FOSTER & MOTLEY
Wealth Management

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# Review & Outlook

## Market Notes

In 2014, the S&P 500 returned 13.7%, its third year in a row of double-digit gains. Large U.S. stocks were bolstered by a stronger economy, underlying earnings growth, and rising valuations, to a level not seen since before 2008. Small U.S. stocks (the Russell 2000), on the other hand, returned only 4.9% after a spectacular year in 2013.

Established and emerging stock indices fared much worse, each producing negative returns of -4.9% and -2.2%, respectively. Instability in Russia, unemployment in the Eurozone, and slowed growth in China were all contributing factors.

In the bond markets, taxable bonds earned 6.4% for the year and outpaced municipals bonds which earned 4.3%. The 10-year treasury yield fell over .8% from a year ago to 2.2%, despite an end to the Fed's quantitative easing program that left $4.5 trillion in assets on the balance sheet. Fed Chair Janet Yellen will weigh an unemployment rate of 5.6%, the lowest the country has seen since June 2008, against muted yearly inflation of only 0.8% when deciding whether to raise interest rates in 2015. REITs were by far the winner for the 4th quarter and the year, returning over 28% in 2014.

Here are the numbers through December 31st:

| Benchmark Returns as of December 31, 2014 | | |
|---|---|---|
| | QTR | 2014 |
| Blended Equity *(includes next 4 indices)*: | 3.4% | 8.0% |
| S&P 500 -large US stocks *(60%)* | 4.9% | 13.7% |
| Russell 2000 -small stocks *(15%)* | 9.7% | 4.9% |
| EAFE -established intl stocks *(15%)* | -3.6% | -4.9% |
| MSCI Emerging Markets Free *(10%)* | -4.5% | -2.2% |
| Dow Jones Industrial Average | 5.2% | 10.0% |
| Merrill Lynch US Master (txbl. bonds) | 1.9% | 6.4% |
| Merrill Lynch Municipals 1-12 years | 0.5% | 4.3% |
| NAREIT Equity REIT Index | 13.0% | 28.0% |

## Better Decisions, Better Outcomes by David A. Foster, CPA, CFP®

Are we hard-wired to make bad decisions? The answer to that is yes, according to behavioral psychologists and economists who study this field. And I agree; what they say rings true.

There has been at least one session on behavioral finance at every conference I have attended over the past several years. The purpose of this article is to share some of what I have heard and read from books like *Thinking Fast and Slow* by Nobel-prize winning psychologist Daniel Kahneman, *Predictably Irrational* by Daniel Ariely, and *Decisive* by Dan Heath. By the way, I would recommend all three for further reading if this interests you. *Decisive* is the easiest read, while the Kahneman book gets pretty deep. And why are they all named "Dan"?

To say that I have perfected my decision-making would be a wild overstatement. Even the most diligent among us is still naturally wired to get it wrong sometimes, but knowing our bad habits is a good place to start the life-long process of consciously attempting to make better choices.

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*If you would like to receive our newsletter electronically, please contact Jessica Holcomb at (513) 561-6640.*

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## Better Decisions, Better Outcomes, continued....

I don't have the space to delve into the many facets of this broad field, but I will hit two of the more prevalent pitfalls. Perhaps in future issues of "Review & Outlook" I can dig deeper.

*"...knowing our bad habits is a good place to start."*

Anchoring:
This is the term used to describe how getting a number (or some other bit of information) stuck in your brain impedes the decision-making process. An example I see often, is the top price your home was ever worth. Everyone has that permanently tattooed somewhere in their skull (or so it seems from discussions I have had with otherwise rational people). I hear folks say, "I really don't want to sell the house for X. We are losing money - just a few years ago it was worth Y". OK, but....the fair market value of something is what a willing buyer will pay a willing seller. Just because 7 years ago somebody was willing to overpay your neighbor for their home does not mean you are "losing money".

If you really want to sell your home, you may need to remove that "anchored" number from your brain. Otherwise, it might keep you from accepting a fair offer, or at a minimum, make you feel bad about a reasonable financial transaction. Let it go....and you are likely to make better financial decisions. I use the home example to make a point, but think about other things that are anchors, and be aware of how they can weigh down your decision making.

*"At a minimum, ask yourself, "Where am I likely to be wrong in my thinking about this."*

Overconfidence:
This might be villain #1 in your battle for good decisions. Study after study shows that we believe we know more than we actually do. We believe the future is much more certain than it actually is. That overconfidence can cause us to get lazy with our analysis and decision making. We will seek out affirming opinions and ignore disagreeable ones. This works against sound decisions, likely causing you to miss the full range of potential outcomes. You may fail to honestly assess the likelihood of success or failure. It creates a blind spot.

One process to deal with this is to invite disagreement. I know it doesn't sound like fun, but for important decisions find someone who will play "devil's advocate" and talk through your decision with them. At a minimum, ask yourself, "Where am I likely to be wrong in my thinking about this?"

To be fair, pros or "experts" are likely to fall prey to this hubris as well. We can sound awfully sure of ourselves when we need to. So let's agree to help each other with this "overconfidence" problem. First, we promise not to just be "yes-people" to your financial decisions; we may challenge you to think about other alternatives, or be more realistic about the prospect of success or failure of a particular path. In exchange, you agree to challenge us when something isn't clear, or doesn't ring true to you. We welcome open and honest discussion. The evidence is strong that it leads to better decisions and better outcomes. Isn't that what we're all shooting for?

