January 27th 2014

MONTHLY INVESTMENT OUTLOOK

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UPCOMING EVENTS

- 02/12: **The Importance of Estate Planning** with attorney Nadine Aarsheim
- 05/07: **Top 10 Strategies to Enhance the Value of your Business** with M&A attorney Jessica Karner
- 09/15: **Maximizing the Value of your Privately Held Business** with David Ryan of Upton Financial
- Dec '14: **Vital tax Changes and Your Checklist** with Coree Cameron of Cameron Coffey & Kaye

SPEAKING ENGAGEMENTS

- Feb 10th: **Lenore Hawkins in Irvine, CA** on Currencies to Profit and Protect, sponsored by **Merk Investments, Morningstar and Deutsche Bank**
- April 23-25th **Lenore Hawkins in Monaco** at the **XIIth International CIFA Forum**

Meritas Advisors structures portfolios to meet our clients' personal goals and preferences within the scope of their risk tolerance. We strive to manage risk most effectively by utilizing a wider blend of asset classes, with the objective of achieving our client's goals with a reduced amount of overall portfolio volatility.

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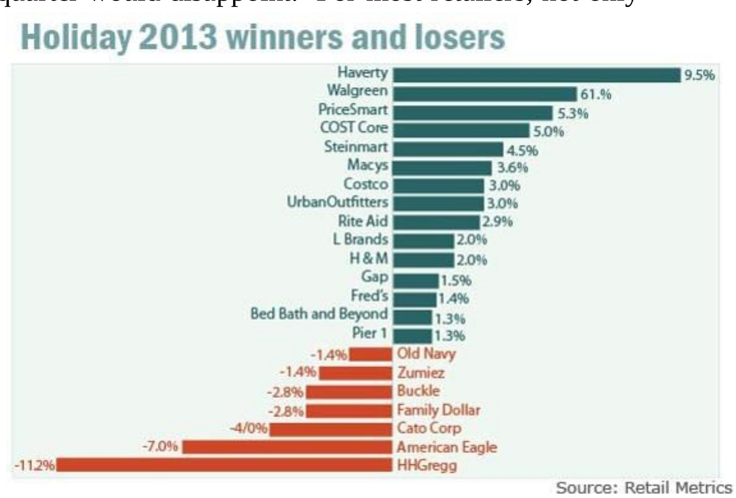
Dear Clients and Friends: Last week was the worst week for the markets in over a year, with January getting the New Year off to a decidedly rocky start. Does this portend a volatile year or are these just periodic market jitters? Read on to learn more.
Lenore Hawkins, Principal

Market Update

While 2013 closed with equity markets up dramatically, 2014 has so far been much more challenging. Last Thursday the Dow dropped 176 points, among the worst one-day falls in six months, leaving the index down 2.3% for the year and Japanese stocks faced their biggest drop in 7 months. Friday continued the downward trend with markets again falling and the Dow Transports collapsing 3.25% at Friday morning's opening, its biggest drop in 9 months. Friday the S&P500 fell 2.09%, closing at -3.06% year-to-date. Meanwhile gold is making a comeback, trading at levels not seen since last November. Earlier this week the Wilshire 5000 index was worth about 116% of US GDP. Warren Buffet considers any reading above 115% to indicate a potentially overvalued stock market. **Bottom Line**: *Last year the US equity markets appeared to ignore the majority of the underlying challenges facing the domestic and global economies. The Fed's imminent tapering coupled with increasing fears of major troubles in China and India appears to have ignited a period of "risk off" in a relatively hot market. However, we believe the Fed hasn't yet lost its ability to move markets thus we think it unlikely that we'll experience a major correction in the first half of the year, barring any macroeconomic or political surprises. The good news, this year is likely to bring more of these market fluctuations which provide investors with attractive entry points.*

