Investment Perspectives
2013 Q2

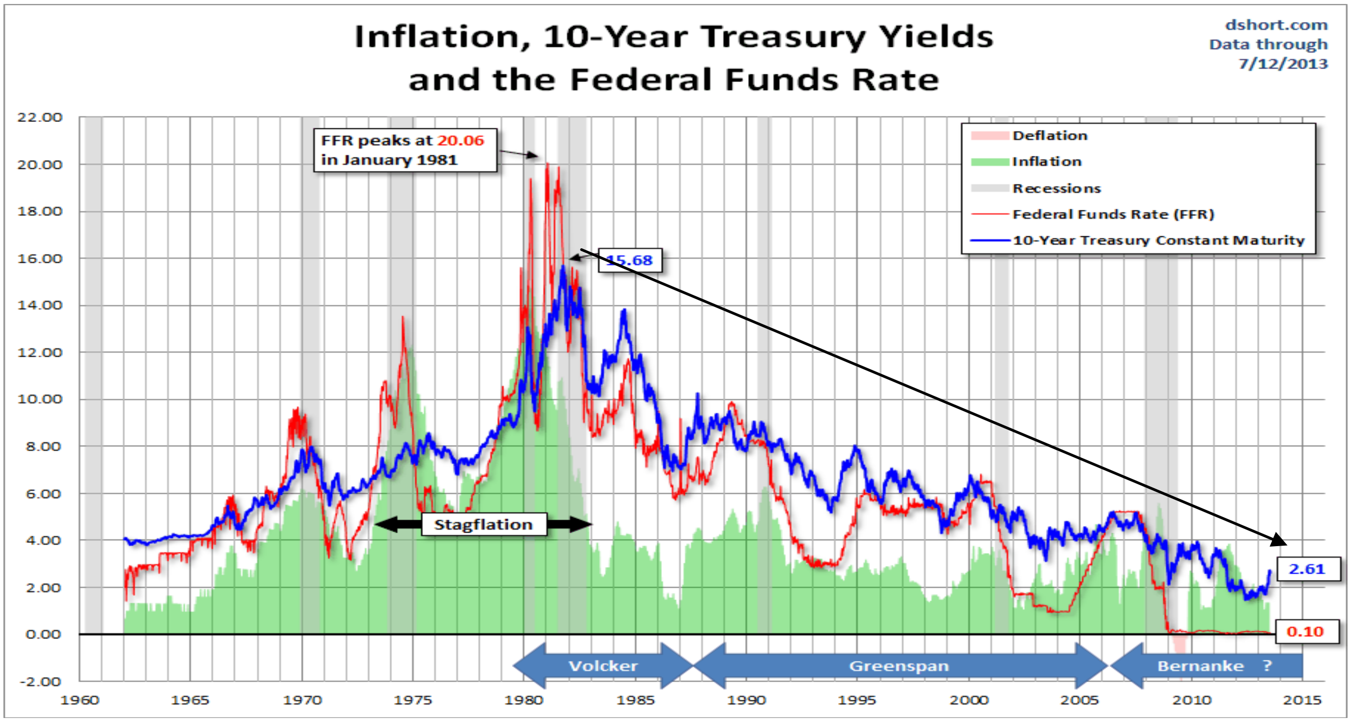
The Fed is in Control

We are now at the half way point in 2013 and to sum up the events of this year in one word would be… unexpected.

If you recall we were trying to avoid the financial cliff to start the year which politicians averted at the last hour and kicked the "deficit can" down the road just a little but further. Despite not completely resolving the issues at hand, it was enough for the equity markets to record one of the best first half finishes since 1998. The magnitude and length of this rally without any measureable correction was certainly a pleasant surprise to everyone. But as these political events tend to come full circle, we are back to discussing a possible government shutdown this September.

During Q2 Fed Chairman Ben Bernanke's June speech helped send both equity and bond markets lower, due to the hint of a pullback in quantitative easing. The Fed collectively tried to "re-clarify" the chairman's statement, but by that time the equity markets had already dropped 5% and the 10 year treasury yield was up over 2.5%.

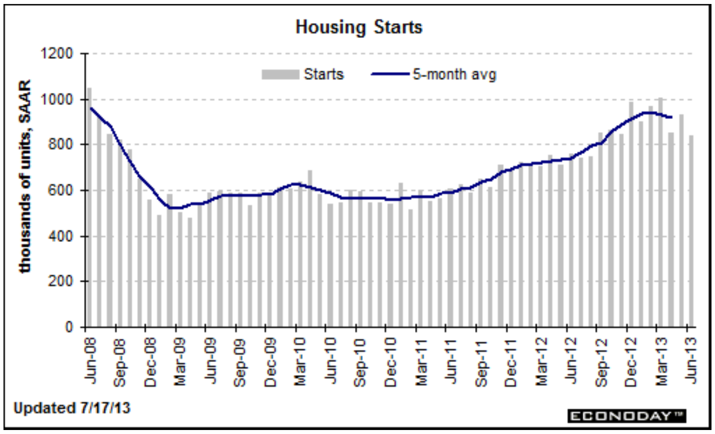
Bond king, Bill Gross of PIMCO tweeted on May 10, "The secular 30-yr bull market in bonds likely ended 4/29/2013. PIMCO can help you navigate a likely lower return 2 - 3% future." Just take a look at the chart below, by Doug Short and you will see that this streak of lower rates had to end at some point. The topic of conversation should now turn to how to manage investments in an increasing rate environment with continued sluggish growth.