## The Price of Oil, by John A. Melville, CFA

You've noticed the dramatic decline in the price of gasoline – the result of oil prices plummeting from over $100/bbl in June of 2014 to about $50/bbl today. Some have suggested this decline will have the same impact as a tax cut of $500 million this year. That's huge – the equivalent of about one-sixth of federal tax receipts! Before we celebrate a rebirth of consumer spending due to this "tax cut", we should first review the less visible repercussions of this decline.

The fall in oil prices, driven by oversupply, is largely due to the development of hydraulic fracturing (fracking) of shale oil in the United States. But why did this come about? After all, the technique has been around for some time. A significant factor may have been the Zero Interest Rate Policy (ZIRP) adopted by our Central Bank. Low interest rates have encouraged yield-starved investors to accept more risk to increase returns from investments. Much of the incremental shale drilling was financed with high-yield bonds (bonds below investment grade). In the last six years, $400 Bil. in leveraged loans have been made to drillers and another $175 Bil. in high-yield bonds has been issued to the same group of borrowers.

***"Some have suggested this decline [in oil] will have the same impact as a tax cut of $500 million this year."***

With a dramatic decline in oil prices, drilling activity is falling. Fracking is a relatively high-cost method of producing oil. With oil prices at today's levels, that method is increasingly unprofitable. We have already seen a few bankruptcies among the frackers and layoffs are beginning. As drilling declines, rig counts also plummet. Some steel companies have announced layoffs due to declines in orders for drilling pipe. Further down the line, all the restaurants, apartments, and strip malls built to accommodate the influx of workers into the oil fields are also likely to be hit.

A retrenchment in shale drilling could have significant repercussions. Every net job created since June of 2008 has been in the shale states of CO, ND, PA, TX, and WV. The number of jobs in the other 45 states is just now approaching 2008 levels. A reduction in shale drilling jobs is just beginning. As high-paying jobs in North Dakota and Texas begin to disappear, the lost incomes could offset other benefits from the oil price "tax cut".

***"Every net job created since June of 2008 has been in the shale states of CO, ND, PA, TX, and WV."***

What about a "tax cut" for Europeans? There has not been a boom in oil production there! Yes, Europeans will benefit from lower gas prices without the worry of substantial energy-related job losses, but oil prices are quoted in dollars. While the dollar price of oil has fallen by half, the Euro (and the Japanese Yen) has also dropped 20% in value relative to the dollar! So while the dollar price of oil has fallen significantly, the currency weakness of the Euro has offset some of that benefit.

As usual, there are winners and losers from the falling price of oil. We are not forecasting a weaker or a stronger economy as a result. We are just pointing out that the recent drop in the price of oil is not an unambiguous positive for the economy. Rather, it is complicated, and the simplistic answers are seldom useful. What really matters to investors is diversification and valuation!

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## Foster & Motley Welcomes Two New Shareholders

Congratulations to **Zach Horn, CFP®**, and **David Nienaber, CPA, CFP®,** who became the firm's newest shareholders on January 1, 2015!

**Zach** joined the firm in January of 2007 as the firm's Securities Trader and was promoted to Portfolio Manager in 2012. Zach graduated from Ohio University in 2005 with a bachelor's degree in Finance. Upon graduation, he worked for Ameriprise Financial, Inc. as a Financial Advisor. Zach obtained the Certified Financial Planner and Chartered Mutual Fund Counselor designations in 2012 and completed an MBA in Finance from Xavier University in 2013. He lives in Loveland, Ohio with his wife Lindsay and son Zion.

**David** joined the firm in 2010 as a Financial Planner. He graduated *magna cum laude* from the University of Dayton in 2004 with a MBA and a bachelor's degree in Accounting and Finance. He was also a Portfolio Manager for the University's student-run portfolio, one of the nation's largest student-run portfolios. Following graduation, David started his career at Deloitte, providing audit and tax services. He earned his CPA in 2004 and CFP®in 2009. David resides in Fort Wright, Kentucky with his wife Moreen, and their children Ella, Luke, & Nicholas.

## News and Notes

**Foster & Motley** is pleased to announce that client assets under our management recently surpassed $1 billion. This is quite a milestone in our history, and we would like to thank all of our clients for the trust and confidence they've placed in us. We'll work hard to continue to earn it!

**David Nienaber** attended the Advanced Personal Financial Planning Conference hosted by the American Institute of CPAs. The conference brought together more than 1,300 financial planners from across the country to learn and interact with national thought leaders in areas of tax, investments, insurance, and more.

**Zach Horn** recently attended Schwab Impact in Denver, CO. He participated in breakout sessions focused on fixed-income opportunities, increasing portfolio yield, and managing volatility and market risk. Zach attended keynote speeches from Liz Ann Sonders, CIO of Schwab & Greg Valliere, Chief Political Strategist of Potomac Research Group, who discussed market outlooks and political impact on markets; Ben Bernanke, former Fed Chairman, who discussed the Fed's current policies and the impact on markets; Dan Heath, author and Senior Fellow at Duke University, who discussed improving decision making; and George W. Bush, 43rd President of the United States, who discussed his time in office and his outlook for the effects of politics on the economy.

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