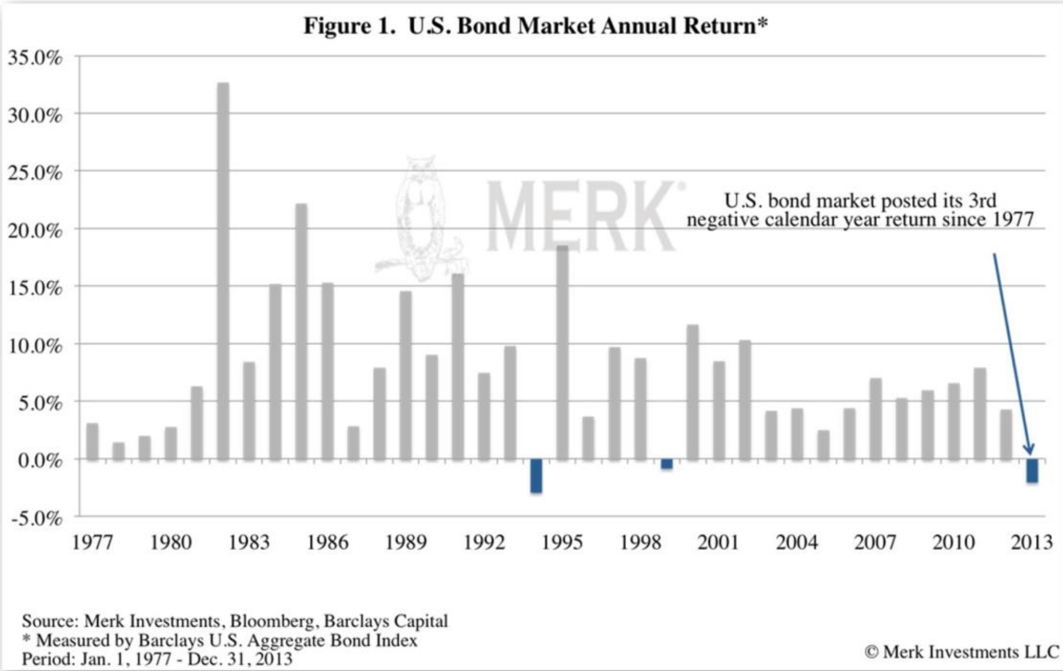
Holiday Retail Report

According to the National Retail Federation, holiday sales increased 3.8% in November and December, just shy of the group's forecast that sales would rise 3.9% and the slowest growth since 2009. A wide range of retailers, from Lululemon to Express and American Eagle Outfitters, warned investors that earnings in the holiday quarter would disappoint. For most retailers, not only was topline revenue below expectations, but margins also declined due to the pressure to increase promotions. **Bottom Line**: *Unemployment, underemployment and lackluster real household income levels do not translate into robust consumer spending.*



Bye Bye Bonds?

While US equity markets enjoyed a booming year in 2013, it was the first negative year since 1999 for the US Bond market. The chart below shows the Barclary's US Aggregate Bond Index's annual returns since its inception in 1977.



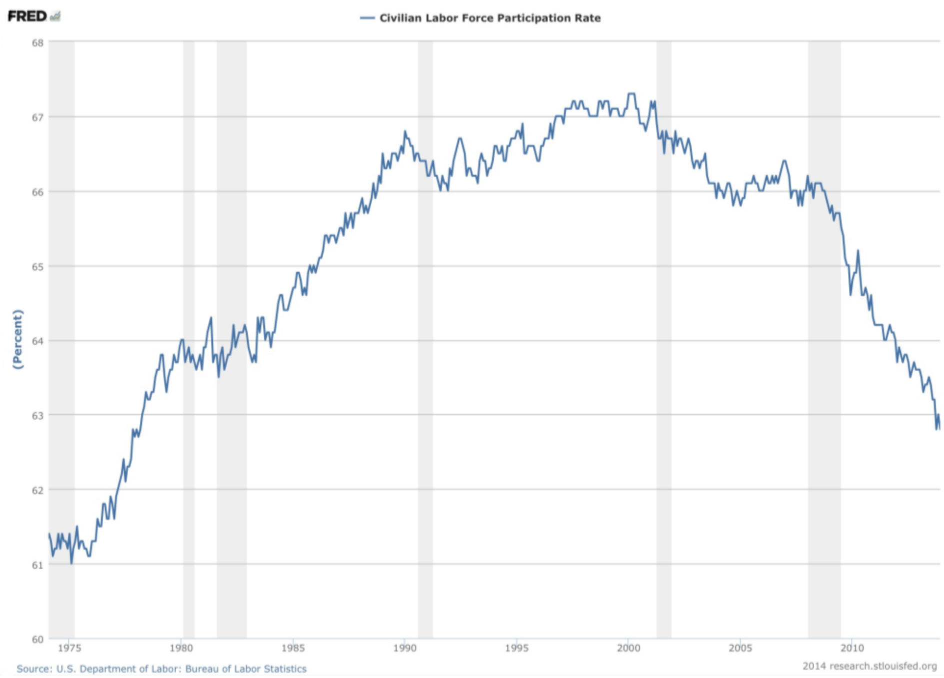
Bond yields are currently near their historical lows. The Fed, currently the single largest buyer of Treasurys and mortgage-backed bonds, buying about 90% of the newly-issued eligible mortgage bonds last November, is expected to decrease its purchases over the coming months and years, which could be a headwind to bond prices. Starting this month the Fed is reducing its monthly purchases of Treasurys from $45 billion to $40 billion and its purchases of mortgage securities from $40 billion to $35 billion.

