SARGENT BICKHAM LAGUDIS

JULY 2015

SUMMARY:

Implications of compound interest, the right portfolio, expenses, and performance.

Working with an advisor is estimated to add 3% to an investor's return.

The building blocks of the economic recovery are still in place.

Greece is having issues (again), but nothing to drive another major financial crisis.

China's recent volatility is more worrisome.

Learn why a financial plan is so important and how to get started.

Is a family limited partnership right for your family?

Welcome Barbara Lommen, our newest employee.

In This Letter

Market Commentary and Review

by Brad Bickham, CFA, CFP®

"Compound interest is the eighth wonder of the world. He who understands it, earns it… he who doesn't pays it". – Albert Einstein

Dear Clients and Friends,

Following are returns for the last one, five, and ten years ended June 30, 2015.

Returns as of June 31, 2015	2nd Qtr 2015	Last 12 Months	Last 5 Yrs. Annual	Last 10 Yrs Annual
60/40 Balanced World Index	-0.4	1.2	9.0	5.8
World Stock Index (ACWI)	0.5	0.8	12.2	6.7
Large Cap U.S. Stocks	0.3	7.4	17.3	7.9
Small Cap U.S. Stocks	0.4	6.5	17.1	8.4
Foreign Stocks – ACWI ex U.S.	0.5	-5.3	7.8	5.5
Foreign Stocks - Emerging	0.7	-5.1	3.7	8.1
U.S. Bonds – Taxable	-1.7	1.9	3.4	4.4
Hedge Fund Index	0.5	4.3	4.2	3.2
Gold	-1.1	-12.2	-5.0	10.0

Each quarter I begin this commentary by completing the table above. I am always curious how it will turn out, and often the numbers alone dictate the theme I will write about. It fascinates me that from one quarter to the next, the story the numbers tell can change so dramatically. Even the longer term numbers can vary widely. Only a few years ago, people were writing about "the lost decade" because stocks had a zero return over the trailing 10 years. Then, as if by magic, a few bad years are dropped from the average and a few good years are added, and a completely different story emerges. Does it surprise you that U.S. stocks have averaged 16% per year for the last 5 years?

As investment managers and financial planners, we spend a lot of time with these numbers. Their most important use is to help people and organizations plan for the future. When someone is trying to decide whether they can afford to retire, the difference between 5% and 6% might be a deciding factor because, as Einstein's quote above refers, when you compound interest over a long period of time, it makes a big difference. Similarly, an organization may adjust capital spending plans or a nonprofit may adjust gifting based on their long term returns.

On the other hand, a few tenths of percent difference in returns between indexes, benchmarks, or managers probably does not mean too much. If you

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read about investments at all, you are bombarded with information about keeping expenses low, index funds versus active managers, portfolio allocation, and other confusing advice. What's important and what isn't? Let us try and explore a few examples.

As mentioned above, for financial planning a small difference in return assumptions can make a big difference. Consider a 65 year old person considering retirement. That person has at least a 20 year life expectancy, and let us assume they are trying to decide between two portfolios and have $500,000 to invest. One has 65% in bonds, and the other has 65% in stocks. Over the last 90 years, the compound annual returns were 7.4% and 8.9% (1.5% difference). Meaningful? After 20 years, the portfolios would be worth $2.08 million and $2.75 million respectively - a 32% difference and almost $700,000. I would call that meaningful. However, the risk factor is also significantly different. The bond heavy portfolio was about 40% less volatile – best exemplified by only a 10% drop in 2008 versus a 22% fall for the equity tilted portfolio. And, after 5 years the cumulative difference is only 10%, so for those with a shorter time horizon, risk management may be more important than increasing return.

How about mutual fund expenses? Jack Bogle, the founder of Vanguard Funds, writes 'You get what you don't pay for', and in general he is correct. According to Morningstar, the average expense ratio for all equity funds in a 2013 study was 1.25%. They then studied the performance of funds after dividing them into five quintiles based on their expense ratios. They found that for equity funds 56% of the cheapest quintile outperformed the average versus only 34% for the priciest. For bond funds it was 65% versus 32%; so on average it is clear that lower expenses are better.

