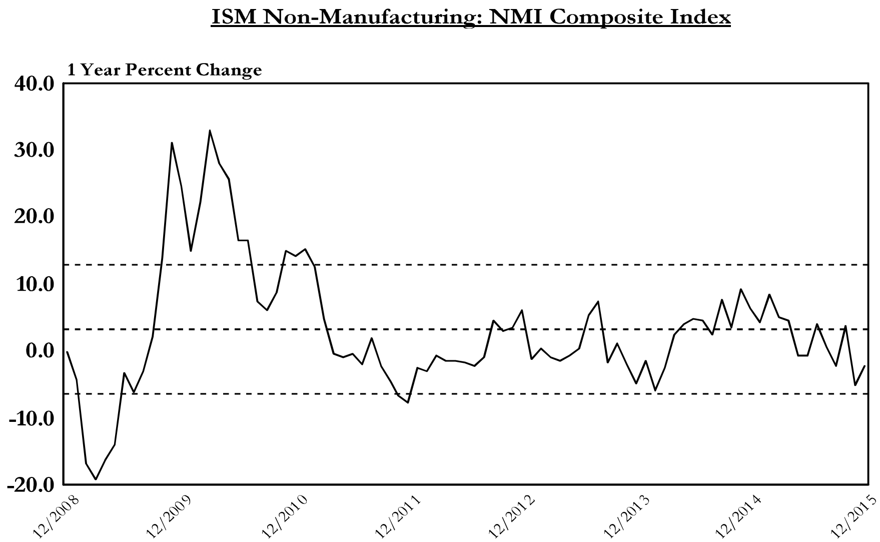


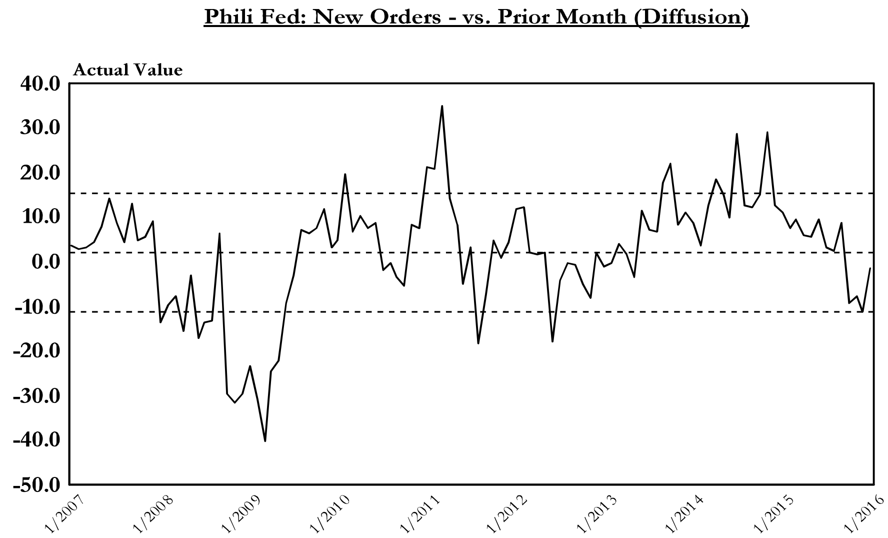
Consumer Price Index Less Food and Energy



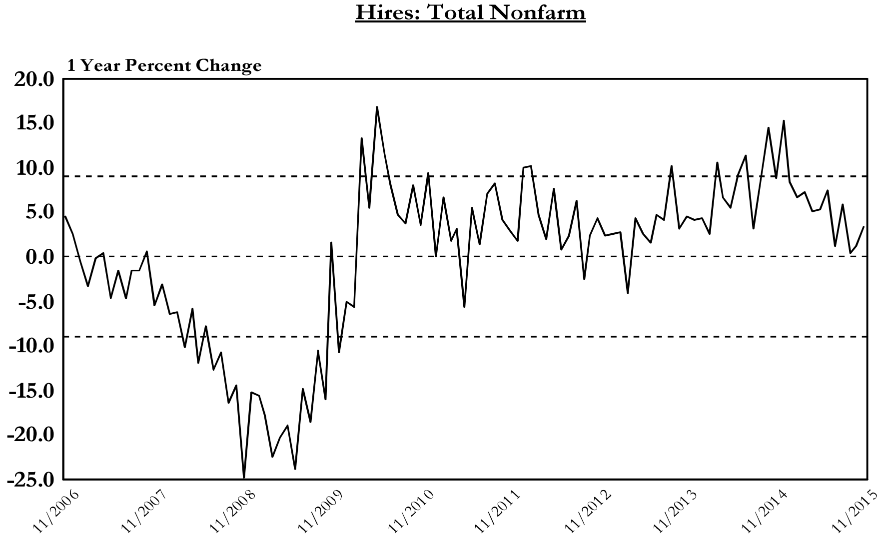

Industrial Production
1 Year Percent Change
12.0
8.0
4.0
0.0
-4.0
-8.0
-12.0
-16.0
12/2006
12/2007
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015

