

# MONTHLY INVESTMENT OUTLOOK

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## UPCOMING EVENTS

- 12/09: **Vital tax Changes and Your Checklist** with [Coree Cameron](#) of [Cameron Coffey & Kaye](#)
- 01/28: **New Tools for Maximizing the Value of your Privately Held Business** with [David Ryan](#) of [Upton Financial](#)

## MORE FROM MERITAS

You can read more from our chief economist [Lenore Elle Hawkins](#) at [TheStreet.com](#) where she publishes weekly articles along with co-author [Chris Versace](#), (not affiliated with Meritas Advisors).

Lenore and Chris are also writing a book on investing that is scheduled to be published in the Spring of 2015 by



*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:

Global tensions continue to rise as the U.S. and its partners conduct airstrikes against ISIS, the standoff endures between Russian and the West in Ukraine, and trauma is endured in Seattle two weeks ago as the San Diego Chargers kicked some major bootay, (I could not resist as a Bolts fan who has suffered for years under former coach Turner). Meanwhile central bankers are engaging in an impressive loose money relay game which we'll discuss this month along with what else is going on in the world that impacts your investments.

--- *Lenore Elle Hawkins, Meritas Advisors Partner and economist, wondering where I hid my tear-soaked Chargers jersey last season....*

## Markets and the Economy

Last week the markets were all about the statements coming out of the FOMC (Federal Reserve's Open Market Committee) meeting. The FOMC statement was more dovish, (meaning less worried about inflation), while Fed Chair Yellen did a lot of hedging at her press conference.

As the Fed's latest round of quantitative easing comes to an end, China (the world's second largest economy) announced last week that it is injecting \$81 billion into the country's five major state-owned banks in the form of three-month low-rate loans to counter slower-than-expected growth. Apparently taking a page from the Fed's playbook, the PBOC (People's Bank of China) is expected to guide banks to channel credit into areas of the economy the government has deemed important, such as public housing and private and small businesses. The announcement helped snap Asia's longest losing streak in 12 years with China H-share index up 1.6% and Shanghai up 0.5%.

China's move follows on the heels of the surprise announcement by the European Central bank earlier this month that it is lowering all its interest rates and announced two new asset purchase programs to begin in October. These steps are intended to induce higher inflation expectations and weaken the euro, something strikingly different from all the other major central banks around the world, (you're right to detect a snarky undertone). Apparently the Chinese think that they will get a different outcome than everyone else doing the exact same thing.

- In the US headline PPI inflation has calmed to an annualized three-month trend of 1.8% from a previous peak of 2.9% in March while core PPI is down to 1.9% from a March high of 2.6%. As for growth, the OECD recently dropped growth expectations for the US from 2.6% to 2.1% for 2014.
- Eurostat's latest figures showed that the annual rate of inflation across the Eurozone fell to its lowest level since Oct. 2009 in July, and was unchanged in August. The OECD also cut the zone's growth forecast for 2014 from 1.2% to 0.8% as France's economy stagnates, Italy has fallen back into recession and even Germany is showing signs of economic weakness.

- Over in Japan, core consumer CPI was 1.3% in July while industrial output rose 0.2% in July after a 3.4% fall in June, versus expectations of 1.2%. Household spending fell 5.9% year-over-year in July, exceeding expectations of a 2.9% drop. The OECD also lowered growth expectations for Japan from 1.2% to 0.9%.
- China is becoming more of a concern every month as the world's second economy slows considerably, impacting all sorts of raw materials, such as iron ore which is illustrated in the chart below. The slowing



growth translates into deceleration of the nation's massive infrastructure build-out. The HSBC Flash China Manufacturing PMI was 50.5 in September, just a tad over 50 which is the breakeven point for growth.

If that didn't convince you that things are slowing noticeably in China, how about the chart at right? It shows the price, year-to-date, of steel rebar futures in Shanghai, converted to USD. The contracts are over 2.5 standard deviations oversold versus their 50-DMA (50 day moving average) as of 9/23, demonstrating just how bearish certain aspects of the China/commodities complex have gotten. This is something to watch here in the States because as China's economy slows, so does its demand for raw materials and finished goods. This affects prices globally, and keep in mind, that the Eurozone is also struggling to avoid slipping into another recession.

