MERITAS ADVISORS
Comprehensive Wealth Management

MONTHLY INVESTMENT OUTLOOK

IN THIS ISSUE

- Markets & Economies
- Margin Debt
- Ukraine… Cliff Notes-ish
- Greg Tull's Your Money
- Market Recap

UPCOMING EVENTS

- 05/07: **Top 10 Strategies to Enhance the Value of your Business** with M&A attorney Jessica Karner
- 09/24: **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

- April 23-25th **Lenore Hawkins in Monaco** at the **XIIth International CIFA Forum**
- July 9-12th **Lenore Hawkins in Las Vegas** at **FreedomFest**

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Northern California
4040 Civic Center Drive, Suite 200
San Rafael, CA 94903
415.690.8547

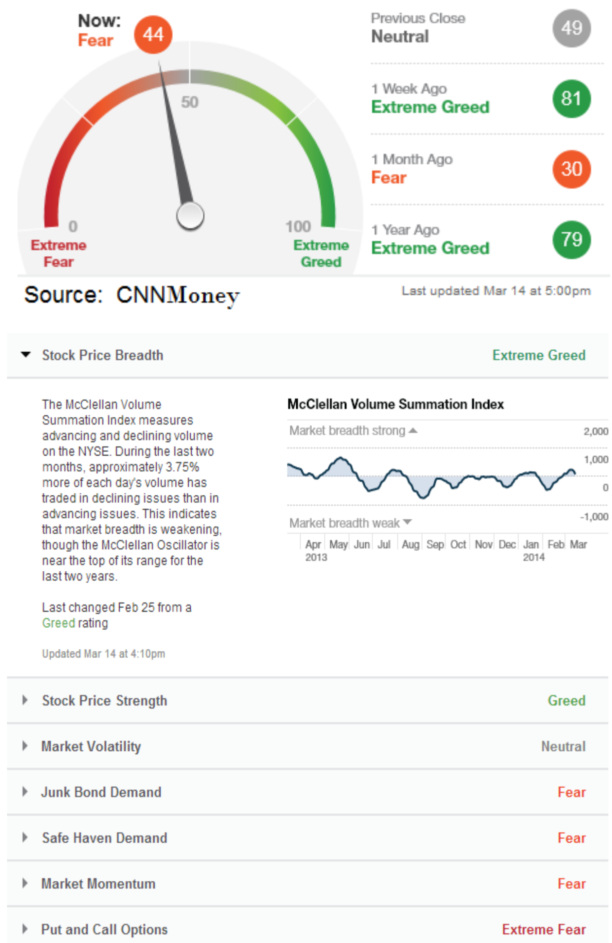
Southern California
11622 El Camino Real, Suite 100
San Diego, CA 92130
858.461.8547

Dear Clients and Friends: U.S. markets have continued to vacillate, with no clear direction while global politics take center stage in what some are saying could be the start of Cold War Part II between Russia and the West. There's a lot to cover, so without further ado, let's get to it! *Lenore Hawkins, Principal*

