December 22nd, 2014

MERITAS ADVISORS
Comprehensive Wealth Management

MONTHLY INVESTMENT OUTLOOK

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UPCOMING EVENTS

- 01/28: **New Tools for Maximizing the Value of your Privately Held Business** with David Ryan of Upton Financial
- 04/22-24: **XIIIth International CIFA Forum in Monaco,** guest speaker Lenore Hawkins

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 Cocktail Investing that is scheduled to be published in the Spring and is available for pre-order from Amazon.

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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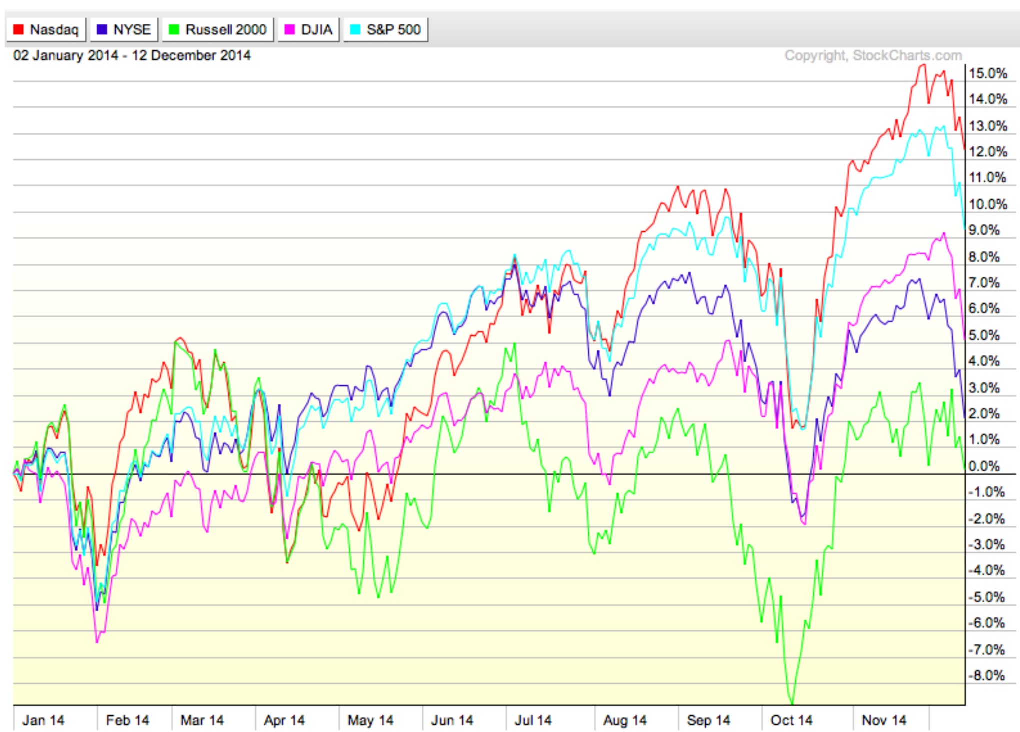
Dear Clients and Friends:

As 2014 comes to a close we are reminded that in the U.S., we have an awful lot for which to be thankful. While this year has brought the nation more strife and internal conflict than we've seen in years, maybe even decades, from Ferguson to New York to the CIA torture revelations, we are still blessed to live in a nation where each of us can speak our mind, annoy the bejaysus out of each other in relative safety and aspire to improve our lives. Many around the world are not so fortunate. Our holiday wish for you this year is for a heart full of joy when you look at your life as it truly is, with all its pleasures and even its pain, with gladness for the laughter and love you've known and wonder at all that you've yet to share.

--- *Lenore Elle Hawkins, Meritas Advisors Partner and economist, full of holiday cheer, sipping eggnog, praying for snow and hoping Santa will have overlooked her occasionally devilish moments.*

Market & Economic Update

The S&P500 fell 3.5% for the week of Dec 8th, the worst week for US large company stocks since May 2012. On Dec 5th, the S&P 500 was up 12.2% for the year, and by Dec 12th it had retreated to up 8.51% for the year.

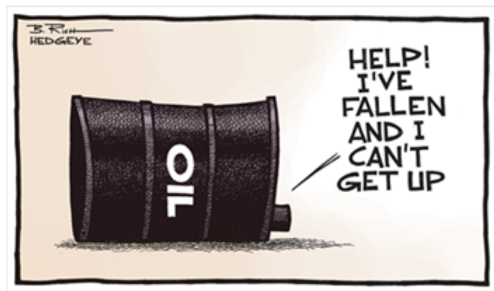


In the past couple of weeks the world has see an awful lot of tumult.