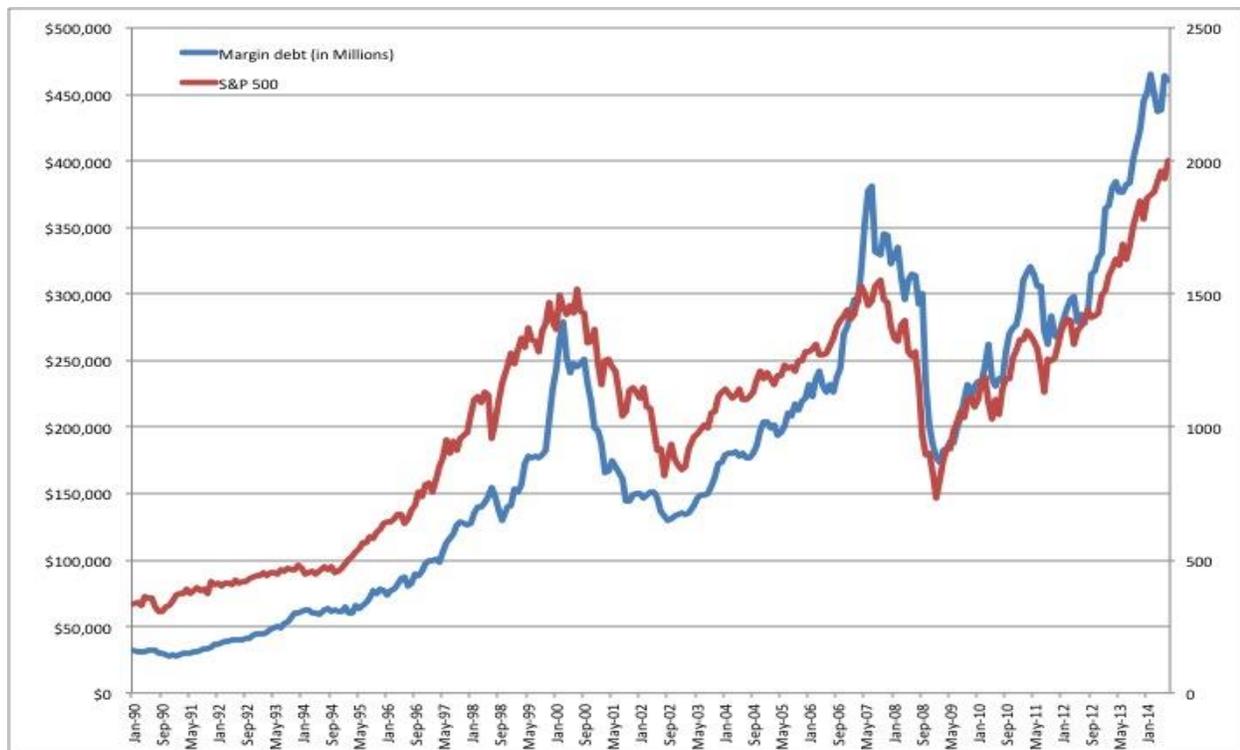


All these central banks have been working like mad to get their economies growing with questionable results. However, despite the weak economics, the stock markets in all these areas have enjoyed notable returns over the past 12 months.

- Dow Jones Industrial Average up 10.4%
- S&P 500 up 17.2%
- Germany’s DAX up 12.4%
- Japan’s Nikkei 225 up 11.0%
- France’s CAC 40 up 10.3%
- Spain’s IBEX up 13.8%
- Euro Stoxx 50 up 16.0%

The market’s breathless anticipation over whether or not the Fed would (gasp) drop the phrase “considerable period” from its statement last week, after the [Jon Hilsenrath piece in the Wall Street Journal](#), is understandable in lights of such a relationship. **I highly recommend that everyone read Mohamed El-Erian’s** (of PIMCO fame) September 16<sup>th</sup> piece entitled “[Markets’ Rose-Tinted World](#)” on [Project Syndicate](#). He discussed how the markets have ignored fundamentals and ignored long-time correlations in ways we’ve never seen before.

