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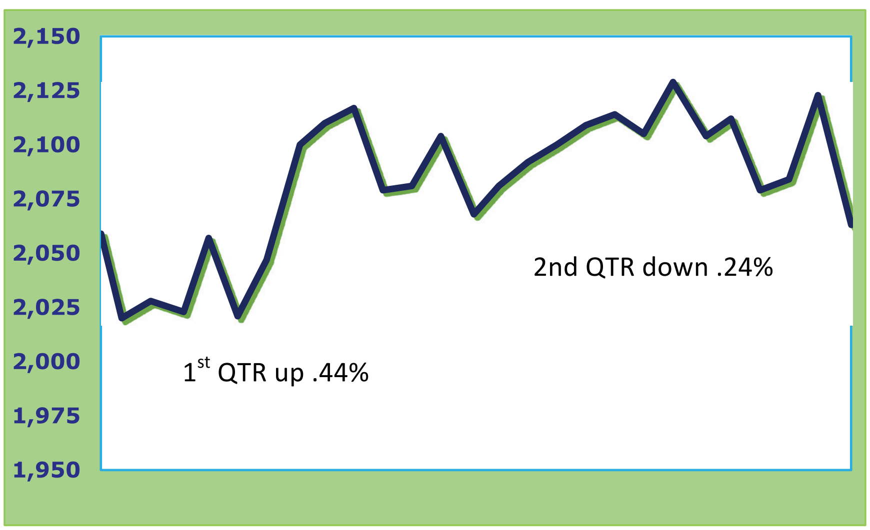
QUARTERLY INVESTMENT REPORT
June 30, 2015

Dear Investor:

After a volatile first quarter, the second quarter started out as a yawner. May and June quickly reverted to form with more than a handful of daily moves higher or lower than 1%. With two days to spare in the quarter, Greece made it tragically clear that it would not pay its quarter end bond payment to the International Monetary Fund (IMF); this was the first time any nation has defaulted on a debt payment to the IMF. More on Greece later…but it was no surprise that the markets were shocked and the indices tumbled 2%. What started out as a promising quarter, ended with the S&P 500 down .24% in the 2nd quarter and essentially flat for the year so far.

S&P 500

Year-To-Date up .20%



It is often difficult to determine which events affect the markets most and not surprisingly there were many events to choose from in the quarter. A boom in mergers and acquisitions activity across many industries certainly contributed; year-to-date global M&A activity surpassed $2 trillion with domestic M&A breaking a new record at just over $1 trillion. Other major events in the quarter include a heavily debated Trans-Pacific Partnership agreement involving 11 Asian Pacific economies and the United States, economic strains on Europe from Middle Eastern and African refugees, and two momentous Supreme Court rulings – making Obamacare and legalized gay marriage the rule of the land. Undoubtedly, Greece's troubles and the Federal Reserve's nearing commitment to increase short-term interest rates have led the fray.

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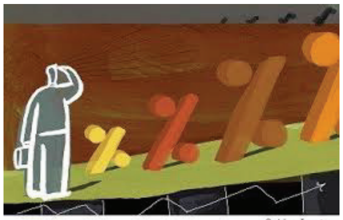

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We are pretty confident that the Fed will begin to hike rates some time in 2015, and with the next Fed meetings scheduled for July, September, October and December, the markets are expecting them to begin in September.

The initial increase will likely be a small .25% with additional raises to follow. We can expect gradual increases over a one year period that could total at least one percentage point. These increases directly affect the very short end of the yield curve – the interest rates that banks charge each other to borrow money overnight. Longer maturity bonds in the market tend to rise also when the Fed is raising rates, but those increases are market driven based on inflation expectations.

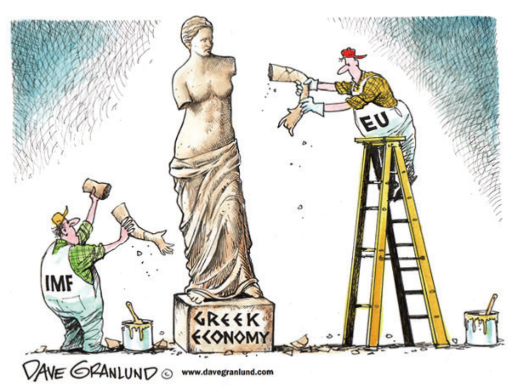
In four out of the five recent historical rising interest rate periods (2004-2006, 1999-2000, 1994-1995, 1988-1989, and 1986-1987), returns on the S&P 500 index outperformed more conservative bond strategies. In fact, in every period, stocks were positive. Interestingly, all bond categories except for longer maturity treasury bonds, had positive returns. On average during rising rates, stock prices rose 14%, 2-year treasury prices rose 2%, short corporate bond prices rose 3% and 10 year treasury prices declined 2%.

Historically the Fed has raised rates to cool off the economy and keep inflation in check. This go around the Fed is just trying to get interest rates back to a more normal level without jeopardizing economic growth. So, theoretically, stocks have an even better chance of responding favorably to rising rates.

How tragic, that the country that invented democracy in the 6th century BC is on the brink of bankruptcy largely due to a capitalistic privilege – debt - offered democratically to all people and governments.