But how predictive is the expense ratio when comparing two funds? Over the short term, not at all. Over the longer term, it is more important, but it is unlikely to be the dominant factor. Research has shown fund size, style consistency, manager tenure, and whether the manager invests in his or her own fund to have as much predictive power as the expense ratio.

Finally, coming closer to home, is a Financial Advisor's fee a worthwhile expense or would an investor be better off using index funds and managing a portfolio themselves? Vanguard's research group published a paper last year attempting to quantify the value an Advisor can add to an investor. Admittedly, they say, the value proposition is easier to describe than to define, but they go on to compare the projected results of a portfolio that is managed using best practices for wealth management with those that are not. Their conclusion… "Based on our analysis, advisors can potentially add 'about 3%' in net returns. They go on to conclude it will not be every year, but is likely to be "very lumpy" with the value added varying based on each client's unique circumstances.

The following table summarizes Vanguard's research of value adding opportunities.

Advisor activity	**Potential added return (%)**
Asset Allocation*	0 - 1.0
Cost effective implementation	0.45
Rebalancing	0.35
Behavioral coaching / mgmt.	1.50
Tax management asset location	0 - .75
Spending (withdrawal) strategy	0 - .70
Total return vs. income investing*	0 - 1.0
Total	**~ 3.0%**

** Vanguard states 'deemed significant but too unique to each investor to quantify'. 0 – 1% estimated by SBL.*

There is a difference between investment management and other professional services because it *is* possible to invest your own portfolio, whereas one wouldn't want to attempt surgery for example. But, while I am undoubtedly biased, I strongly believe the value added by a good financial advisor will pay off in spades over time – it just might not show up in a given year compared to a benchmark or index.

Market Environment and Strategy

Greece

As the second quarter ended and the third began, the international markets began convulsing. Greece once again led headlines with daily swings in opinion about whether they will remain in the Eurozone or not. One of the best summaries we saw came from Bank Credit

Analyst titled 'Ten Questions on Greece' published June 29th. Here is their summary (somewhat abbreviated):

Can Greece cause a correction? Yes, especially given the context of valuations and upcoming Fed tightening.

What went wrong this weekend? Policymakers are playing a two level game with domestic politics influencing international bargaining. It takes a crisis to get policymakers to overcome domestic opposition.

What is the upcoming timeline of events? The key date is the 3.5 billion euros Greece owes to the European Central Bank (ECB) on July 20.

Will the ECB pull the plug on Greece? Yes, if the July 20 payment is not made.

Was the referendum a vote on euro membership? No. Athens still has until July 20 to get a deal.

How does Greece exit the euro area? By printing drachmas. Everything else is ancillary.

Can 'Grexit' produce substantive contagion beyond sentiment? No. It is a source of volatility in the short term, but a buying opportunity in the long term.

Is Greece better outside the euro area? Not a chance.

Are there geopolitical ramifications of the crisis? Yes; positive for European integration, negative for Greece, neutral for Russia.

So what should investors do? Prepare for short term volatility, look for long term opportunities.

Is Greece the next Lehman Brothers? No.

China

At the same time as the Greek drama is unfolding, Chinese equities have also been hammered – roughly $4 trillion in value has been wiped out. The Shanghai index is down over 30% and the Shenzhen index is down 40% from mid-June. But these drops are after extraordinary gains over the last year. Starting last summer, those same indexes gained over 150%. Even after the recent losses they are up about 70%.

China is a strange mix of capitalism and state control; and control is the operative term. The government wants to manage and control everything from free speech to markets. First, they wanted to stimulate the markets to help the economy, so they relaxed margin rules, lowered interest rates, encouraged government pensions to buy stocks, cut securities transaction fees, and trimmed banking reserve requirements. Now that the market is falling they have suspended trading on 51% of all stocks and even sent the police to investigate "malicious short selling". I have been surprised at the extent China has been able to control the internet (and thereby free speech) and the economy, so maybe they will be successful at controlling the market, too. We will see.