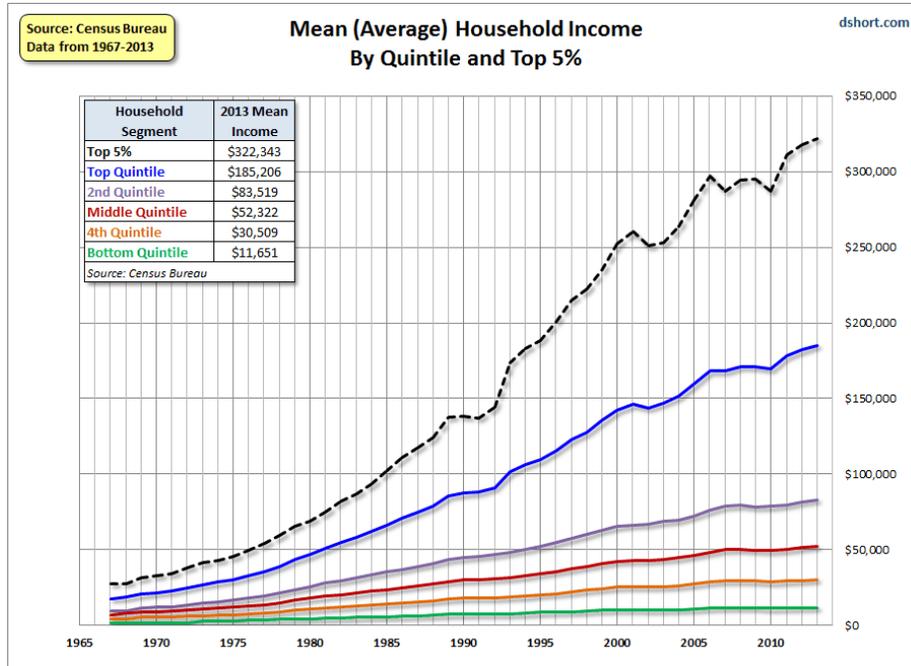
We would not be surprised to see a contraction in the somewhat stretched price-to-earnings multiples as Fed policy becomes hazier, geopolitical/terrorist risks continue to mount and margin debt hits all time highs. The chart below, using data from NYSE, shows the S&P500 versus margin debt over time. Note the last two major market contractions occurred after big run ups in margin debt, which is rather intuitive. Towards the end of a bull run, the market gets pushed higher and higher as investors seek to squeeze out extra returns using leverage. This may exacerbate the fall as losses are compounded by the same leverage that helped jack up returns on the way up and investors are forced to sell in order to cover their margin accounts, compounding the downward pressure.



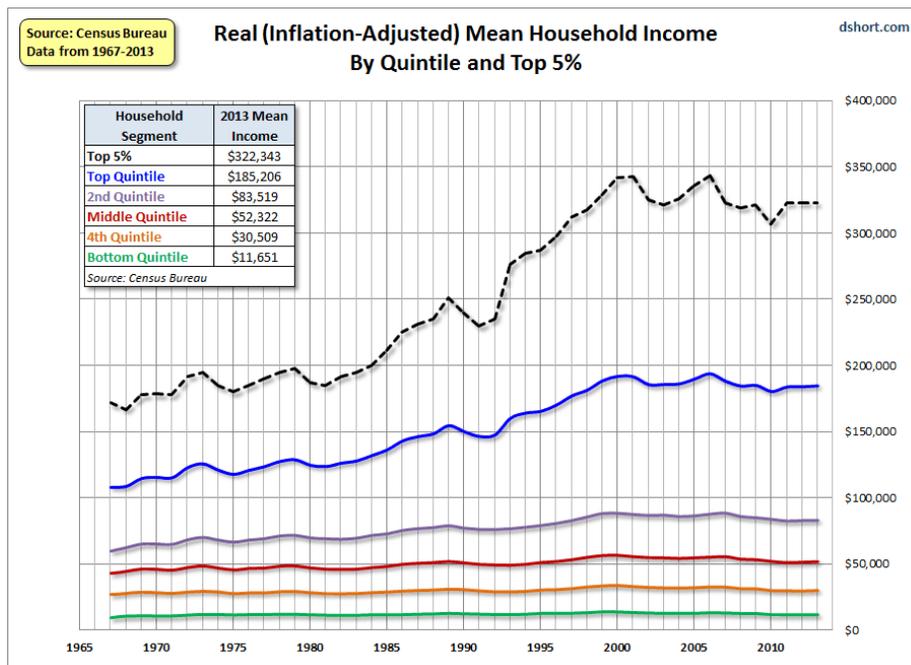
**Bottom Line:** *We’ve all been hearing for a while that markets are topy and the past few days we’ve seen the markets taking some hits, but with the markets so disconnected from the underlying fundamentals (remember El-Erian’s piece), we believe an exogenous shock is required for any major pullback.*