- Greece experienced the largest one-day drop in its stock market.
- Shanghai's stock market had its biggest one-day decline in five years.
- Various parts of Italy went on strike to protest Renzi's labor reforms. You just have to love that somehow the Italians always manage to schedule strikes on Fridays and Mondays…. Respect the 3-day weekend!
- London's airports were shutdown after a power outage led to a server failure. Ooops!
- The CEOs of Seaworld, Gucci and Abercromie and Fitch departed their respective companies.
- The protestors in Hong Kong were ousted.
- Considerable internal conflict arose in the U.S. as the nation struggles to deal with events in Ferguson, New York and recent revelations concerning CIA torture practices.
- Instagram overtook Twitter with 300 million monthly visitors.
- Google is to close its news-linking service in Spain next in response to a new law which will force it to pay publishers for using their content.

On December 17th and 18th, the markets shot up after the Fed gave some comfort that it would likely not raise interest rates before June 2015, meanwhile Russia desperately tries to save its crashing currency.

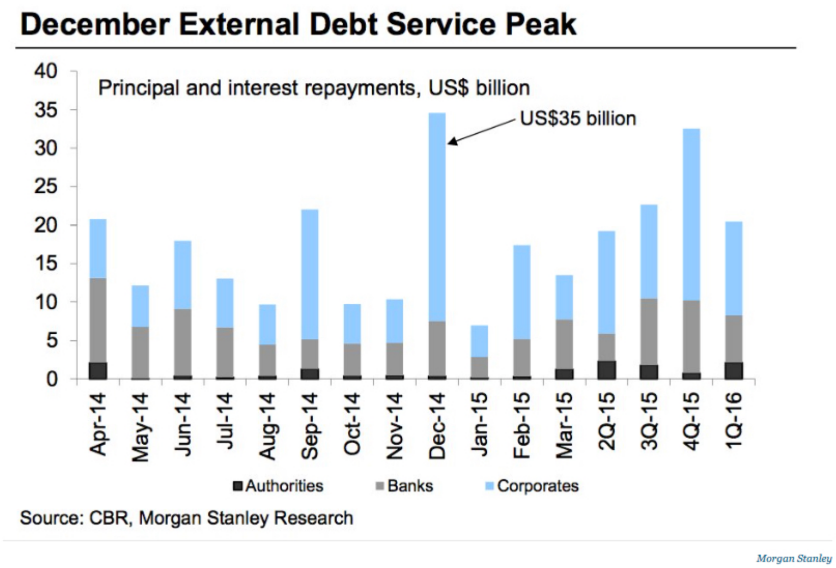
Russia and the Plunge in Oil



On Monday December 15th, the ruble had its biggest one-day drop since 1998, falling almost 13%, which prompted the Russian Central Bank to raise rates from 10.5% to 17%. Meanwhile the Russian stock market reached lows not seen since 1999. Many are starting to compare this rout to the 1998 crisis, which led to the Fed's bailout of Long Term Capital Management (LTCM) courtesy of the last Russian debt crisis. We think this time things are materially different, so investors need to understand what is happening, why it is happening and be careful to not overextend the trend.

According to the World Bank, Russia depends on oil for about 50% of government revenue. Oil and gas products represent about 70% of the nation's exports, so the over 40% drop in oil prices in the past 15 months hurts. However, unlike in the U.S., Russian government debt, (according to the International Monetary Fund) was less than 13% of GDP in 2012. So the sovereign side doesn't look too shabby at first glance. The nation has been running a deficit however, which is likely to increase materially this year. That being said, Russian bond yields are now above those of Rwanda, ouch!

Russian corporate debt is another thing entirely. The chart below is Morgan Stanley's chart of the debt repayment schedule for Russian companies.



You'll notice December is a particularly tough month for repayments. Normally a company could simply roll over the maturing debt by issuing new bonds and using the proceeds to pay off the old, but Russian corporates don't have access to the markets thanks to the sanctions imposed by the West in response to the situation in Ukraine. Those same sanctions are also impacting Russia's economy for a doubly painful impact. Some of the big oil and gas companies will likely default on their debt, which will force the Kremlin to step in, much like what happened in the US during the financial crisis. Speaking of Russian sanctions, word from the White House is President Obama stands to tighten them even more.

While Russia's current sovereign debt is small relative to GDP, which stands at just over $2 trillion in USD terms, bailing out the corporates could lead to a major liquidity crisis very soon. The question for those of us in the west is, how much of an impact will this have and in what sectors? Over the years Putin's regime has so alienated investors that exposure is rather limited. For example, Russia's stock market is valued at a nearly $1 trillion dollar discount relative to other emerging markets when looking at PE ratios, so the direct impact on the equity side is likely to be muted.