On January 7th, Janet Yellen was confirmed by the Senate in a 56-26 vote to serve as the next chair of the Federal Reserve, the first woman to lead the Federal Reserve in its 100-year history. Yellen is widely considered to be more of a "dove" than a "hawk" on the Federal Reserve Open Market Committee, (FOMC) meaning she is more concerned with improving unemployment than with the risk of rising inflation levels, thus we believe tapering is likely to be more muted under her leadership than had a more hawkish candidate been selected. She is a decided Keynesian economist, thus is also likely to continue using the power of the Central Bank to boost markets in an attempt to improve economic growth. **Bottom Line**: *With such low yields and tapering likely to increase over the coming months, bonds, and more specifically, long-term treasuries, may not provide the type of low risk returns and stability that they did over prior decades. The Fed is likely to continue its active use of bond buying to attempt to impact the economic recovery, which could also lead to increased volatility in the bond markets. Investors should view this asset class in a different light, reflecting the realities of today's market.*

Fed Chairman stature as a proxy for interest rates?

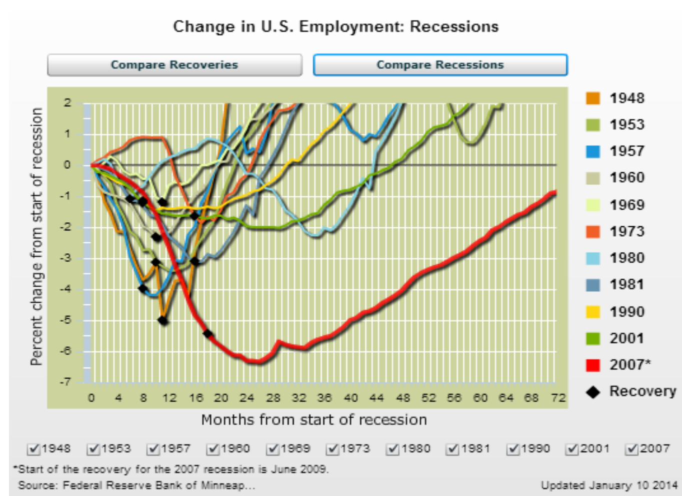
What Savings?

The IRS recently released its Quarterly Statistics of Income Bulletin which is packed with all kinds of information about the nation's individual tax filings. This release is for the 2010 and 2011 tax filings, so it is a bit dated, but nonetheless, very insightful as to trends. According to the release 145.6 million taxpayers were eligible to contribute to an individual retirement account (IRA) in 2010, but only 3.5 million actually did so and of those that did, 62% were over 49 years old. Uh oh! Only 2.4% of those eligible to contribute to their IRAs did so. The average account value is only $92,000 and only 27.6% of all tax filers even have an IRA. Consumer spending accounts for around 70% of GDP. The largest segment of the population, the baby boomers, are entering retirement with savings accounts below what they will need to maintain their level of spending throughout retirement. There is no money in the social security "trust fund" thus all social security payments for this enormous generation will have to be paid for by money taken away from the younger generations. The younger generations are smaller, thus if social security payments are to remain consistent with historical levels, the members of the younger generations will have to contribute a proportionally larger amount than the baby boomers contributed. ***Bottom Line***: *Adding it all up, unless the labor pool is expanded, it will be very difficult for consumer spending to continue to expand in real terms, which is a significant headwind to GDP growth.*