Change in Environment

If indeed interest rates have hit bottom and are headed higher, we still don't anticipate a steep drop off in the Fed's current monetary policy. The Fed will continue to pump out liquidity in order to support and manage this tepid recovery.

Certain asset classes perform very differently in this type of environment. Obviously increasing bond yields mean that bond prices are heading lower - which is not good for those heavily invested in fixed income. Also cyclical sectors such as housing and autos tend to suffer as the cost of borrowing increases and people pull back on major expenditures. However, in the current economic situation there may be enough pent up demand to keep these sectors growing. Although rates have moved higher, they are still closer to historical lows than highs.



Multi-national companies tend to underperform in this type of situation due to the strength of the US dollar vs. other competing currencies. The current rise in the US dollar should offer some relief in commodity costs such as gas and oil which are usually denominated in US dollars. Looking at growth stocks vs. dividend paying stocks, growth tends to outperform in this climate because of the loss of purchasing power and the need to keep up with inflation and rising interest rates.

Market Vulnerability Ahead?

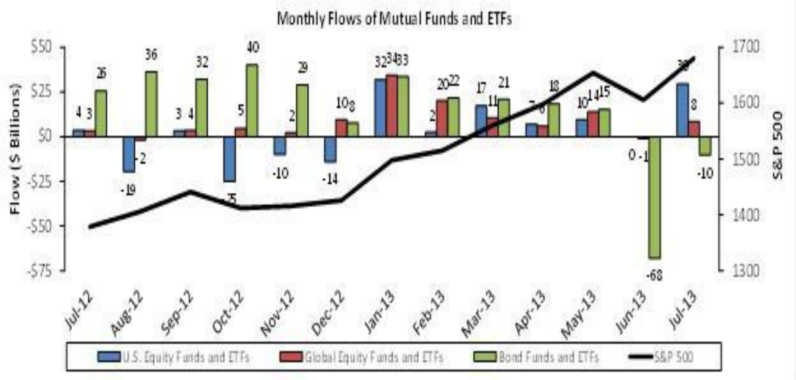
One of the investing conundrums is that asset prices only make sense in a lower interest rate environment. Since 2009, practically every asset class has been bid up as a consequence of the Fed's monetary policies to keep interest rates low in order to stabilize the economy and spurn growth. This situation leads to a vulnerability in all asset classes that has never really existed. If you take away the expectation of lower rates, just about every asset is susceptible to a fall in price.

This is not simply a bond vs. stock scenario. You might think increasing your cash position is about the only way to take shelter from a significant downturn.

But one question to consider is what if investors switch from one asset class to another rather than going to a conservative cash position? What if there is a "great rotation" from bonds to equities which further ignites this bull market rally we have seen in stocks?

With market yields still below inflation, cash could prove to be a losing proposition. So an alternative strategy could be the *right* stocks. Growth stocks tend to be leaders in this environment vs. cyclical, utility, telecom, and dividend paying stocks.

Strategies for Changing Market Conditions



The likelihood of knowing when this change could take place is pretty close to zero. However, this does not mean that you cannot begin to prepare for it and adjust your investment strategy going forward. At TAMMA we are taking the following steps to prepare clients for this possible change in market conditions:

- Reduce exposure to fixed income assets. Investors who have been carrying a heavier asset allocation towards bonds should begin to shift towards equities, cash, and/or a combination of the two.
- We recommend shortening the duration of your bond portfolio. This means reduce your exposure to long-term bonds such as 30 or 20 year maturities and move into shorter dated maturities such as 2, 5, and 10 year bonds.
- Increase your asset allocation towards growth oriented US equities and away from cyclical and possibly some dividend paying stocks such as utilities and telecoms. You should be looking for growth at a reasonable price that has some downside protection and scaling into positions rather than allocating all of your assets at once.
- Reduce exposure to certain types of hard assets such as commodities and gold.

Education Planning: What Are the Best Savings Vehicles?

This quarter, we review the third pillar within the “Five Pillars of the TAMMA Wealth Management Process”, Education and address the question, “what are the best savings vehicles.”

