rebalance IRA

Market Review

Fall 2015

As we look back at the third quarter of the year, it seems clear that the stiff stock market correction of August and September, while serious, was not permanently damaging to prudent investors who stayed the course.

Nobody knows if the sharp correction that occurred in the quarter is completely behind us. But we do know that **Rebalance IRA** clients avoided a serious mistake that many a "long term" investor can fall prey to during such periods — succumbing to fear and abandoning a well-conceived strategy.

We all know that slow and steady wins the race. By sticking to a rigorous, defined investment strategy one avoids destructive, knee-jerk reactions and ensures a path to a secure retirement. As a **Rebalance IRA** client, you passed a difficult test with flying colors!

Corrections are never fun. The global stock market fell by nearly 10% in the third quarter, wiping out trillions of dollars of wealth and shocking some investors who had grown accustomed to four years of steady gains and a general lack of volatility.

The S&P 500 fell by 6.5%. Small caps, international developed and emerging markets stocks fared worse, down 9.7%, 10.3% and 17.9%, respectively. Many people looked back at the beginning of the year and began to doubt themselves. It's only natural to be concerned.

Yet the market decline in Q3 turned about to a classic, even predictable correction, and one that was long overdue. It happened suddenly and for reasons that were not, at the time, highlighted in the financial media. The investment world was obsessed with the chaotic politics of Greece, yet it was news of a slowdown in China that ultimately set the stage for a steep decline.

Nevertheless, roughly two-thirds of all stock corrections fade away soon enough, and we don't see anything suggesting that the rebound we have seen so far is out of step with historical experience. In fact, most investors have moved on and instead are worried about the bond market and, specifically, the U.S. interest rate.

For instance, several of our clients recently asked us a very important question, paraphrased below:

> *"If the Fed is going to raise interest rates, then shouldn't we sell our bonds and buy them back at a later date?"*

Our answer is that simple. *The expected rise in interest rates is already priced into the market.* This concept, that information that is widely known is already "priced in" to market valuations, was illustrated years ago by **Rebalance IRA** Investment Committee member Professor Burton Malkiel, in his investment classic *A Random Walk Down Wall Street.*

Having been tested and proven over many market cycles in the years since, it is important to understand what Burt's ideas mean for your retirement investments.

Many of us read the financial news or watch CNBC. Over time, it's normal to develop strong opinions about what we think will happen with the markets, to bond prices or to stocks. Insofar as having an opinion goes, that's fine. But acting upon such opinions as if they were facts is treacherous.

As Burt said during a recent interview on the PBS show "WealthTrack," a little bit of knowledge can be a terribly dangerous thing for investors. "Let me tell you, all of us need to be very modest about what we know and don't know about financial markets," Burt told the show's longtime host, Consuelo Mack. And Burt knows more than most!

Daily financial media is not different from other media. You get a taste for the trends and ideas as they surface, but that's not nearly the same as participating firsthand in the conversation. While we sit back at home and watch the dizzying array of securities prices on CNBC, the global factors driving those numbers are nearly incalculable. We might appreciate the ripples of a broad river in the sunlight, but the speed of the water underneath is unfathomable, and quite possibly dangerous.

There are many forces at work setting prices, most of them impossible to accurately measure, even in hindsight. All day every day, around the globe, thousands of professional investors with the highest IQs and the most advanced degrees are competing to find inefficiencies in the prices of everything — from microcaps in Japan to municipal bonds in California to the movers and shakers on the big boards.

They are among the mostly highly compensated people in the world because the stakes are so very high. Full-time traders research literally every security: IBM, Nestlé, Japanese debt, euros, gold, pork bellies — and so on. It is their business to know a lot about a company, often more than the management teams running those enterprises know.

These folks sleep only a few hours a night and go years without vacations. Armed to the teeth

supercomputers, they pore over data in borderline quixotic bid to figure out what each security is worth, minute by minute, every trading day. They read obscure online sources. They hire private investigators to verify retail sales figures. Some have famously staked out parking lots and counted employees coming and going to estimate changes in headcount.

A few will stop at nothing to get the slightest edge. Recently, in fact, several hedge fund managers were arrested for insider trading. Their crime? They paid spies inside publicly traded companies to give them information that others didn't have, just to beat a competitor to the punch on a trade.

Based on all this research, above-board or otherwise obtained, they form professional opinions and then bet billions of institutional dollars on what they think will happen next.