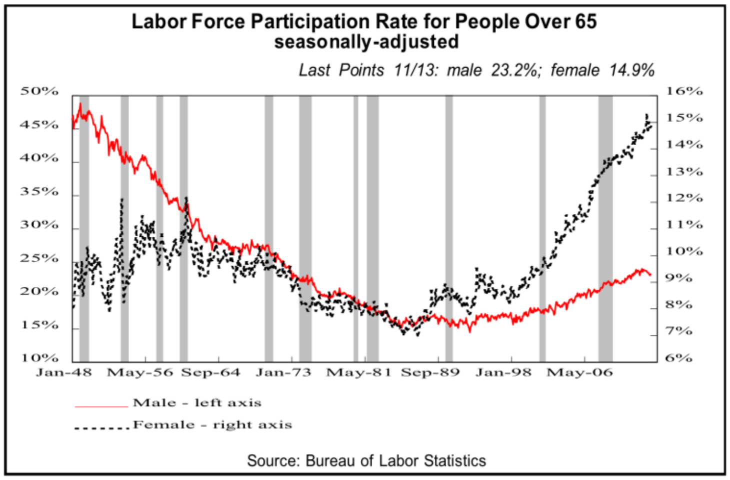


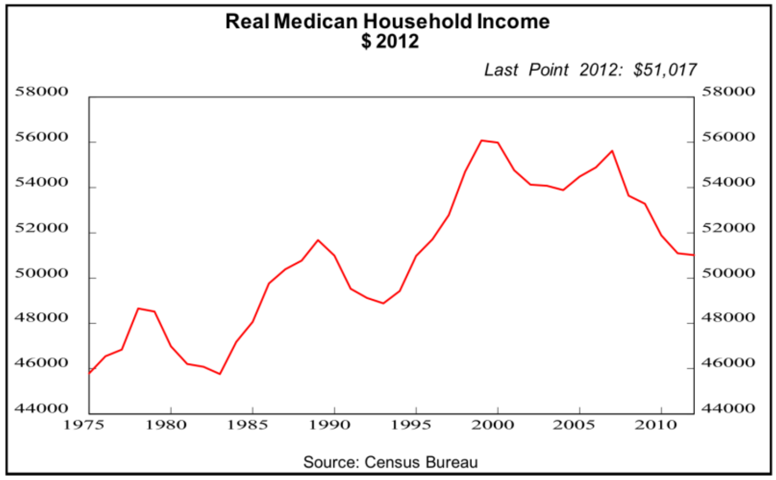
Unemployment

Perhaps the reason so few are saving is because the job situation isn't exactly rosy, nor are income levels. According to the most recent report from the Bureau of Labor Statistic, the unemployment rate has dropped to 6.7% which looks on the surface to be good news. However, if you look a bit deeper, the source of that improvement is troubling. The labor force participation rate, meaning the proportion of the population either employed or looking for employment has continued to drop, see chart at left, and is now at mid-1970s levels. Without the drop in the participation rate, the unemployment rate would be around 13%, rather than just under 7%. Additionally, according to data from the Minneapolis Federal Reserve (see chart at right), the American economy is experiencing the worst performance for labor markets since the Great Depression.



Some argue that the decline in the labor force participation rate is primarily driven by the inevitable retirement waves of the baby boomers. However, the chart on the next page illustrates that baby boomers are in fact participating in the work force at a higher rate than in decades.





Along with the grim jobs recovery, household income levels continue to struggle, with income levels close to those 20 years ago, see chart above at right. **Bottom Line**: *The fiscal and monetary stimulus has been unable to get employment or income levels back to anywhere near the levels enjoyed during the start of the 21st century. So far the impact appears to be more visible in rising prices in the stock markets and more recently rising home prices.*

Foreign Account Reporting

For our clients with investments outside of the country, starting this year, Foreign Bank and Financial Accounts must be filed electronically with paper filing no longer accepted. The deadline for reporting remains June 30, with no extensions permissible. You can download the new form and instructions and complete the filing process here.