However, we cannot stop there. Russia will likely have to sell other assets it owns in order to deal with this crisis, which could adversely impact commodities such as gold. It also isn't just Russia that is feeling the pain from oil, it is Nigeria, it is Venezuela and it is high yield debt in the US, as the largest sector in corporate high yield is energy. As we've mentioned before, the suppressed oil prices may result in defaults by US energy companies, which could have a ripple effect in the markets, pushing investors away from riskier assets.

All of this comes amid slowing global growth and increasing deflationary pressures. The latest Empire State manufacturing report came in at -3.6 versus expectations of 12, up from 10.2 in November. The latest CPI report from the Bureau of Labor Statistics found that CPI for all items fell 0.3% in November after being unchanged in October. The Eurozone is stalling and China's growth has slowed further in November, with Bloomberg's gross domestic product tracker for China dropping to 6.78% growth year-on-year, down from 6.91% in October and the fourth month in a row below 7%.

Central banks have been pulling out all the stops to avoid asset price deflation and encourage orderly management of debt since the start of the financial crisis and with all the attention on Russia and oil prices, much less attention has been paid to the rest of the commodity complex, which is also showing global weakness; S&P GSCI Copper Index is down 13% year-over-year, while natural gas is down just shy of 10% and Dow Jones Industrial Metals and Mining Index is down over 15%.

Fed Continues to Make Headlines

While shoppers are watching their pennies this holiday season, I have been grinching over the relationship between the Fed and the big banks - bail them out then hammer them with an onslaught of massive fines –sounds a bit like a storyline in a bad country & western tune! According to a global banking study by the Boston Consulting Group, legal claims against the world's leading banks have reached $178 billion since the financial crisis, with heavy fines now seen as a cost of doing business, a cost ultimately borne by shareholders with no banking employees or executives facing charges for wrongdoing.

Earlier this month, the country tune evolved into Human League's 1981 hit "Don't You Want Me" with the refrain, "But don't forget it's me who put you where you are now, and I can put you back down too." On December 9th the Fed passed a proposal for risk-based surcharges on the eight US banks with $50 billion or more in assets, aka "too big to fail." Essentially, this is a hike in the required capital cushion, which ironically is demanded the same day that, with barely 48 hours left to avoid another government shutdown, a 1,603 page bill was filed by Congress to provide $1.1 trillion to fund the government through September 2015. Seems like Green Day's "Walking Contradiction" suits Capitol Hill these days!

The increased lending oversight by the Fed, which has ironically made it difficult for even former Chairman Ben Bernanke to get a mortgage, and seemingly endless fines are an ongoing headwind to financials. The sector has been priced with hopes for interest rate hikes in 2015, but if we see significant dollar strengthening (as we've discussed before), continued weakness in commodities and declining inflation expectations, the Fed may hold off on its long-promised hikes. Just look back to the Asian Crisis of 1997-1998 to see a time when a hawkish-biased Fed left rates unchanged until the fall of 1998, despite 4% GDP growth and unemployment falling to 4.5%.

Your Money and Your Life with Greg Tull

Today we'd like to cover two timely topics in "Your Money".. The first is the small number of days in any given period (year, decade or decades) in which most of the market's returns for the period are achieved. For example, the two best days to date in 2014 for the S&P500 were Dec. 17 (+2.04%) and Dec. 18 (+2.40%). With compounding, this two day return equates to 4.49%, so you can see the opportunity cost of missing just these two days in the market. The same holds true for the long-term. For the 15 year period Dec. 31, 1998 through Dec. 31, 2013, the Dow Jones Industrial Average returned an annualized 6.5% for a cumulative gain of 155%. However, missing the 10 best days in this 15 year period causes the annualized return to fall to 2.1%, for a cumulative gain of just 36%. And it gets much worse if you miss the best 20, 30, or 40 days of the 3780 days (15 years x 252 days per year) that the market is open over the course of those 15 years. Missing the best 20 days leads to an annualized loss of -0.9% and a cumulative loss of -12.5%. Missing the best 30 days results in losses of -2.9% annualized and -35.5% cumulatively. And missing the best 40 days of the 3780 days results in losses of -5.0% annualized and over half of the portfolio or -54% cumulatively. For more information and to see this data graphically, here is the research report from the mutual fund company, Putnam Investments: https://www.putnam.com/literature/pdf/II508.pdf

The second topic is year-end fund income and capital gains distributions. Late in the year, most mutual funds declare and distribute their dividend income, short-term capital gains, long-term capital gains, and for international funds, foreign tax credits. At first glance, if you look at the closing price of the mutual fund on the day the fund declares the annual distribution, something appears to be amiss. For example, on Dec. 18th, an actively managed international fund was quoted as down $1.11 or -4.5% from the closing price of the prior day. However, the fund also declared a distribution of $1.61 on Dec. 18th, so after factoring in this gain that investors are receiving, the fund was actually up $0.50 ($1.61 - $1.11 = $0.50) or 2.03% from the prior day.