Should we care? Yes. China is the second largest economy and has significant demand for commodities, oil, metals, and food. Copper has fallen to a six year low, and Chinese demand has contributed to the weakness in oil prices. However, pundits have been predicting a crash of one type or another in China for years, and I'm beginning to believe crash predictions are more hype than substance. Nevertheless, China is still an emerging economy and as such will add more volatility and uncertainty to global growth.

Investment Pillars

The basic building blocks for a positive investment stance remain in place. Inflation and interest rates remain low. The Fed is still likely to raise rates this year, but only modestly and the timing continues to be pushed out by a weak economy and the global situation. Year over year earnings growth was -5.6% through 1Q15, but excluding energy companies it was +8.5%. The forward PE ratio is 16.4 vs a 15.9 average for the last 15 years. GDP was slow in the 1st quarter, but is expected to rebound to 2.3% growth in the 2nd quarter by the Atlanta Fed's GDPNow forecast, and the IMF predicts 3.3% growth for the global economy for the full year – slow but positive. Despite Greece and China, the St. Louis Fed's Financial Stress Index remains low; and finally politics and government policies will remain benign until next year's general election.

Strategy and performance

Year to date returns for balanced portfolios were in the 1% to 1.5% range through June 30th, depending on allocation and client specifics. This was right in line with the balanced indexes we track. The returns were almost double that amount just a few days before the end of the quarter, but the aforementioned crises in Greece and China pulled equity markets lower in the final week. Nonetheless, equities were the best performing asset class. For SBL, our individual stock portfolios had the best relative performance along with one or two large cap mutual funds. It is too early to claim victory, but after a tough last year in comparison to the S&P 500, it is nice to have outperformance by active management. Bonds were flat and our Tactical Bond and Alternative Strategies added a little value, but the returns were modest at best.

Focusing on the 2nd quarter, balanced accounts were down slightly – around 0.5%. Bonds and income related investments fared worst, down about 1.5%. Long term bonds and REITs were down more, falling 10%. Equities were mostly flat.

Has the long awaited reversal of interest rates arrived? It is too early to say. The Fed is nearing the point of raising short term rates, but balancing that is the global market turmoil. It is unlikely we will see rates rise significantly in this environment, and inflation remains benign.

We remain neutral in our equity targets. The fixed income allocation is our greatest concern and area of research. We are searching for the right combination of bonds or fixed income alternatives to achieve safety and a decent return. This has been a challenge for the last few years and is not going to get easier as rates rise. This is one of the consequences of the Fed's policy and there is no magic bullet. There is simply no security or mutual fund that offers a yield without accepting either duration or credit risk.

Finally, we increased international investments in the 2nd quarter. Relative to the global equity index ACWI, we remain far underweighted at about 25% of our equity allocation, but with the ongoing risks in Europe, Asia, and the emerging markets, we believe this is about right. As stated above, this may turn out to be a good time to add to international holdings and we will be evaluating the situation as it unfolds.

Financial Planning

Why Create a Financial Plan?

By Viktoria Falus, CFP®

Most people have life goals for themselves and their family. These might include buying a home or business …saving for college education for their children … taking a dream vacation …reducing taxes …retiring comfortably. Financial planning is the process of managing your finances so that you can achieve your dreams and goals in every stage of life.

Financial planning can help you set realistic financial and personal goals. It can help you assess your current financial health by examining your assets, liabilities, income, insurance, taxes, investments, and estate plan. The planning process is designed to help you develop a realistic, comprehensive plan to meet your financial goals. Having a financial plan in place enables you to take guided action to reach the goals defined in your plan. Having a clear plan of action makes it easier to monitor your progress and stay on track. Regularly updating your plan helps make sure that adjustments are made as your circumstances change, and also ensures that your plan is up-to-date with tax law changes and new financial products and strategies.

What are some life events or needs that might trigger the need for a financial plan?

- Planning for retirement
- Handling the inheritance of a large sum of money or other unexpected financial windfall
- Preparing for a marriage or divorce
- Planning for the birth or adoption of a child
- Facing a financial crisis such as a serious illness, layoff, or natural disaster
- Caring for aging parents or a disabled child
- Coping financially with the death of a spouse or close family member
- Funding education
- Buying, selling or passing on a family business

What are some of the most important questions that a financial plan can help you answer?