## Household Update

The U.S. Census Bureau recently released its annual report on household income data through 2013. Doesn't look too shabby does it? Except, this data isn't adjusted for inflation. (Hat tip to Doug Short for putting together some great charts)



If we adjust for inflation, we see that the picture is far less rosy after the millennium.

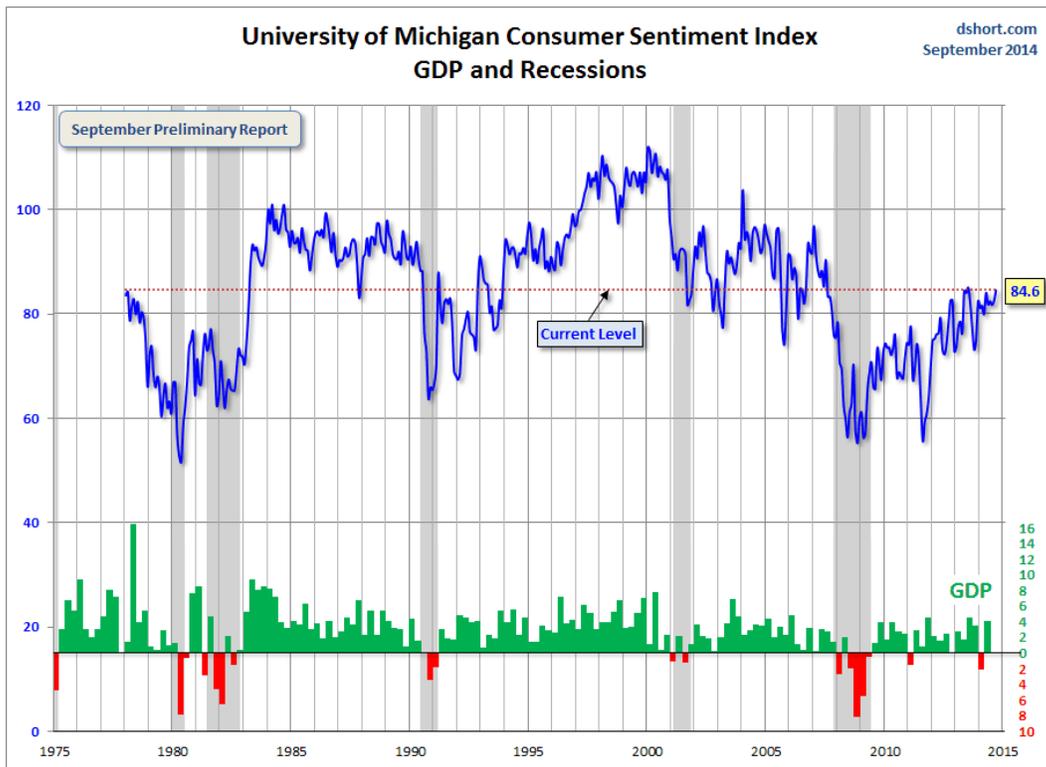


All income quintiles are below their peak year earnings, with the lower quintiles suffering the most. The Fed's easy money policy has done a fantastic job of pushing up the stock market, but has done little to stimulate the real economy. One of the unintended consequences of such actions is the growing income gap, (although this isn't the sole reason for this widening).