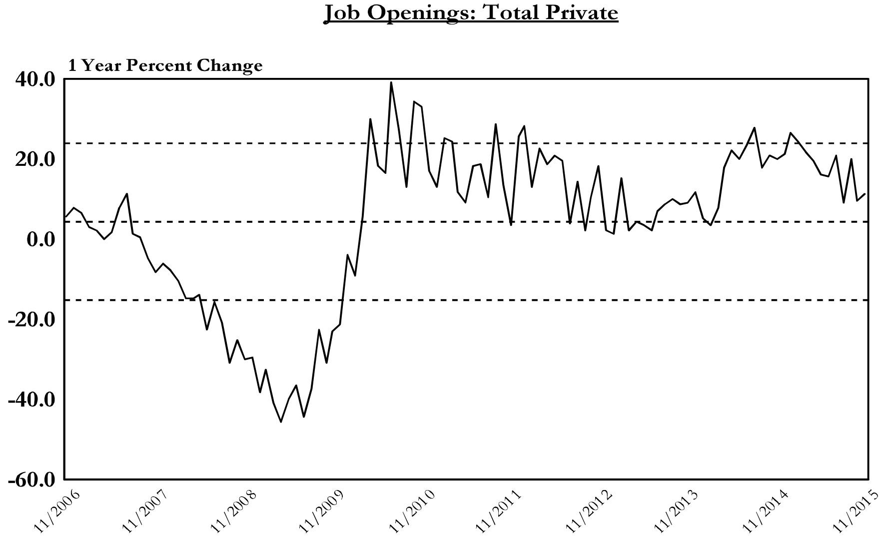

ISM Manufacturing: Purchasing Managers Index
1 Year Percent Change
80.0
60.0
40.0
20.0
0.0
-20.0
-40.0
12/2006
12/2007
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015

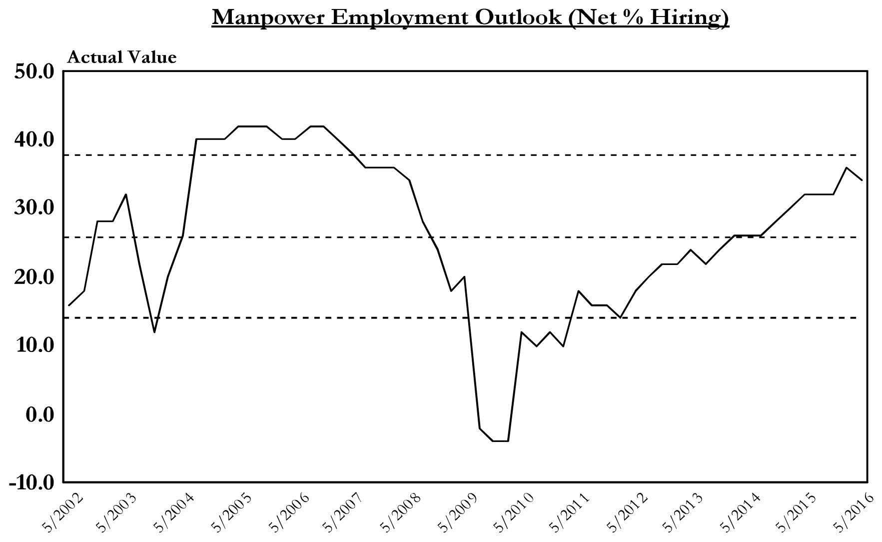

ISM Non-Manufacturing: NMI Composite Index
1 Year Percent Change
40.0
30.0
20.0
10.0
0.0
-10.0
-20.0
12/2008
12/2009
12/2010
12/2011
12/2012
12/2013
12/2014
12/2015

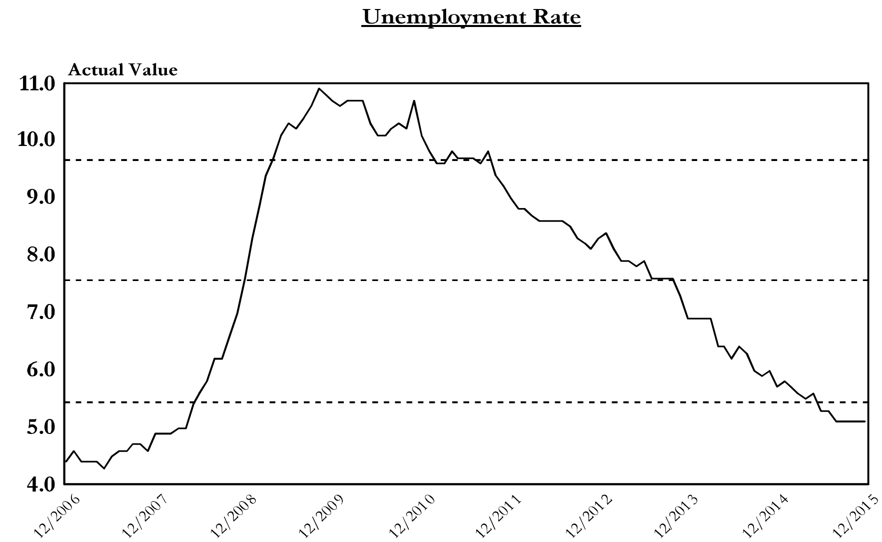

Phili Fed: New Orders - vs. Prior Month (Diffusion)
Actual Value
40.0
30.0
20.0
10.0
0.0
-10.0
-20.0
-30.0
-40.0
-50.0
1/2007
1/2008
1/2009
1/2010
1/2011
1/2012
1/2013
1/2014
1/2015
1/2016