Histrionics aside, the asset bubble that became Greece was indeed a debt financed bubble, but many other countries leading up to the 2008 financial crises were similarly in trouble. The difference for Greece was a combination of being too complacent with economic austerity measures and the fact that its export economy was too weak to pick up the slack.

After multiple bailouts by the International Monetary Fund (IMF) and European Central Bank (ECB) since the financial crises, Greece still owes billions on an IMF loan, a Eurozone loan, and bank liabilities to other nations in the Eurozone; not to mention Greek household and corporate debt held by non-Greek Eurozone banks.



It seems that Greece has now chosen default and capital controls. It's possible for them to still cut a deal to relieve both, but whether or not they can stay in the Eurozone is another question. The debt part of the problem is not terribly threatening because

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Greece is a small economy. Its Gross Domestic Product (GDP) is less than half a percent of the world economy. And its outstanding debt amounts to barely 1% of Europe's banking assets. Default will not threaten Europe's financial stability. Plus, there are additional safeguards against uncertainty since the debt is now largely held by government entities and the ECB's bond buying program should restrict escalating borrowing cost in Italy, Spain, and other at risk countries in the Eurozone.

There are some economic dangers, though, should bank depositors in the Eurozone follow the Greek example and withdraw bank deposits. The capital controls that Greece established heightened the fears of consumers and businesses and made a weak economy even weaker. And the ECB can only do so much buying. It has opened an emergency credit line for Greek banks, but it isn't in a position to re-liquefy the banks if the current situation turns into a panic and if the Italians, Spaniards, and others follow the Greek example. Thankfully, so far, there is little sign that depositors' fears extend beyond Greece. The story will play out over the coming weeks as Greeks vote to play ball with the Eurozone or not.

Getting back to more domestic thoughts, though we don't believe that rising interest rates will, in and of themselves, derail this bull market, we are very cautious about our stock holdings based on valuation. Prices based on Price to Earnings (PE) multiples, are about 20% higher than their historical average. As threatening as that sounds, three things keep us from dramatically paring back on stocks at this time: (1) historically a rising stock market typically goes well above its norms before peaking, (2) stock valuations look much better when compared to bonds and cash, and (3) economic growth can support a continued increase in company earnings.

We expect to see more price volatility and prices gradually grinding higher, and should that happen, we will reallocate a portion of our stock allocation into cash and bonds.

Enjoy the Independence Day weekend!

Sincerely,

Ellen P. Le, CFA
President

Reverse Mortgages (RM)

For most investors, a reverse mortgage (RM) is inappropriate. However, as it is a growing source of funds for many seniors, understanding its details may be helpful, if not for yourself, then for family or friends who turn to you for counsel.

With a traditional fixed mortgage loan, homeowners borrow money from a bank to buy their home. Over the term of the mortgage, the homeowner pays the bank partial principal and interest every month. The "reverse" of this allows seniors to access the equity they have built up in their homes *now* and defer payment of the loan until they die, sell, or move out of the home. With the RM the bank pays the homeowner cash from the available equity in the home while charging interest to do so.

A RM is a nifty way for seniors to get cash from their home without having to sell it and move to an apartment or bunk with their children. Because there are no required mortgage payments on a RM, the interest cost is added to the loan balance each month. The rising loan balance can eventually grow to exceed the value of the home, particularly when home values are declining or if the homeowner continues to live in the home for many years. But, the borrower (or the borrower's estate) is not required to repay any additional loan balance in excess of the value of the home. RM's are insured by the Federal Housing Administration (FHA) which guarantees that even if the home value declines, homeowners can still continue to get their cash (according to the terms of the loan) and the bank can still get fully repaid when the home is sold.

RM's are generally easier to qualify for than other sources of income from a home, like traditional home equity loans and lines of credit which require adequate income and credit scores. <u>But there are two huge trade-offs: one is that RM's cost much more than traditional home equity sources of income. And two, the equity in the home gets depleted and there may be little or no equity left for heirs.</u>

<u>The rules are simple</u>. The homeowner <u>MUST</u>: (1) be at least 62 years old (2) own their home outright or have a very low mortgage left on it that can be paid off at the closing of the RM (3) have the resources to pay ongoing property charges including taxes and insurance and (4) live in the home.

<u>How much cash received depends on</u>: (1) age (2) interest rates (3) value of the home (limit is typically $625,500). Cash can be received in a lump sum, periodic payments, line of credit, or a combination of all three. And there are no restrictions on how the money can be used.

<u>Costs</u>: Upfront: Lender fees, upfront mortgage insurance, real estate closing costs. Over time: Loan interest and ongoing mortgage insurance premiums. Note that as the loan balance grows, so too will the interest and mortgage insurance charges. **Money should be taken only as needed.**

It's complex, and homeowners are required to receive mandatory (free) counseling by a third party that is approved by the Department of Housing and Urban Development (HUD) or a national counseling agency such as AARP. We also strongly suggest having an investment advisor review all options to see if there are other ways to access funds or reduce expenditures. A RM should be considered only after a very careful review of one's assets, liabilities, income sources, and expenses. If no other sources of income are available to help make retirement comfortable, then one should simply enjoy the benefits of the reverse mortgage!

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