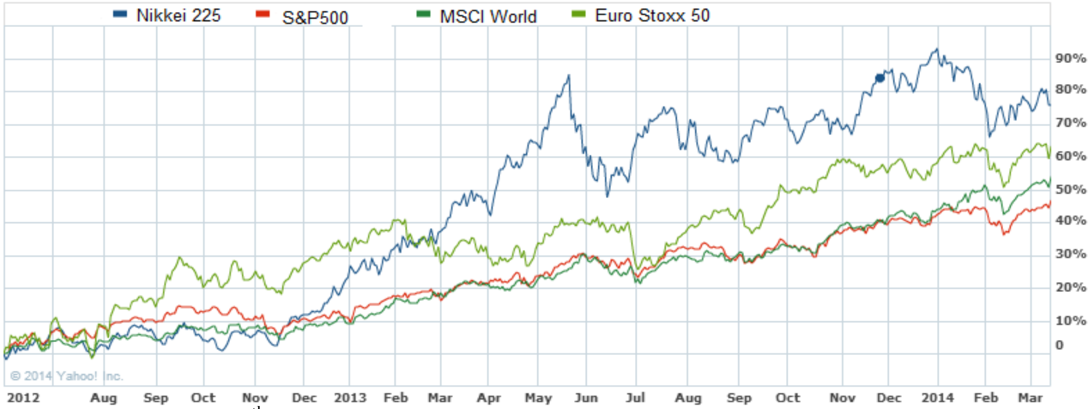
Markets & Economies

The U.S. stock market has given investors a bumpy ride so far this year, but it has been more than 500 days since the S&P500 experienced a correction of 20% of more, a run *which has occurred only 10 times in the past 100 years* so we really ought not complain despite the increased Pepto on Wall Street. January gave the market jitters as the S&P500 closed down 3.6% from its December 21st close. Cupid brought some respite in February, recovering some of those losses with the S&P closing down only 0.6% from the Dec 31st close. As of March 14th, the S&P was essentially flat from last year's close, making the broader indexes in 2014 so far Shakespearean much-ado-about-nothing. In comparison, the Dow and the S&P 500 were up around 10% at this point last year.

The CNN Money's Fear and Greed Index shown at right illustrates that in the past week, the markets have experienced a shift from "Extreme Greed" to entering "Fear" territory. This index looks at seven indicators, shown below at right. Stock price strength indicates that the number of stocks hitting their 52-week highs is at the upper end of its range. The yield demanded on junk bonds is higher than what has been typical for the last two years, while the S&P 500 has typically been further above the 125-day average than it is now, indicating that investors are committing capital to the market at a slower rate than they had been previously. We are also seeing puts at among the highest level seen in the last two years, indicating significant concerns that the market's direction is likely to change for the worse. *Overall, the market today is a lot like a sophomore headed to his first dance, sitting on her father's couch as he waits for his date to emerge; understandably nervous, but still holding onto hope that the night could be a success.*

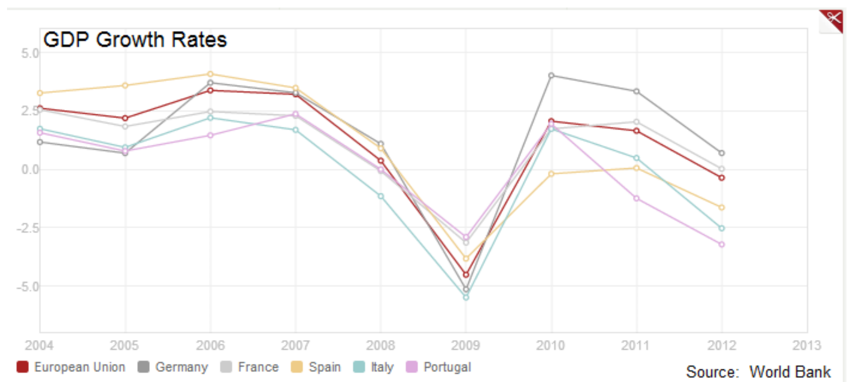


While the U.S. markets have been pushing higher and higher, other markets around the world have been even more ambitious.

