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Spring 2014

Dear,

While spring is just arriving in many parts of the country, Arizona temperatures are already threatening triple digits. Regardless of weather, April marks the beginning of spring and many events to follow. It's a great time to wish you a happy Earth Day. Believe it or not, more than 175 countries celebrate Earth Day, but the April 22 holiday we observe in our country was put into motion by a U.S. senator back in 1970. For sports enthusiasts, April brings the start of Major League Baseball, The Kentucky Derby and The Masters. April is National Poetry Month. Good Friday and Easter are also around the corner. However you observe the holiday and whatever your interests are, we hope your April is a month worth celebrating. Let's take a look at the numbers.

	(As of 3/31/14)
Dow Jones Industrials	-0.72%
S&P 500 Index	+1.30%
NASDAQ Composite	+0.54%

Major Bond Indexes	(As of 3/31/14)
Lipper Intermediate U.S. Government	+1.79%
Lipper Intermediate Investment Grade (Corporate)	+3.75%

Major Mutual Funds Indexes	(As of 3/31/14)
Lipper Large-Cap Core	+1.99%
Lipper Mid-Cap Core Index	+2.74%
Lipper Small-Cap Core Index	+1.22%
Lipper International Index	+0.45%

Source: The Wall Street Journal and Barron's

*Inclusion of these unmanaged indexes is for illustrative purposes only. Keep in mind that individuals cannot invest directly in any index and index performance does not include transaction costs or other fees, which will affect actual investment performance. Individual investor's results will vary. Past performance does not guarantee future results.

FINANCIAL AND INVESTMENT PLANNING

"I thought you were dead." "Not hardly!"
… John Wayne in the movie "Big Jake" (1971)

The S&P 500 bottomed on March 9th, 2009, so this past March marked the fifth anniversary of the stock market's bull run. Many observers over the years when discussing the stock market have often said, "I thought you were dead." Only to have the market respond, "Not hardly!" These strong market returns over the last five years have given some investors pause – they feel because prices have gone up, we must be due for a recession and/or a bear market. Obviously, at some point, some sort of recession is inevitable. Every other economic expansion in history has come to an end, and this one will, too. But recessions don't just come completely out of the blue. By focusing on price rather than value, investors can often overlook the bigger picture. Christopher Davis, portfolio manager at Davis, recently discussed this point. "Those who point out the market fell sharply in the years following the high prices reached in 2000 and 2007 are forgetting stocks purchased today are a much better value than those purchased in 2000 or in 2007 for the simple reason the underlying businesses are more profitable and less leveraged. To understand why this is important, imagine two hypothetical businesses for sale in your hometown. The first has a price of $1.5 million and generates annual earnings of $50,000 per year. The second has a price of $1.8 million and generates annual earnings of $100,000 per year. Although the price of the second business is only slightly higher, its much higher earnings clearly make it a better value. Looking back to the market high in 2000, the math is almost identical for the companies that make up the S&P 500 Index. At that time, the market as measured by the S&P 500 Index was priced at about 1,500 while the earnings of companies underlying the Index were only $51 per share. Today the market sells at a price around 1,800 but the underlying companies generate earnings around $108 per share making them a far better value. Similarly, since the highs of 2007 just before the financial crisis, the earnings of companies underlying the Index have climbed from $83 per share then to $108 per share today, while at the same time companies have significantly reduced leverage. In short, by simply comparing today's share prices to past market highs, the pessimists overlook the significant increase in the value of the underlying businesses. On the other hand, Investors buying stocks today are paying 30% more than if they bought one year ago while underlying earnings have only grown about 12% during the past 12 months. This diminished gap between price and value leaves investors today with the prospect of lower future returns." While we try not to be optimistic or pessimistic, but realistic about the market, the leading economic indicators are not signaling the typical warning signs. So, while the bull market is no longer a spring chicken, age itself is no reason to get worked up.