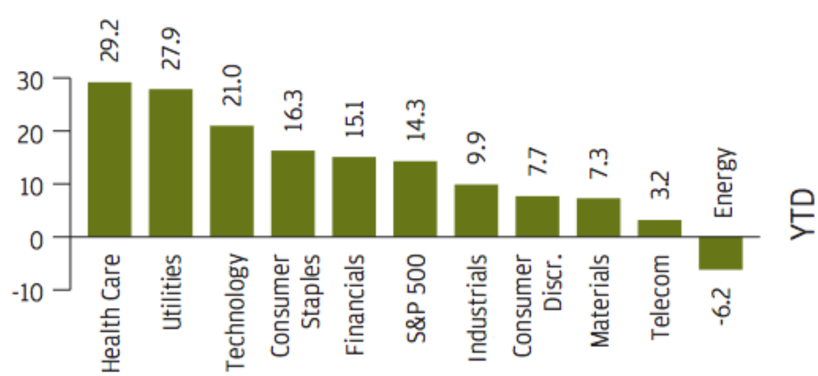
These year-end distributions are also important to keep in mind from a tax management perspective. For example, assuming your investment objectives and risk tolerance between taxable and tax-deferred accounts is similar, it's usually preferable to own actively managed funds that may generate substantial capital gains and interest income in a tax-deferred account such as an IRA, rather than in a taxable account. In the taxable account, you will owe taxes to the IRS and the state on the income and gains that the fund distributes, while in the IRA the gains and income can accumulate and compound annually with no taxes due for many years until you take distributions from the IRA in retirement. Actively-managed funds are often less tax-efficient than passively-managed funds like exchange-traded index funds.

Market Recap

(as of December 19th, 2014)

		Index Returns (%)				
Equities	**Level**	**1 week**	**QTD**	**YTD**	**1 year**	**3-yr. Cum.**
S&P 500	2071	3.44	5.48	14.28	16.79	83.25
Dow Jones 30	17805	3.08	5.00	9.85	12.61	62.94
Russell 2000	2972	3.80	8.84	4.05	7.65	75.91
Russell 1000 Growth	639.17	3.10	5.33	13.64	16.53	81.34
Russell 1000 Value	637.19	3.74	5.27	13.77	16.10	86.34
MSCI EAFE	1782	0.87	-3.18	-4.14	-0.98	44.70
MSCI EM	944.60	0.69	-5.81	-3.22	-2.00	15.73
NASDAQ	4765	2.41	6.32	15.42	18.83	96.18
Fixed Income	**Yield**	**1 week**	**QTD**	**YTD**	**1 year**	**3-yr. Cum.**
U.S. Aggregate	2.26	-0.27	1.61	5.77	5.65	7.98
U.S. Corporates	3.13	-0.30	1.51	7.19	7.08	15.92
Municipals (10yr)	2.07	-0.37	1.09	8.41	8.43	12.80
High Yield	6.98	1.08	-1.57	1.86	2.17	28.05

	Levels (%)					
Key Rates	**12/19/14**	**12/12/14**	**9/30/14**	**12/31/13**	**12/19/13**	**12/19/11**
2-yr U.S. Treasuries	0.67	0.56	0.58	0.38	0.35	0.24
10-yr U.S. Treasuries	2.17	2.10	2.52	3.04	2.94	1.82
30-yr U.S. Treasuries	2.77	2.75	3.21	3.96	3.91	2.79
10-yr German Bund	0.59	0.62	0.90	1.94	1.87	1.88
3-mo. LIBOR	0.25	0.24	0.24	0.25	0.25	0.57
3-mo. EURIBOR	N/A	0.08	0.08	0.29	0.30	1.44
6-mo. CD rate	N/A	N/A	N/A	0.27	0.27	0.68
30-yr fixed mortgage	4.06	4.06	4.33	4.72	4.62	4.08
Prime Rate	3.25	3.25	3.25	3.25	3.25	3.25



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