Real Household Income Declines from Peak Year				
Household Segment	Peak Year	Peak Income	2013 Income	Percent Change
Top 5%	2006	\$343,608	\$322,343	-6.2%
Top Quintile	2006	\$194,296	\$185,206	-4.7%
2nd Quintile	2007	\$88,880	\$83,519	-6.0%
Middle Quintile	2000	\$57,129	\$52,322	-8.4%
4th Quintile	2000	\$34,306	\$30,509	-11.1%
Bottom Quintile	1999	\$13,861	\$11,651	-15.9%

Source: Census Bureau, chained in 2013 dollars

The result is that consumers continue to struggle, which is illustrated well by the University of Michigan Consumer Sentiment Index. The index has never been this low for this long when the economy was not in a recessionary period.

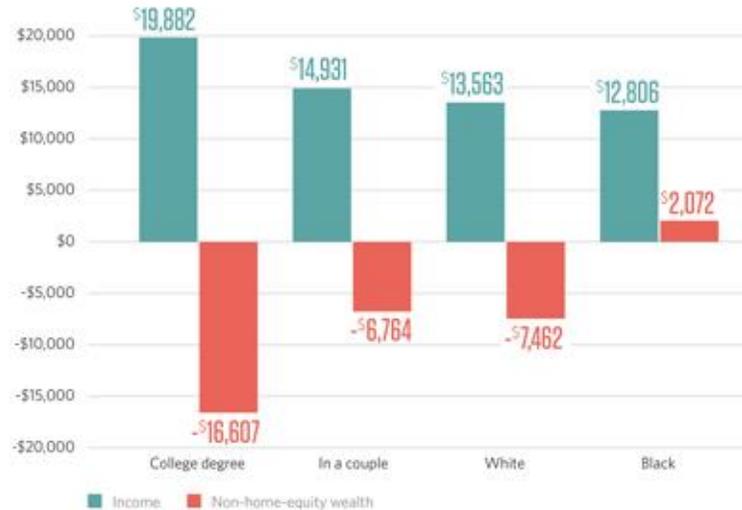


In fact, according to a [survey funded by the Ford Foundation](#), nearly three out of four Americans (72%) say the recession is still on. 7% of Americans say that they are in excellent financial health with about a third claiming that they or someone else in their household has had to cut back on food in the last year to save money. Two-thirds believe the economic system unfairly favors the wealthy with nearly half saying the American dream once held true but doesn't anymore.

For those in their peak earning years, the Gen Xers (born between 1965 and 1980) a Pew report released last Thursday found that this age group earns significantly more than their parents, but only 36% of them are wealthier than their parents.

## Gen Xers' Incomes Are Well Above the Last Generation, but Their Wealth Lags

Median income and non-home-equity wealth differences between Gen Xers and their parents' generation, in 2011 dollars



Note: Wealth totals do not include home equity. Income and wealth are adjusted to 2011 dollars.

Source: Pew's analysis of the Panel Study of Income Dynamics

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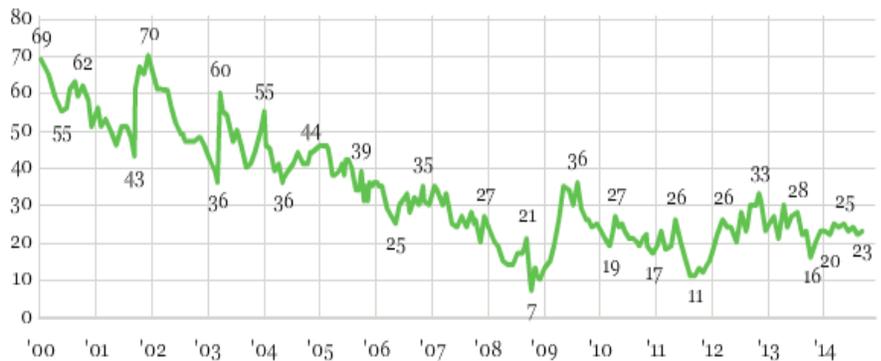
How can they earn more but have less wealth? No big surprise here, it's debt. The median Gen Xer carries nearly 6x the debt of their parents at the same age, with nearly all holding student loan, credit card, medical or other debt. Gen Xers also report that economic mobility is much tougher than for their parents. Of those in their 30s and 40s born into families in the lower income levels, half believe they are permanently stuck there while 3/4 have not been able to make it to middle class.