So, what's occurred so far this year? The first quarter of 2014 was somewhat lackluster, as U.S. stock indices were flat. The equity markets showed some resilience during the last week of the month after Federal Reserve Chair Janet Yellen signaled that "considerable slack" in a "tough" labor market means the central bank will continue its monetary support of the economy for some time. Emerging markets, which had faced some geopolitical turmoil in the past year, seemed to find better footing at the end of the quarter, however concerns about events in Ukraine and a slowing Chinese economy haven't gone away completely. It must be pointed out that April is the best month to be in blue chips, if history is a guide. Since 1950, April has been the best month for the Dow, which has scored an average gain of 1.5 percent. As for the S&P 500, it plays favorites. While April is either second or third best performer with an average 2 percent gain, the best month for the S&P historically has been December. For the NASDAQ composite, April is the fourth best month for the tech-heavy index, with an average monthly gain of 1.5 percent. (source: CNBC – Giovanny Moreano).

Perhaps you've heard us talking about the market's seasonal effect. Its basic premise is that the 4th and 1st quarters typically produce most of the positive return for the year, and the 2nd and 3rd quarters tend to be more uninspiring. Thus, the adage "Sell in May and go away". While it may be fun and interesting to talk these types of phenomena, and before we all decide to jump out of equities for the next six months, it must be made clear that this prognostication has seen inconsistent results.

Despite the equity markets' strong performance over the past five years, there are still reminders of the Great Recession and the after effects. For example, five major banks didn't pass the Federal Reserve's annual stress tests. The central bank recently rejected the companies' plans to raise dividends and increase stock buybacks, citing a need for better risk management or more robust capital cushions. On the other hand, 25 banks did get the go-ahead for their planned dividend payouts and share repurchases.

Real estate continues to heal around the country. The value of Americans' equity in their real estate peaked at $10.3 trillion as of 12/31/07, fell to $6.3 trillion by 12/31/11, then climbed back to $10.0 trillion as of 12/31/13 (source: Federal Reserve). With the Fed anchoring rates at the short end of the yield curve, long term rates (i.e. 30 year mortgage) have stayed near generational lows the past few years. The average rate on a 30 year mortgage today is 4.32%. Compare that to the 1980s when the average rate nationwide on a 30 year mortgage was at least 10% for the 12 consecutive years of 1979-1990 (source: Freddie Mac). The current low rate environment makes buying vs. renting much more affordable in most markets.

With tax season upon us, we thought we would take a look back at our history of paying taxes. The federal income tax was first introduced with the Revenue Act of 1861 to help pay for the Civil War. It was subsequently repealed, re-adopted, and then ruled unconstitutional. By 1913, however, the Sixteenth Amendment to the U.S. Constitution was ratified giving Congress the legal authority to tax all incomes. Through the years, rates have gone up, come down and new tax rules have been introduced – all leading to a much more complex tax code. In fact, the total number of pages of the Federal Tax Rules, i.e., the IRS explanation of income tax code and regulations, has increased by +34,108 pages (to 74,608) since 1995, an increase of 5 new pages a day, 365 days a year for the last 19 years (source: Internal Revenue Service).

While many of us have fulfilled our patriotic duty of giving a small or large part of our income to our government, we thought we would take a closer look at the numbers. While it is true the highest wage earners have enjoyed one of the lowest tax rates in history, it is also true the top 10% of wage earners pay roughly 71% of the total federal income tax. The 1%'ers have been in the headlines a lot over the years, so we took a look at their average tax rates. The top 1% of US taxpayers paid an average tax rate (i.e., federal income taxes paid as a percentage of adjusted gross income) of 23.5% in 2011 vs. an average tax rate of 3.1% for the bottom 50% of taxpayers (source: Internal Revenue Service).

When we look around and compare our wages to the rest of the world, we are very fortunate to live in such a wonderful country. In the U.S., you need around $500,000 in annual income to be in the top 1 percent of wage earners. Globally, income of $34,000 a year gets you in the top 1 percent, according to Branko Milanovic, a World Bank economist. In China, it takes only $91,000 to be in the top 1 percent—equal to about the top 25 percent in the U.S., according to stats from the Internal Revenue Service and China's Southwestern University of Finance. India is similar to China as far as the 1 percent goes. In India, it takes more than $87,000 to make the top 1 percent, according to the most recent figures available from the World Top Incomes Database.