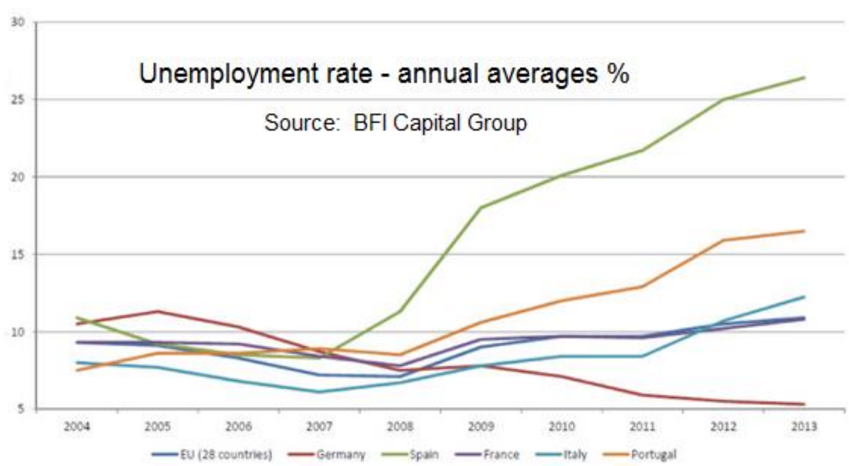


From June 2012 to December 30th the **Nikkei** *rose over 90%*, (up 52% in 2013 alone) but has since stumbled from its Dec 30th high and is now up around 70%, having briefly entered into a bear market (20%) contraction by last month. The index as of March 14th sits down 12.21% from its year-end high, falling 3.3% last Friday. I'll bet there's a bit more sake being consumed this quarter in the after-hours!

The **Euro Stoxx 50 Index**, the leading blue-chip index for the Eurozone, *has gained over 50% since June 2012, outperforming the S&P,* despite the region's sluggish economy. The chart at right illustrates the growth rates, (or lack thereof) for the Eurozone and its major economies through 2012. Estimates for 2013 aren't much better, with the region as a whole contracting 0.4%, Germany up just 0.5%, while Spain and Italy are estimated to have contracted as well by, falling 1.2% and 1.8% respectively.



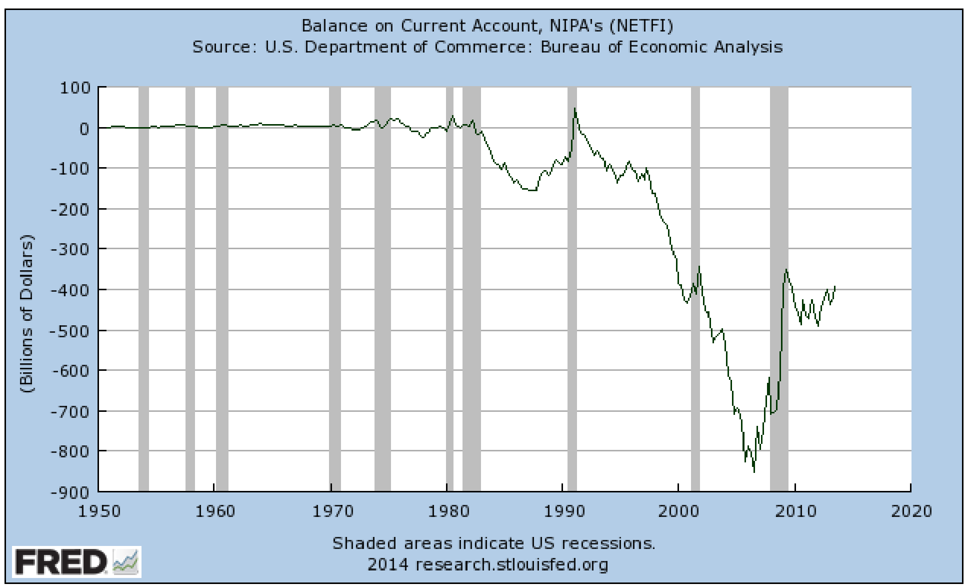
Unemployment in the region started 2012 at 10.2%, but has frustratingly worsened to 12.1% today and is anything but consistent across member nations. Unemployment in Spain, Italy and Greece are 26.7%, 12.7% and 28% respectively with *youth unemployment shockingly high at 57.7%, 41.6% and 61.4%* respectively! In contrast, German unemployment is just 5.2% with youth unemployment an enviable 7.5%. The impact of these employment levels for the young in the southern European nations will be a drag on those economies for decades to come as studies show the early years are critical for developing skills which impact an individual's income generating potential over their entire career. I imagine many parents in these nations would be happy to be able to complain about not seeing their kids enough as they start their careers and build their young lives!



Meanwhile over in **Japan**, despite the massive run up in its stock market and levels of monetary stimulus that could make Bernanke blush, things are also not rosy either. Japan's economy grew even more slowly than initially calculated in the final three months of 2013 and posted another record current-account deficit in January, increasing the likelihood that an economy already struggling with ugly demographics is in for yet more near-term angst. According to government figures, the overall economy grew just 0.7% on an annualized basis in the final three months of 2013, a downward revision from the initially projected 1% growth. The slight silver lining is business investment, which grew by an annualized 3% in the fourth quarter, compared with a preliminary reading of a 5.3% increase. Consumer spending was up an annualized 1.6%, revised lower from a preliminary 2% rise.