When they trade, when they publicly agree on a price, they do so for very different reasons than you or me. The institutional buyer believes in the upside thanks to months of deep analysis. He thinks the seller has gotten emotional and will capitulate. (The seller obviously thinks the opposite, but only one can be right!)

Prices thus change in a nanosecond based on incremental, nearly inconsequential data, a rumor that two tech giants might merge, a protest in a remote Chinese mining region, even a minor bug found in a new smartwatch.

So, yes, you might have formed an opinion about the bond market, the "correct" price of gold or the future return of U.S. stocks, but hundreds of fully engaged professional investors have already thought about all of this, their teams of analysts have thought about it, their acres of computers have thought about it, and then they bid against one another with big dollars to determine a live, daily price.

All of these elements are already factored into ("priced in," to quote Burt) the trading price you see on a ticker and the news you hear at the top of the hour. No matter what you think you know, all of us are getting the information equivalent of very stale leftovers. Today's "live" price quotes are definitely already yesterday's news.

At **Rebalance IRA** we don't compete in this game. We don't bet against the big-fish investors. Rather, we let them battle it out over prices and instead use index funds to take advantage of all their hard, expensive work — at a tiny fraction of the cost!

This is why the **Rebalance IRA** process works so well for retirement investors and why the most sophisticated pension funds, such as CalPers, IBM and others do so, too. And as a client of **Rebalance IRA**, you should feel proud that you are managing your money in the smartest and safest way possible.

Our portfolios have all largely recovered from the beginning of 2015 with no "betting" or market timing, no fancy funds or trading strategies. Our clients are safe and relaxed. After corrections like this we often wonder, why doesn't everyone invest with **Rebalance IRA**?

The **Rebalance IRA** Investment Committee works with two broad asset classes for the basic building blocks of our client's retirement portfolios: Growth and Income. During 2015, the asset classes performed as follows:

Growth Asset Classes*	Q1 2015 Returns	Q2 2015 Returns	Q3 2015 Returns	YTD 2015 Returns
U.S. Total Market (VTI)	1.7%	0.2%	-7.9%	-5.5%
U.S. Small Cap (IJR)	3.5%	0.2%	-9.7%	-5.0%
Emerging Markets (VWO)	2.3%	1.0%	-17.9%	-14.3%
Foreign Developed (VEA)	5.6%	0.8%	-10.3%	-3.%
International Small Cap (VSS)	4.2%	3.4%	3.4%	7.7%
U.S. Real Estate (VNQ)	4.7%	-10.5%	-10.5%	-6.3%

Income Asset Classes*	Q1 2015 Returns	Q2 2015 Returns	Q3 2015 Returns	YTD 2015 Returns
High-Yield Dividend Equities (VYM)	0.0%	-0.6%	-0.6%	-0.6%
US Corporate Bonds (VCIT)	2.4%	-2.0%	-2.0%	0.4%
High-Yield Corporate Bonds (HYG)	2.0%	-0.7%	-0.7%	1.3%
Emerging Market Bonds (EMB)	2.9%	-0.9%	-0.9%	1.9%

*Returns displayed representing the major asset classes of **Rebalance IRA** portfolios include dividends as measured using the ETFs shown in parenthesis.

Growth Asset Classes

U.S. Stocks. As China's economy faltered, investors in U.S. equities pulled back in reaction. The S&P experienced a sharp if easily predicted decline after several consecutive years of gains, putting

the year-to-date return into the red. A correction in hindsight is never a surprise, as unsettling as it seems in the moment. Rather, the surprise has been how long it has taken the U.S. stock market to move to a price level more in line with moderate and uneven economic growth and limited near-term expectations.

Small-Cap Stocks. Small-cap U.S. stocks took a tumble in the quarter as well, falling more sharply than large-cap stocks but doing better year-to-date. By their nature more speculative bets and typically lacking dividends, small caps are often the place short-term investors turn to raise cash in a market decline. That hardly reflects on the quality of the asset class overall, and its performance over time remains hard to beat.

Real Estate Stocks. Real estate has leveled off after a few years of being the shelter of choice for income-seeking investors concerned about the risks implied by historically high bond prices. Constantly talk of an interest rate increase dampens enthusiasm for real estate-backed securities, but an extension of the current regime of very low rates could reignite real estate investments in the quarters to come.