Economic Conditions: Labor

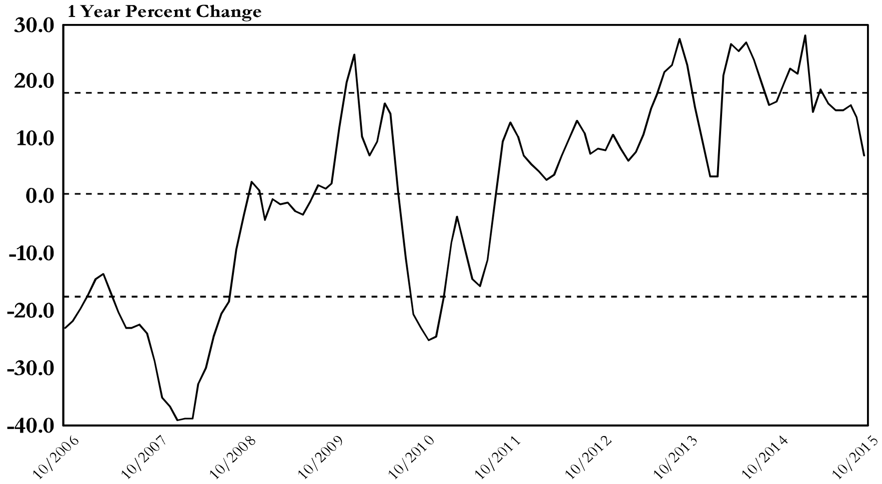




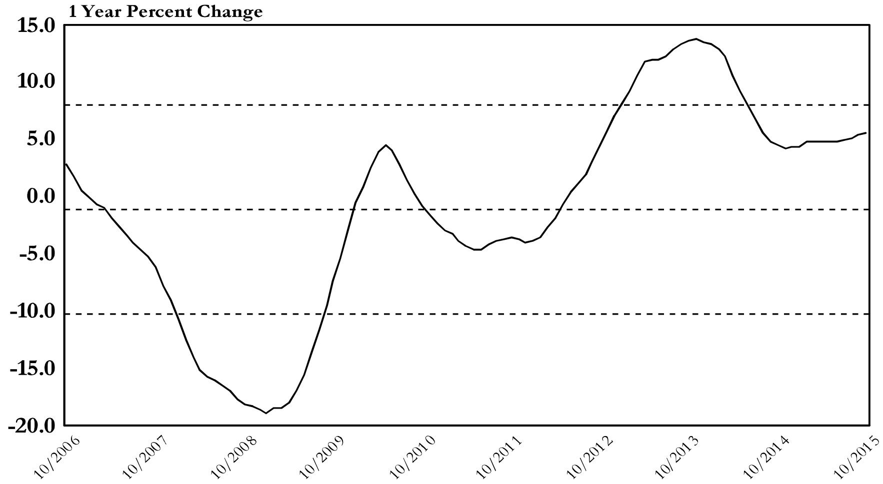




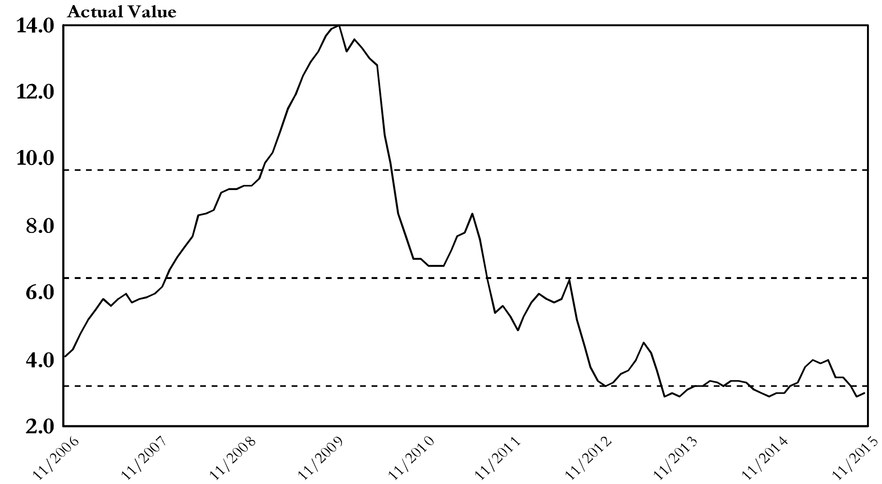
Case Schiller Sales In 20 Largest Markets



Case Schiller Home Price Index: 20 Largest Markets



Median Number of Months on Sales Market



Housing Starts