PERSONAL

With blue skies above, sand under their feet and the tide of the Pacific Ocean rolling in, a group of 14 cyclists snapped a photo before they set out to ride across the country. One of the 14 riders is Kris' dad, Dave. Dave is riding his bike from San Diego, CA to St. Augustine, FL. By the time they reach the beach in St. Augustine, Kris' dad will have ridden 3,141 miles. Being of sound mind is not a requirement to ride your bike across our beautiful country. The route will cover a variety of terrains, climates and elevations. From below sea level to 8,228 feet, the group will travel through majestic deserts, high mountains, ride along the Rio Grande, dodge a few blowing tumbleweeds, experience the bayou, the forests in the Old South, and alligator filled waters as they cross parts of Florida. The tour stopped in Phoenix for its first rest day. Kris and his father had a great time for the 24 hours they got to spend together. Kora and Macy did their best to make sure grandpa didn't get too much rest on his day off. The three of them spent time playing hide and seek, tag, having tea parties and just rolling around on the floor. There is nothing better than seeing your children laugh so much that they have tears in their eyes. The following morning, Dave was back on his bike heading towards the Superstition Mountains. As of this writing, the tour is in Marathon, Texas having covered 1,149 miles.

As they entered the big dark room, Macy and Kora held mommy's hand until they got to their seats. With a bucket of popcorn and both daughters on her lap, Angie and her adorable girls watched the Disney movie Frozen. For the next few weeks, the sisters paraded around the house singing and dancing to the songs from the movie. Kora didn't just hum or sing the chorus, but every single word of the song! Amazing how fast a three year old can learn! The 20 month old Macy doesn't have the vocabulary of her big sister yet, but she has equal, if not more energy than her big sister. The two peas in a pod seem to forever be giggling and dancing these days!

Macy

Garry and Emily are raising a happy and extremely active two year old tornado. You'd never know that Ava is two. She speaks as if she is five. Sentences have all of the markings of proper grammar, not just jumbles of words in fragments. Perhaps it's the constant bombardment of English and Russian. Kudos to our nanny. She has been instrumental in helping Garry feed as much Russian as possible to our little sponge. Ava's latest obsession is cars. She rides her car around the house. She sleeps, eats, plays outside and goes to the park with cars. Her favorite movie is… Yep, you guessed it…. Cars.

In early February Garry competed in a Spartan obstacle race in Temecula, California. After 4 miles of running in mud and water, climbing hills and mountains, crawling under barbed wire and jumping fire, Garry came in 185th out of 8268 competitors, and 26th out of 875 in his age group.

For Garry, Emily and Ava, the first quarter of the year was filled with family visits. We eagerly anticipate each family visit and are saddened by its brevity. Garry's mom flew in for a few days in January. A day was spent at the McCormick-Stillman Railroad Park, a unique outdoor venue catering to young and old alike. A ride on the carousel and train was the only thing on Ava's mind. She belted out, "Choo Choo!" as the train left the station for a trip around the park grounds. In early March, Emily's dad made the drive out from San Diego for a short visit. Ava quickly made friends with her grandfather, for he brought a box full of matchbox cars. Emily's mom makes the commute from San Diego practically every other weekend. Emily's aunt often makes the trip. We'd like to think it's us they are coming to see, but know full well it's the little 30lb pound gem they can't get enough of. For grandparents, Ava is always the top of mind. Being the only grandchild on both sides of the family definitely comes with its perks.

This spring newsletter marks the beginning of the 8th year that we have been putting our thoughts on paper and sharing them with you. To say a lot has occurred since April 2007 would be a colossal understatement. Our country experienced its first credit crisis in over 80 years. And personally, our lives have changed almost immeasurably. It was fascinating to read through that very first newsletter. Kris and Angie were newly engaged, planning their wedding. Emily had just moved from San Diego to take a job with a now non-existent mortgage behemoth Countrywide Financial. There was another reason for the move. Oh yes, to further test the waters with Garry. Since then, we've created families (read - got unbelievably lucky to find our mates who agreed to spend the rest of their lives with us), our families grew, lives got more interesting, complicated, and demanding. Dear friends and family members have passed, while new tiny, happy shiny faces full of hopes and dreams blessed us with their presence. We know a lot has happened in your lives as well. We want to thank you for being part of our lives and letting us be a part of yours.

> ***"Our greatest weakness lies in giving up. The most certain way to succeed is always to try just one more time."***
>
> \- Thomas A. Edison

Thank you for your trust, confidence and friendship.

Garry Kachkovsky, CFP®
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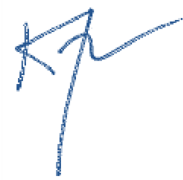

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