China too is showing signs of slowing. Forecasts for China's GDP growth were cut by many in the investment banking world on Thursday after Beijing reported the biggest slowdown in investment for more than a decade coupled with the slowest retail sales expansion in nine years. Confidence was further undermined by news that a well-known steel mill has failed to repay loans that came due last week, the first default on corporate debt that the government has allowed.

European growth in aggregate just isn't happening and the reforms needed to induce it are politically challenging to say the least. Japan continues to try and get out of its decades long funk. The Chinese engine which fueled much growth post-financial collapse is sputtering. In the US, as we predicted in last month's newsletter, GDP growth for Q4 2013 was revised downward from an initial estimate of 3.2% to 2.4% versus Q3 2013 growth which is estimated to have been 4.1%. GDP growth for the full year of 2013 is estimated to be about 1.9% falling from 2.8% in 2012. Even with the downgrade, growth for the second half of 2013 is now estimated to be 3.3% versus 1.8% in the first half, showing an improvement, but not exactly a robust economy.

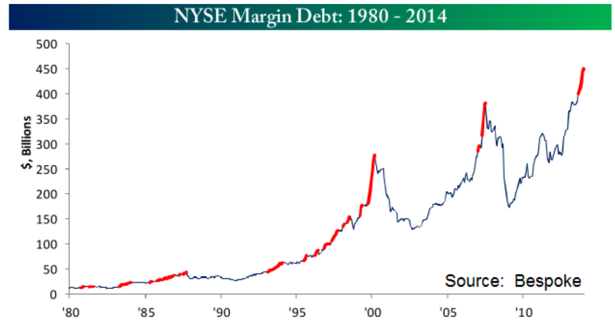


On the global front, keep in mind that for almost 30 years, the U.S. ran growing trade deficits, which effectively provided a lot of stimulus for foreign exporters; in other words we bought a lot of stuff from other countries, (funded in part by increasing debt levels) which helped their economies grow in a global form of seller-financing. *We'll buy your stuff if you lend us the money by buying our Treasuries.* The chart at right shows the magnitude of this trade deficit over time. Notice that since 2006 the deficit has been shrinking which may please those who prefer "made in America", but is bad news for the countries from which we used to buy!

I'll leave this review with one of my favorite sayings, hat tip to Warren Buffet for refreshing my memory in his most recent letter to shareholders, "*A bull market is like sex. It feels best just before it ends.*" Something to always keep in mind when one is tempted to chase returns.

Bottom Line: *The economies of the largest nations and regions around the world continue to struggle to grow in line with historical norms, while their respective stock markets have experienced a wild run up in recent quarters. This makes continued across-the-board-increases in broad indexes increasingly unlikely, thus having a broadly diversified portfolio, with exposure to various markets and asset classes is even more important. The reduction in correlations between investments provides opportunities for those who are patient and pay attention.*

Margin Debt



If you've been listening to CNBC or reading any of the main financial publications, you've probably heard talk about the significance, (or insignificance based on the speaker's perspective) of margin debt. Last week the NYSE released its latest data on margin debt which increased for the seventh straight month. January was also the fifth straight month that margin debt hit a record high. This is unsurprising in a market that has run up so much.

Margin debt refers to the amount of money investors borrow against their investment portfolio in order to invest even more money. For example, I have $1,000 invested in shares of company X. I borrow $400 from Schwab against that investment and put the $400 into an ETF. Now if my shares of Company X drop in value enough, Schwab may issue a "margin call" which means I need to put more money into my account so that the ratio between the value of my account and the amount of money I borrowed stays at or below a specified value.