Greg Tull's Your Money

Financial Advisors are well known for their focus on the long term. The key reason for that focus is the value of compounding over time. For example, a moderate 6% average annualized return generates a total return of 220% over 20 years and 474% over 30 years. At this rate, a $1 million portfolio grows to $3.2 million in 20 years, and $4.7 million in 30 years, assuming no further contributions to the portfolio. For retirement planning, a 4% withdrawal rate in the first year of retirement, with a 3% annual increase each year thereafter for inflation, is the rule of thumb most commonly used for maximizing your chances of not outliving your retirement funds in a 30 year retirement. Therefore, a $3.2 million dollar retirement portfolio would suggest an ability to withdraw $128,000 in the first year of retirement, and $131,840 in the second year. For a $4.7 million dollar portfolio, the first and second year of proposed retirement withdrawals would be $188,000 and $195,520. Determining your portfolio goal size, potential paths to achieving your goal, and your anticipated and actual withdrawal amounts, are important exercises that we are available to work through with you at your convenience, in person or over the phone.

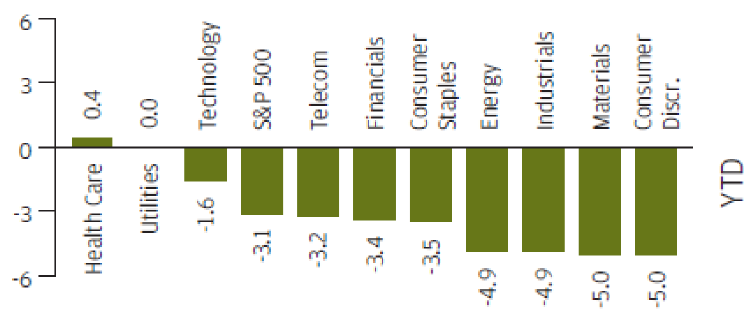
Market Recap

(as of January 24th, 2014)

Equities	Level	Index Returns (%) 1 week	QTD	YTD	1 year	3-yr. Cum.
S&P 500	1790	-2.62	-3.06	-3.06	22.33	47.98
Dow Jones 30	15879	-3.49	-4.02	-4.02	17.60	43.16
Russell 2000	2843	-2.07	-1.64	-1.64	28.79	53.04
Russell 1000 Growth	556.27	-2.35	-2.55	-2.55	24.85	49.83
Russell 1000 Value	553.81	-2.84	-3.22	-3.22	20.99	47.52
MSCI EAFE	1882	-1.99	-1.76	-1.76	16.63	22.62
MSCI EM	949.90	-2.29	-5.21	-5.21	-8.87	-8.98
NASDAQ	4128	-1.65	-1.14	-1.14	33.61	57.49

Fixed Income	Yield	1 week	QTD	YTD	1 year	3-yr. Cum.
U.S. Aggregate	2.36	0.32	1.19	1.19	-0.63	11.49
U.S. Corporates	3.15	0.22	1.42	1.42	0.02	18.57
Municipals (10yr)	2.69	0.73	2.09	2.09	-0.91	19.89
High Yield	6.30	-0.28	0.74	0.74	6.25	29.33

Key Rates	Levels (%) 1/24/14	1/17/14	12/31/13	12/31/13	1/24/13	1/24/11
2-yr U.S. Treasuries	0.37	0.40	0.38	0.38	0.23	0.65
10-yr U.S. Treasuries	2.75	2.84	3.04	3.04	1.88	3.43
30-yr U.S. Treasuries	3.64	3.75	3.96	3.96	3.04	4.55
10-yr German Bund	1.66	1.75	1.94	1.94	1.51	3.15
3-mo. LIBOR	0.24	0.24	0.25	0.25	0.30	0.30
3-mo. EURIBOR	0.30	0.31	0.29	0.29	0.21	1.04
6-mo. CD rate	N/A	N/A	N/A	0.27	0.28	0.39
30-yr fixed mortgage	4.57	4.57	4.72	4.72	3.62	4.80
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25



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