Large European, Japanese & Asian Stocks. Large foreign corporations were drag to overall performance as Europe staved off the worst but definitely stayed in the "glass half-empty" mode in terms of its recovery. A big driver, of course, is declining Chinese demand for export goods, particularly from Germany and Japan. Add to all that a raging debate around Syrian refugees and a major embarrassment for German carmaker Volkswagen over emissions reporting and it's hard to make the case that there's good news from Europe. Growth has stalled in Japan as well, leading to a government revision downward of its prospects.

Emerging Market Stocks. The sharp decline in China naturally hit other emerging economies hard, too. Many of them have prospered by selling commodity food, metals and energy products to Beijing. Although typical of the boom-bust cycles often seen in emerging economies, the impact of China had a more serious effect on these countries, making emerging markets the worst performer year to date for our portfolios.

Income Asset Class

U.S. Corporate Bonds. Lack of direction from the Federal Reserve on government bond rates has fed positively into the corporate bond market as investors sought better yields from commercial paper. Corporate bonds were one of the few positive areas in terms of the portfolio overall. However, if the Fed puts off a decision on raising interest rates into 2016, corporate debt could remain a powerful diversifier for some months to come.

High-Yield Corporate Bonds. A strong performer in quarters past, high yield has begun to slip. Investors worry, rightly, that rising borrowing costs coupled with a slowing U.S. economy could push some borrowers into default. Our portfolios use high-yield debt not as a mainstay but as an uncorrelated diversification tool, so a decline in bond prices allows us to purchase more during our routine rebalancing.

Emerging Market Bonds. Emerging market debt has stayed in the black year-to-date despite a small decline in the third quarter. Foreign hunger for U.S. government debt might be reaching its limits, implying increased demand for smaller-country debt in the months ahead. Broad diversification is important in this category; narrowly concentrating on specific countries is too close to market timing and rarely works out as one expects.

High Yield Dividend Equities. Dividend payers got caught in the down draft affecting all equities, although they fell by less overall in the quarter. While the decline in face value seems like a negative, it's important to remember that a falling stock price means a rising dividend yield. Our rebalancing strategy and dollar-cost averaging allow our clients to enjoy those rising relative yields automatically.

The Rebalance IRA Investment Process

Rebalance IRA portfolios are diversified into thousands of stocks and bonds in the United States and over 45 foreign countries. Market cycles will continue. Research going back decades, much of it done by members of the **Rebalance IRA** Investment Committee, shows that using those cycles in a prudent manner is the most effective long-term strategy for retirement investing.

By systematically rebalancing our clients' portfolios, we are able to take advantage of market gyrations. Trimming what has gotten rich, and adding to what has soured, enables us to take advantage of market ups and downs, rather than becoming paralyzed by it. **Rebalance IRA** proprietary portfolios rely on multiple ways to deliver returns to our clients that are commensurate with the risk taken.

The **Rebalance IRA** Investment Committee has created a vigilant and disciplined rebalancing process that assures that our client portfolios are managed using the best practices of sophisticated endowments and pension funds. We will alert you when we are about to trim winning asset classes, and buy more of the losing asset classes, so that you can better understand how we are managing your money.

Your portfolio is premised on the dialogue that we have with you to understand your situation, risk tolerance and liquidity needs. Our goal: to help you reach your retirement investing goals with the lowest assumed risk possible.

We value your trust and look forward to many years of prudent and profitable investing. And, if at any time you would like to talk, please feel free to send us an email or give us a phone call.

Very truly yours,

Your Rebalance IRA Team

The Rebalance IRA Investment Committee

Burton Malkiel, Charles Ellis and Jay Vivian comprise the **Rebalance IRA** Investment Committee. They are renowned for creating and implementing sophisticated investment methods used today by elite pensions and endowments. The Investment Committee actively develops, oversees and sets policies for the portfolios offered to **Rebalance IRA** clients. Their core ideas include diversification across multiple types of assets on a global basis and disciplined portfolio rebalancing. They also advocate techniques for keeping investment fees low.

Professor Malkiel is an emeritus Princeton University economics professor, a former board member of The Vanguard Group, and the author of the investment classic *A Random Walk Down Wall Street*.

Dr. Ellis was for three decades the managing partner of Greenwich Associates, the leading investment advisor to large pools of institutional capital around the world. He was Chairman of the Investment Committee of the famed Yale Endowment, and he has served on the governing boards of The Vanguard Group, Yale, Harvard, NYU Stern, Exeter, the Whitehead Institute, and the Robert Wood Johnson Foundation.

Jay Vivian is the former Managing Director of the IBM Retirement Funds, responsible for over $100 billion in IBM investment funds for more than 400,000 employees worldwide.