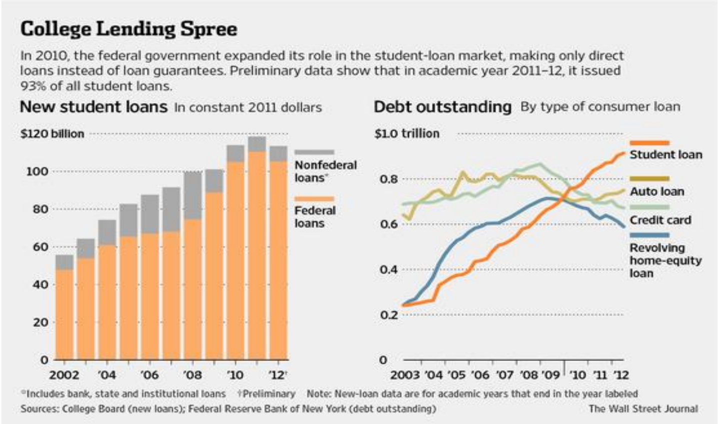
1. Planning for the Unexpected: Emergency, Insurance, & Estate Planning
2. Retirement
3. **Education**
4. Non-Retirement Investments
5. Philanthropy

According to the U.S. Department of Education, for the 2010–11 academic years, annual current dollar prices for undergraduate tuition, room, and board were estimated to be $13,600 at public institutions, $36,300 at private not-for-profit institutions, and $23,500 at private for-profit institutions. Between 2000–01 and 2010–11, prices for undergraduate tuition, room, and board at public institutions rose 42 percent, and prices at private not-for-profit institutions rose 31 percent, after adjustment for inflation. The inflation-adjusted price for undergraduate tuition, room, and board at private for-profit institutions was 5 percent higher in 2010–11 than in 2000–01.

These are staggering figures indeed especially for those families trying to balance current income needs and planning for retirement. We often communicate with parents/families struggling to find financial balance that they must prioritize their needs. You can always get a loan for college but you cannot get a loan for retirement.

But with the average debt load of $26,600 for a college grad in 2011 how do parents/families help their children avoid this tremendous burden?

1. Start talking with your children early about what they want to do and the possible options available to them. This may mean staying closer to home or going to a community college first to defray part of the costs.
2. While financial aid is needs based and most scholarships are merit based, those families who have above average incomes and children not in the top tier of their class could end up paying the highest price of college. Stress to your kids the important of education and maintaining good grades. Also know that there are scholarship opportunities out there that are not strictly merit based but you must be judicious to find them.



3. You need to look at college as an investment no different than your retirement plan or any other savings goal that you may have. You want to achieve the highest return on that investment as possible. We often tell parents/families that if your child gets into Harvard, it may not make economic sense for them to attend school there. You need to look at the burden of carrying possibly tens if not hundreds of thousands of debt with many careers that may only pay for a fraction of that cost.

There are a few very good savings/investment vehicles that have different advantages depending upon the state that you live you. Below are a few:

1. Traditional & ROTH IRA's
   a. Even though these are retirement savings vehicles, they can be used without penalty to pay for higher education expenses. Your assets grow tax deferred (Traditional) or tax free (ROTH) and you have numerous investment options to choose from. In the event that your child does not go to college, you can use the assets towards your own retirement plan without the distribution penalty that other specific college savings plans apply.
2. 529 Plans
   a. For a specific college savings plan this is the best option in our view. Assets grow tax free. Anyone can contribute such as family and friends no matter what their level of income. The max contribution per beneficiary varies among plans but can reach up to $235,000 per year.

b. Depending upon what state you live in, you may also qualify for a state income tax reduction depending upon the specific plan. For example in the State of MI, if you utilize the state sponsored plan, you can receive up to a $1,800 credit off of your state income tax.
c. Contrary to popular belief, 529 plans can be used at any qualifying institution in any state. They are portable and can even be transferred to another family member.

3. Coverdale Savings Account
    a. Assets grow tax free same as 529 Plans, but contributions are limited to just a total of $2,000 per year per beneficiary. Once the parent/guardian reaches a specific income threshold, you can no longer contribute to the savings account.

There are also tax credits that you may want to consider as well such as the American Opportunity Tax Credit and the Lifetime Learning Credit. Please feel free to reach out to us with any questions you may have about these or any other investment vehicles.

TAMMA Capital Updates

We are pleased to announce the launch of our newly designed website. We have received a tremendous amount of positive feedback thus far and we thank those clients and readers for reaching out to us. This project would not have been possible without the hard work of Vinay Pallegar of iPal Media and Camille Jayne, President & CEO of The Community House. You can visit our new site by going here.

And speaking of The Community House, TAMMA was featured as a wealth management subject matter expert in June as part of "Making a Difference at TCH" on the Bloomfield Community Television Network. You can watch the video by going here. On Wednesday, September 18th from 6 from 6:30-8:00pm, TAMMA Capital will be sponsoring the second business book club review at TCH featuring "Contagious: Why Things Catch On" by Jonah Berger.

To clients, we thank you for allowing us to personalize investing for your future. We hope that all readers find our insights to be both educational and helpful.

Paul Fenner, RIA, ChFC
President

TAMMA Capital LLC is a Registered Investment Advisor in the State of MI

*Charts used courtesy of Doug Short, TrimTabs Investment Research, and Econoday