You can think of margin debt a bit like a home equity loan. During the housing boom of the later 1990s and 2000s, home prices kept going up like views of Ellen DeGeneres' Oscar selfie. Homeowners took out home equity lines of credit, refinanced with a larger mortgage or took out a second mortgage to exchange their increased levels of equity for cash. This eventually made home price more volatile as many people had less than even 5% equity in their home so that when their home's current market price dropped by more than 5%, they had nothing invested and many chose to walk-away.

The concern with rising levels of margin debt is that a downturn in the markets can induce higher volatility and make for an even sharper downturn as investors race to sell investments to cover their margin calls. With a margin call, an investor can't just walk away the way many did with their homes. They have to keep a specified amount in their account, like being required to maintain a minimum of 15% equity in your home. Here's how it works:

	Home Value	Debt	Equity	Equity Ratio
Buy a home for $100, borrowing $80 (for simplicity assume an interest only mortgage)	$100	$80	$20	20%=20/100
Home values rise the following two years by 25%.	$125=(100*1.25)	$80	$45	36%=45/125
Borrow extra $20 against the home.	$125	$100	$25	20%=25/125
Home prices fall 12%	$110=(125*0.88)	$100	$10	9%=10/110
Additional funds paid to bank to return minimum ratio	$110	$93.5	$16.5	15%=16.5/110

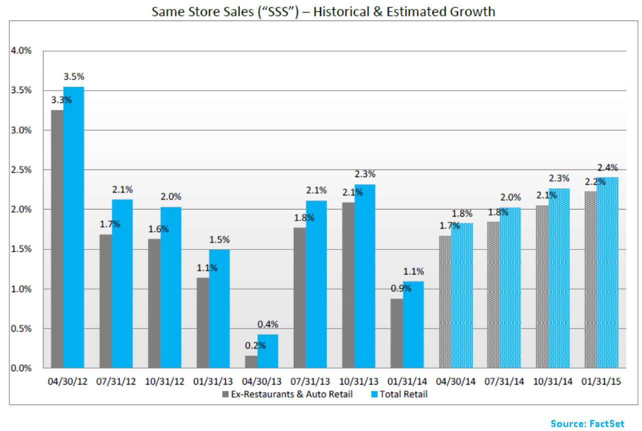
If the bank requires a minimum equity ratio of 15%, the outstanding debt will have to be reduced by $6.5 = ($110 * 0.15) - $10. The homeowner would have to give the bank an additional $6.50 to get the ratio back to the required minimum. This is essentially how margin debt works.

Bottom Line: *While the specific level of margin debt or the fact that the metric has reached a new high may not be a direct indictor of a bubble in security prices, it is indicative of two things:*

1. *The belief that security prices are more likely to rise than fall in the near future. (A reasonable person wouldn't borrow an additional $20 against their home if they thought the price was going to fall significantly.)*
2. *A downturn in prices is likely to be more volatile than it would be with a lower level of debt as investors are forced to sell to cover their margin accounts.*

This warrants portfolio construction that is suited to help minimize such volatility.

Consumer Spending



Holiday sales frustratingly continue to disappoint as more data is released. In the fourth quarter of 2013, same store sales started out low and only moved lower. The aggregate blended growth rate of 174 U.S. retailers has fallen from 1.3% to 1.1% over one month, partially due to Abercrombie & Fitch, RadioShack, Staples, and Cabela's all significantly missing expectations for the quarter. ("Blended" growth rates are calculated with estimated results if actual results have not yet been released.) As the chart here shows, SSS growth for the fourth quarter are less than half that of the third and a full 0.4% below the year before. However, there are a few bits of good news.

- On March 13th we learned that U.S. February retail sales were up 0.3% versus 0.2% estimate.
- Since August over 600,000 net new jobs have been created for those between 25 and 34, which is the primary first time homebuyer. This rate of growth, at almost 5%, hasn't been seen since spring of 2000.