1. Do you know how much you save or spend each year?
2. What is my current net worth?
3. What are the five most important things I want to accomplish in my life (bucket list)? Do I have the proper amount of resources to accomplish my goals? If not, what do I need to do to get there?
4. If something were to happen to me, will my family be able to put everything together?
5. Do I have the proper amount of insurance so my family will be taken care of if I die, become disabled or am sued?
6. Is my estate plan up to date and do I have a will, a durable power of attorney, a healthcare proxy, or do I need a trust?
7. Is my investment portfolio and risk level in line with my financial planning goals?
8. Have I named the proper beneficiaries of my insurance and retirement accounts?

Our financial planning team is available to help answer these and to help you develop a plan to reach your goals. Please contact us if you have any questions about the financial planning process or if you would like to get started.

Family Limited Partnerships

By Gary Powell

An estate planning technique that is commonly used to pass assets to future generations is the Family Limited Partnership (FLP). This technique incorporates valuation discounts (generally 30%) for minority ownership interests in the FLP. The economic justification for the discounted value is based on a minority interest being less valuable than an interest greater than 50%.

Over several years, the IRS has been reviewing the discount and has opposed this minority discount in a number of court cases. The IRS has indicated that they intend to take steps to reduce or eliminate the discount, which would make this estate planning technique less attractive. Because the IRS review and opposition has been ongoing for a number of years, we suggest that you contact your estate attorney about the appropriate time to move forward with an estate plan that involves a family limited partnership before there are any changes to the tax code.

Company News

By Patty Meneley, COO

We are happy to announce that we have hired another great team member at SBL. Barbara Lommen joined us in June as an associate advisor. She will be working with Luke in Denver and providing financial planning and advisory support for our Denver clients and we are thrilled to have her. We are also in the process of locating new office space in Denver, so stay tuned for more info on our new Denver location towards the end of the summer.

If you haven't yet explored the Schwab mobile app, you should! Two of our team members, Christiana and Barbara, recently attended a Schwab Solutions Workshop and learned about all the latest enhancements to these tools (among other things). Many of us use them for our own accounts and really appreciate the efficiency and speed offered by these mobile options.

We are in the process of onboarding a new tool for the production and distribution of Quarterly Reports. Look for a whole new statement towards the end of this year and a new way to deliver your report. We will be adding a client portal where you can log in to retrieve your reports. Or, if you prefer, you can continue to receive them via email or by regular mail. We are continually working to upgrade our cybersecurity and are excited to be able to offer you the option of a secure portal where you can both receive reports from us and deliver documents back to SBL. Stay tuned for more about this new tool next quarter.

The Last Word

By Rick Lawrence, CEO

One day last week I was at breakfast with a friend (and potential client). We were discussing the value one receives in exchange for the fee paid to Sargent Bickham Lagudis, and working through our own analysis of whether it will be smart for her family to have us manage their money. I wish I'd had an advance copy of Brad's comments with me for that meeting!

How often does a newsletter from a financial advisor take on the subject of whether the advisor's fee is justifiable?

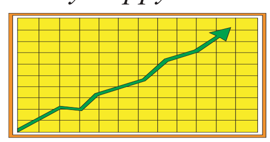
But the Vanguard study that is discussed in this newsletter doesn't capture it all. That was a mathematical analysis based only on the financial returns realized in a portfolio. There is more to our story, as many of you know. I hope you will read the rest of our newsletter.

In their section, Gary and Viki provide great food for thought about financial plans, what triggers the need for a plan and what kinds of questions can be answered by going through the financial planning process. Not to mention that a well-reasoned financial plan creates another layer of context against which your account's financial results can be viewed and understood. We believe in this stuff! We have six Certified Financial Planner™ professionals on our staff. And (back to the Vanguard study), we provide financial planning services to all clients as a part of your relationship with us – at no additional fee.

Patty mentioned the work she is doing to improve our client statements and our upcoming investment in a new Denver office location. There will be more communication about those important initiatives in the next few months. And I echo her comments welcoming Barbara Lommen (who passed her Certified Financial Planner™ exams last year!) to our staff in Denver. She has been a terrific add to our team.

Thank you for your business.

Many happy returns,



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