It should then come as no surprise that 76% of Americans are dissatisfied with how things are going in the U.S., according to a recent Gallup poll.

**Bottom Line:** While there are some strong signs of economic recovery, when it comes to take-home pay and household wealth, the situation is still very tough, which will continue to dampen any recovery in the housing market and this cash-strapped

### Percentage Satisfied With Direction of the U.S.

In general, are you satisfied or dissatisfied with the way things are going in the United States at this time?



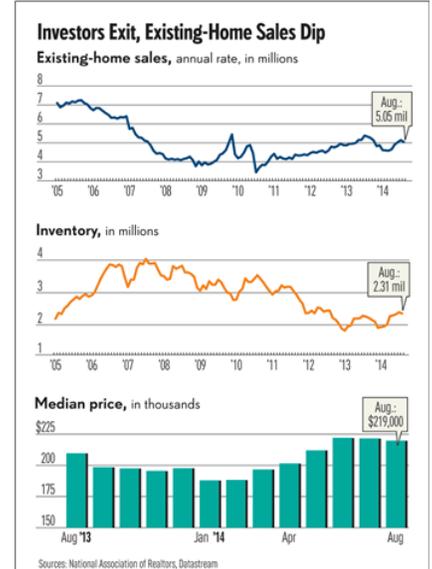
Recent trend: January 2000-September 2014

GALLUP

consumer is unlikely to contribute notable growth in discretionary purchasing. The stock market has done well for those who already had significant wealth, but Main Street has not seen much relief.

## Home Sales Cool

According to a [recent report by the National Association of Realtors](#), total existing-home sales decreased 1.8% to 5.05 million in August from a downwardly-revised July sales of 5.14 million. August enjoyed the second-highest monthly rate for 2014, but is still 5.3% below this time last year. Additionally all-cash sales were 23% of transactions in August, down from 29% in July and the lowest share since December 2009. Much of the pull back has been attributed to investors, pulling back, which means the market is more available to first-time home-buyers. Bottom Line: Housing is slowly recovering, but don't expect any take off like we saw in the 2000s, not while families continue to struggle with stagnant income levels and debt burdens.



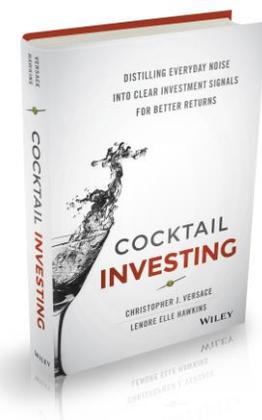
## Your Money and Your Life (with Greg Tull)

Let's explore the rule of 72 and the power of compounding. Dividing 72 by a percentage growth rate provides a good approximation of the amount of time it takes a portfolio to double. For example, at an annual rate of 6%, 8% or 10%, it will take 12 years, 9 years, or 7.2 years respectively for a portfolio to double. Over time, the power of compounding really adds up. For example, in 36 years, these growth rates result in 3 doublings at 6%, 4 doublings at 8%, or 5 doublings at 10%. In dollar terms, a \$1MM portfolio doubling 3 times becomes \$8MM, 4 times becomes \$16MM, and 5 times becomes \$32MM. Earning these types of gains over a few decades requires patience, discipline, adaptability, continuous learning, objective analysis, and a realization of and correction of mistakes. It is also essential to have a well-designed, implemented and monitored investment plan that can adjust to changing circumstances over time.