Bottom Line: *Until household income levels improve, significant GDP growth will face strong headwinds as consumer spending represents about 70% of total GDP. Household income requires an improvement in employment levels. Employment growth depends on the growth of existing businesses and even more on the emergence of new businesses. New business formation is at very low levels relative to historical norms. Existing business are wary of expanding with the level of political and economic instability they perceive, which also affects the formation of new businesses that face a more challenging environment in which to get started than in decades prior.*

Ukraine

As if things in Europe aren't complicated enough, the situation in Ukraine is getting more troubling by the day. The turmoil there is having vast geopolitical impacts that are keeping the investing world as nervous as a long-tailed cat in a room full of rocking chairs. Here's the quick, errrrhhh, fair enough, as quick as a verbose Irish lass can get, version of how we got to today.

In late 2013, Ukrainian President Viktor Yanukovich was expected to sign some agreements that could eventually integrate Ukraine with the European Union economically. Ultimately, he refused to sign the agreements, a decision thousands of his countrymen immediately protested. Demonstrations eventually broke out with protesters calling for political change. When Yanukovich resisted their calls, they demanded new elections. Eventually the protestors won, Yanukovich was forced to flee the country and now we have a nation in flux.

So why does anyone outside of Ukraine, population 44.6m and with 233k square miles, care? Ukraine is central to Russian defenses, sharing a long border with the former Soviet Union and more importantly, Moscow sits all of 300 flat and easily traversed miles from Ukraine. Therefore, from a Russian perspective a tighter Ukrainian-EU integration represents a threat to Russian national security. Putin appears to be disinterested in actually governing Ukraine, but rather his goal seems to be to effectively have negative control, the ability to *prevent* Ukraine from doing anything Russia dislikes. With that in mind, it appears that even the very idea of further EU integration was provocation enough for Putin. The European Union's and the Germans' public support for opponents of Yanukovich crossed his red line.

From a European perspective, Ukraine isn't quite as interesting. Economically the Eurozone wasn't enamored with having the nation join the EU, it just liked the possibility of such. Adding a country as weak and disheveled as Ukraine to an already strained union didn't make much sense, but the idea of the possibility someday is attractive. The talk about joining was really more about inviting Ukraine to make a cultural shift towards Europeanism, with a constitutional democracy and a more liberalized economy. Germany found itself between the proverbial rock and a hard place as it continues to work with Russia on its mutual energy and investment interests while trying to manage coalitions within the European Union, particularly attempting to appease the Baltic States and Poland who would like to see Ukraine closer to them and further from the Russian camp, giving them an additional buffer.

The U.S. strongly supported the Orange (anti-Yanukovich) Revolution, siding with the Germans and the Eurozone, which was no doubt going to get under Putin's skin; but then the U.S. owed him one after the Snowden situation. Throughout history, many of the global conflicts, and for that matter noteworthy familial brawls, have been catalyzed by the little things.

The situation has evolved into a tense standoff between the G7 nations and Russia. On March 12th, the U.S. Department of Energy announced that it would draw down from the U.S. Strategic Petroleum Reserve in what it claimed was a "test sale to check the operational capabilities of system infrastructure." In reality, this was a warning shot fired at Putin. Later that same day Bloomberg reported that the U.S. has escalated the situation even further, with General Martin Dempsey, the Chairman of the Joint Chiefs of Staff, claiming that "*in the case of an escalation of unrest in Crimea, the U.S. Army is ready to back up Ukraine and its allies in Europe with military action.*" The G7 has threatened sanctions against Russia if it continues, with the U.S. Congress passing a resolution on March 11th to work with European allies and others to "impose visa, financial, trade and other sanctions" against key Russian officials, banks, businesses and state agencies. In a quick tit-for-tat, Russia responded on March 13th that it is prepared to retaliate with sanctions of its own against the west. Germany responded to this by announced that Angela Merkel is prepared to cancel a summit with Russia if Moscow does not help to defuse the situation.

To add a little extra flame to the fire, Iranian Oil Minister Bijan Namdar-Zanganeh arrived in Moscow late March 13th to meet with Russian Energy Minister Alexander Novak and Deputy Prime Minister Igor Shuvalov, IRNA reported. Namdar-Zanganeh will discuss ways to deepen economic cooperation between the countries, because there weren't nearly enough strained relationships!

