2015 Second Quarter Review

"Doing nothing is hard to do – you never know when you are finished."   Leslie Nielson

An island of instability - Greece is the Word

Last quarter I spent a good deal of time talking about the patience and discipline it requires to be a successful investor. Looking at the results (see table) at halfway through 2015, those points are more evident than ever. I track 12 different assets and only US and International stocks are positive in the first six months. All other asset classes are near zero or below. It is also true for the last 12 months. Stocks have continued their growth, while other asset classes have struggled. The last time I witnessed this type of trend was in the late 90's and early part of 2000 at which time we saw a reversal of this type of trend and a multi-asset strategy paid off in a big way. Patience/Discipline!

SUMMARY STATISTICS	YTD	1 YR (Annlzd)	5 YR (Annlzd)	10 YR
7Twelve Moderate	0.4%	-3.4%	7.6%	6.2%
1 US Large Cap	1.2%	7.4%	17.3%	7.9%
2 US Mid Cap	4.2%	6.4%	17.8%	9.7%
3 US Small Cap	4.2%	6.7%	18.4%	9.3%
4 Intl Developed	5.5%	-4.4%	9.9%	6.1%
5 Emerging Mkts.	3.8%	-2.8%	4.3%	9.2%
6 Global REITs	-4.1%	1.4%	13.8%	6.0%
7 Natural Rsrcs	-2.5%	-17.6%	2.0%	4.8%
8 Commodities	-1.6%	-23.7%	-3.9%	-2.6%
9 US Bonds	-0.1%	1.9%	3.3%	4.4%
10 US TIPS	0.1%	-2.3%	3.1%	4.0%
11 Intl Bonds	-6.3%	-13.6%	1.2%	2.9%
12 Cash	0.0%	0.0%	0.1%	1.3%

Source: S&P Dow Jones Indices/7Twelve Partners

But this quarter, I want to turn my attention to the international arena. In one word, it's Greece. Greece is a small nation in southern Europe that has been rocking the Eurozone boat. In 2014, the U.S. exported $773 million in goods to Greece. That compares with a U.S. economy that totals over $17 trillion (U.S. Bureau of Economic Analysis).

Greece is a beautiful country that is rich in history and culture. However, simply from an economic standpoint, Greece will not have any effect on the real U.S. economy.

Should the latest blow-up be a surprise? Well, not for students of economic history. You see, since Greece became an independent nation in 1829, it has been in default or rescheduling its debt 51% of the time through 2006. That comes from our friends at First Trust.

This most recent crisis started in 2009, so financial markets have had plenty of time to prepare. At least that is the prevailing wisdom.

What's different this time around is that Greece no longer has an independent currency – the drachma. Instead, it is part of the 19-nation European bloc that shares the euro.

No nation that has traded in its old currency for the euro has ever torn up the contract or has been forced to give up the euro. Such an event, if it were to occur, creates a heightened level of uncertainty because markets are woven together.

Short-term, stocks do not like added uncertainty and that accounts the nearly 2% selloff in the Dow on June 29 (MarketWatch).

But let's put that into perspective. A 350 point daily loss in the Dow does grab headlines, but it is modest when compared with the 4.4% drop registered the day after Lehman Brothers collapsed in September 2008 (Wall Street Journal). Furthermore, the dollar, which we might have expected to surge on safe-haven buying, was little changed against the euro. That could change in the days ahead as this is good short-term barometer of risk.

The June 29 drop in stocks may have just been an excuse to sell, since the decline was preceded by an inordinate amount of complacency in markets over the last couple of months. While Greece has been in the headlines, there had been a general expectation that we'd eventually get some type of "kick-the-can-down-the-road" deal.

Put another way, it would have been a cleverly crafted headline that offers modest progress but fails to address the fundamental issues. It just buys more time.

The financial plans we recommend take into account bumps in the road. Because no one knows the future with certainty, it sometimes surprises us when we get big daily moves. Stepping back and taking a broader perspective, it really shouldn't.

As I've counseled on repeated occasions, look past the daily gyrations and keep your focus on the financial plan. The long-term, disciplined investor is the one who has historically been rewarded. The childhood story of the tortoise and the hare comes to mind.

Let's get back to the central issue – credit markets

Economically speaking, remember that Greece is too small to impact the global economy. But if it can create significant tremors in credit markets – think the fallout from the collapse of Lehman Brothers in September 2008 – it can leave its mark.

Unlike the Greek crisis of 2010 and 2011, the private sector holds very little in the way of Greek debt – eurozone banks hold about $6 billion (MarketWatch, JP Morgan). Most of it is held by the IMF, the ECB, and European governments. Therefore, it is less likely a Greek default would spread across Europe and roil credit markets.

Skeptics, however, would argue that we're set to enter uncharted waters, raising the possibility of something more serious.

In the aggregate, about $350 billion of Greek debt is at risk, but only around $40 billion resides in commercial banks. Out of that $40 billion, $14 billion is owed to U.S. banks (Guggenheim Investments, MarketWatch).

It really isn't very much, unless a large bank or hedge fund is overexposed to Greece. In 1998, the collapse of the hedge fund Long Term Capital Management nearly created a financial crisis, which was averted with a hastily arranged rescue package.

Where do we go from here?

For now, the situation is tense and extremely fluid in Europe.

The general consensus suggests a default by Greece will not create treacherous conditions for global financial markets. That would not have been the case in 2010 or 2011 but it is probably the case today since markets have had time to adjust.

It's a different matter for the country itself. In the short-term, it would create very difficult conditions for the Greek population, as was suggested in recent report released by the Bank of Greece. Yet, a much-devalued drachma could help spur growth down the road.

Investor, know thyself!

It's something I always counsel when recommending a financial plan.

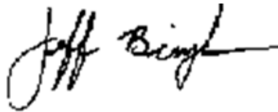
A young person that is, say, 28 years old and has accumulated $25,000 in his or her 401(k) won't need the cash for 40 years. Such an investor has the time horizon that lends itself to a more aggressive posture.

An investor in retirement or closer to retirement may not have the stomach to handle a steep drop in the market. A more conservative approach has historically prevented such an investor from realizing steep gains in a roaring bull market, but he or she is much more likely to sleep well at night when (and a correction is inevitable) stocks drop sharply.

While markets have been reasonably calm over the last four years, we will eventually hit a rough patch. While stocks will recover from an eventual decline – that has been the trend over the last 200 years, I want to be sure you are comfortable with such volatility. If not, let's talk.

In closing, I want to express my gratitude for the trust and confidence you've placed in my firm. It is something I never take for granted.

I trust that you have found this quarter's summary to be beneficial and educational. I always emphasize, that as your wealth advisor, it is my job to partner with you as you travel down the road to your financial goals. If you ever have any questions about what I've conveyed in this quarter's message or want to discuss anything else, please feel free to reach out to me.



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