## Other News

One of the core values of Meritas Advisors is to invest in our community. To that extent we are proud that Michael Mink, our COO, was recently re-elected as the co-President of the Glenwood School Foundation (GSF). The GSF, a registered 501(c)(3) organization, is the fundraising and volunteer arm of Glenwood Elementary School in San Rafael, California. The GSF provides art, science, computers, physical education and music along with technology and campus improvements for the students at Glenwood. Michael began his second term as co-President in August. Prior to his election as co-President in May of 2013, Michael served as the GSF secretary for 2 years.

We are also excited that Lenore Hawkins' book, along with co-author Chris Versace, will be published shortly. If you are interested in it, you can pre-order it from Amazon by [clicking here](#) or on the image of the book cover at right.



## Market Recap

(as of September 19<sup>th</sup>, 2014)

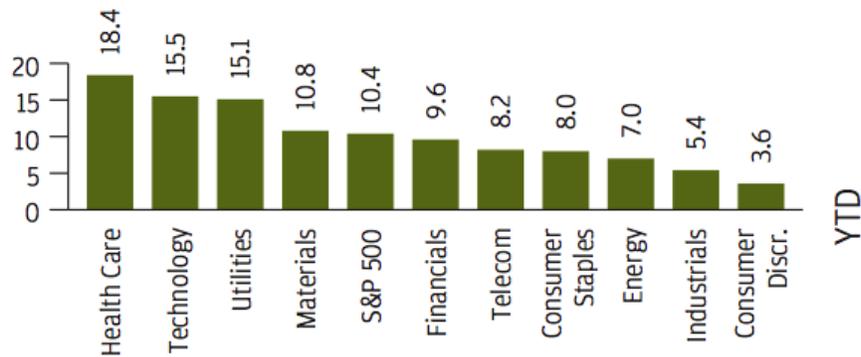
		Index Returns (%)				
<b>Equities</b>	<b>Level</b>	<b>1 week</b>	<b>QTD</b>	<b>YTD</b>	<b>1 year</b>	<b>3-yr. Cum.</b>
S&P 500	2010	1.27	3.04	10.39	19.16	78.21
Dow Jones 30	17280	1.76	3.23	6.00	13.01	63.40
Russell 2000	2850	-1.16	-3.63	-0.55	8.04	70.29
Russell 1000 Growth	619.07	0.93	3.14	9.65	18.92	73.11
Russell 1000 Value	623.95	1.23	2.28	10.75	18.83	84.34
MSCI EAFE	1901	0.04	-3.21	1.76	6.28	50.32
MSCI EM	1054	-0.66	1.27	7.67	5.96	20.97
NASDAQ	4580	0.27	4.16	10.60	22.34	82.08

<b>Fixed Income</b>	<b>Yield</b>	<b>1 week</b>	<b>QTD</b>	<b>YTD</b>	<b>1 year</b>	<b>3-yr. Cum.</b>
U.S. Aggregate	2.39	0.17	-0.09	3.83	4.29	7.02
U.S. Corporates	3.10	0.28	-0.14	5.53	7.36	15.65
Municipals (10yr)	2.20	0.09	0.96	6.71	7.23	13.64
High Yield	6.15	0.20	-0.64	4.79	8.08	34.59

		Levels (%)				
<b>Key Rates</b>	<b>9/19/14</b>	<b>9/12/14</b>	<b>6/30/14</b>	<b>12/31/13</b>	<b>9/19/13</b>	<b>9/19/11</b>
2-yr U.S. Treasuries	0.59	0.58	0.47	0.38	0.34	0.16
10-yr U.S. Treasuries	2.59	2.62	2.53	3.04	2.76	1.97
30-yr U.S. Treasuries	3.29	3.35	3.34	3.96	3.80	3.22
10-yr German Bund	0.99	1.04	1.24	1.94	1.92	1.80
3-mo. LIBOR	0.23	0.23	0.23	0.25	0.25	0.35
3-mo. EURIBOR	N/A	0.08	N/A	0.29	0.22	1.56
6-mo. CD rate	N/A	N/A	N/A	0.27	0.27	0.48
30-yr fixed mortgage	4.36	4.36	4.28	4.72	4.75	4.29
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25



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