Militarily things are also nail-biter as around midnight on March 5th the Russian navy used tugboats to maneuver a 9,000-ton hulk of a mothballed anti-submarine cruiser into the inlet to Crimea's Donuzlav Lake, effectively blocking access to the sea from Ukraine's primary naval installation on the peninsula. Reportedly seven of the Ukrainian's twenty five ships are trapped, picture at left.

According to the Ukrainian Defense Ministry, on Saturday March 15th, Ukrainian forces repelled an attempt by Russian troops to land in the southern Ukrainian region of Kherson Oblast. The landing reportedly occurred on Arbatskaya Strelka, a long spit of land running parallel to the east of Crimea. Earlier, it was reported that four Russian military helicopters deployed around 60 Russian troops near the town of Strilkove, forcing around 20 Ukrainian border guards and servicemen to retreat from their positions. Later in the day Ukrainian and Russian defense ministries announced a truce in Crimea until March 21st. Anyone else feel like renting Red Dawn (the original of course)?

On Sunday March 16th, the people in the Crimean region reportedly voted to have Russia annex Crimea by an overwhelming majority of some 95%+. On Monday the EU announced that it would impose travel bans and asset freezes on 21 Russian and Ukrainian officials that are considered central to Crimea's move to separate from the Ukraine. The U.S. issued sanctions as well, via an executive order signed by the President, to freeze the assets of and ban visas for seven Russian officials and four Ukrainians.

Tuesday the Kremlin announced that it had officially annexed Crimea, which could be the most dangerous geopolitical event of the post-Cold World era. The two most likely outcomes are:

(1) Russia will quickly prevail, gaining the power to redraw its borders and set the precedent for exercising veto powers over the governments of its neighbors or,
(2) Western-backed Ukrainian government will push back and the second-largest country by area in Europe will descend into a Yugoslav-style civil war that will likely pull into its turmoil, Poland, NATO and eventually the U.S.

An alternative outcome is unlikely as Putin cannot at this point give up Crimea. It would mean a publicly shaming on a global level that could destroy his presidency.

Bottom Line: *This situation has the potential to rock the markets, which are for now keeping a wary eye. Europe desperately needs Russian fuel. London and much of Europe is greatly beholden to the nouveau riche Russians for their highly demonstrative consumption of luxury goods and services, which only adds more pressure. There's even a reality TV show called "Meet the Russians" which follows the lives of some ultra-bling Russians who are buying up Britain and "setting a new benchmark for extravagant living." Europe can't afford to push too hard back against Russia, but they also cannot ignore a precedent for unfettered Russian aggression. It is impossible to predict exactly how this will play out, but close attention is warranted.*

Greg Tull's Your Money

In our annual meetings with clients this year, we covered the "Rule of 72" and the "4% Withdrawal Rule" on several occasions. The Rule of 72 is a mathematical rule of thumb which determines the approximate amount of time that it will take for a portfolio to double. A portfolio that grows at 3% will double in about 72/3 = 24 years. Using the same formula, 6% growth takes approximately 12 years, 8% takes 9 years, and 12% takes 6 years to double. (Making annual contributions to the portfolio will decrease the amount of time it takes to double in size.)

The 4% Withdrawal Rule is the amount of money that can be withdrawn from a well-designed, multi-asset class, well-diversified retirement portfolio each year, while preserving a very high likelihood that the retirees will not run out of principal in a 30 year retirement. Thus a $1,000,000 portfolio could support a $40,000 withdrawal each year for 30 years in retirement in the vast majority of cases. It's also generally accepted that the withdrawal rate can reasonably safely be increased at the inflation rate each year. So with 3% inflation, $41,200 ($40,000 * 1.03) could be withdrawn in the 2nd year of retirement for a cost of living increase, followed by $42,436 ($41,200 * 1.03) in the 3rd year.

With the aid of a third rule of thumb, the amount of money a retiree will spend in retirement, vs. what they spent annually towards the end of their working years, an estimate can be made of the size your portfolio should be in order to confidently retire. Spending estimates in retirement range from 70% to 100% of the annual amount spent in the years preceding retirement. For a couple who is spending $200,000 per year when they are 65, estimates range that they will spend between $140,000 and $200,000 per year in their early retirement years. (Building an actual annual budget as your retirement approaches enables a refinement of this third rule of thumb for greater accuracy.) A first year retirement budget of $140,000 would suggest a recommended portfolio size of $3,500,000 ($140,000 / .04), while a $5,000,000 ($200,000 / .04) portfolio would be recommended for a first year retirement budget of $200,000.

In an upcoming newsletter, we will cover some recent updates in the research regarding the 4% Withdrawal Rule, as well as some examples of how portfolio growth rates increase when contributions are factored in.

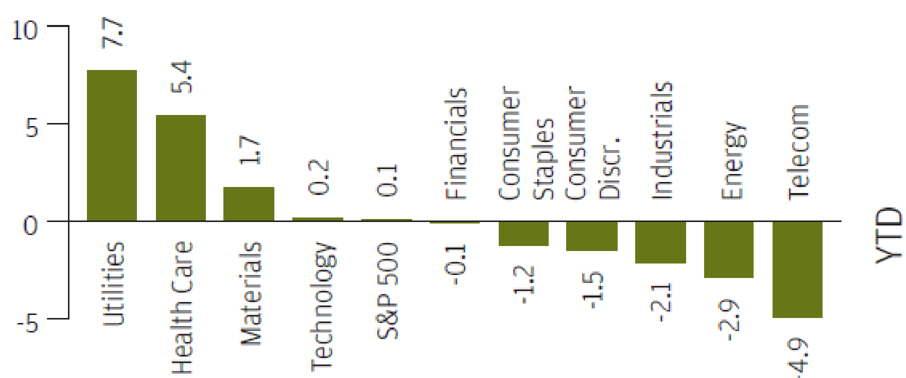
Market Recap

(as of March 14th, 2014)

Equities	Level	Index Returns (%) 1 week	QTD	YTD	1 year	3-yr. Cum.
S&P 500	1841	-1.91	0.07	0.07	20.28	51.60
Dow Jones 30	16066	-2.31	-2.59	-2.59	13.09	44.66
Russell 2000	2936	-1.77	1.75	1.75	25.60	54.34
Russell 1000 Growth	573.41	-2.01	0.75	0.75	23.76	54.04
Russell 1000 Value	570.95	-1.76	0.18	0.18	18.40	50.77
MSCI EAFE	1867	-3.06	-2.08	-2.08	13.39	25.10
MSCI EM	937.69	-2.97	-6.17	-6.17	-7.89	-8.51
NASDAQ	4245	-2.07	1.91	1.91	31.98	63.07

Fixed Income	Yield	1 week	QTD	YTD	1 year	3-yr. Cum.
U.S. Aggregate	2.33	0.56	2.01	2.01	0.56	11.41
U.S. Corporates	3.08	0.71	2.72	2.72	1.89	18.50
Municipals (10yr)	2.50	0.56	3.24	3.24	1.22	18.05
High Yield	6.16	-0.15	2.37	2.37	7.22	29.16

Key Rates	Levels (%) 3/14/14	3/7/14	12/31/13	12/31/13	3/14/13	3/14/11
2-yr U.S. Treasuries	0.36	0.38	0.38	0.38	0.27	0.61
10-yr U.S. Treasuries	2.65	2.80	3.04	3.04	2.04	3.36
30-yr U.S. Treasuries	3.59	3.72	3.96	3.96	3.25	4.52
10-yr German Bund	1.55	1.65	1.94	1.94	1.47	3.22
3-mo. LIBOR	0.23	0.24	0.25	0.25	0.28	0.31
3-mo. EURIBOR	N/A	N/A	0.29	0.29	0.21	1.19
6-mo. CD rate	N/A	N/A	N/A	0.27	0.28	0.37
30-yr fixed mortgage	4.52	4.52	4.72	4.72	3.81	4.79
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25



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4040 Civic Center Drive, Suite 200
San Rafael, CA 94903
415.690.8547

11622 El Camino Real, Suite 100
San Diego, CA 92130
858.461.8547

info@MeritasAdvisors.com
www.MeritasAdvisors.com