April 2014

First Quarter Letter

By Martin Weil

"High-frequency traders are gaming the system, reaping billions in the process and undermining investor confidence in the fairness of the markets. It's a growing cancer and needs to be addressed. If confidence erodes further, the fuel of our free-enterprise system, capital formation, is at risk."

~ Charles Schwab

The S&P 500 US stock index ground out a 1.8% gain in a challenging first quarter. Large cap stocks outperformed smaller companies for a second consecutive quarter. Foreign stocks rose less than 1% and investment grade bonds rebounded with the Vanguard Total Bond Market index returning nearly 2%.

Model Portfolio Performance[i]

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3/31/2014

	Risk Benchmark	1st Quarter	Trailing Twelve Months	Cumulative Since Inception	Annualized Since Inception
All Equity	100% Stocks	1.5%	14.6%	161.5%	6.5%
Growth	80% Stocks/20% Fixed Income	1.5%	12.5%	148.8%	6.2%
Balanced	65% Stocks/35% Fixed Income	1.5%	9.1%	152.2%	6.3%
Conservative	40% Stocks/60% Fixed Income	1.5%	5.0%	130.7%	5.6%
S&P		1.8%	21.6%	95.8%	4.6%

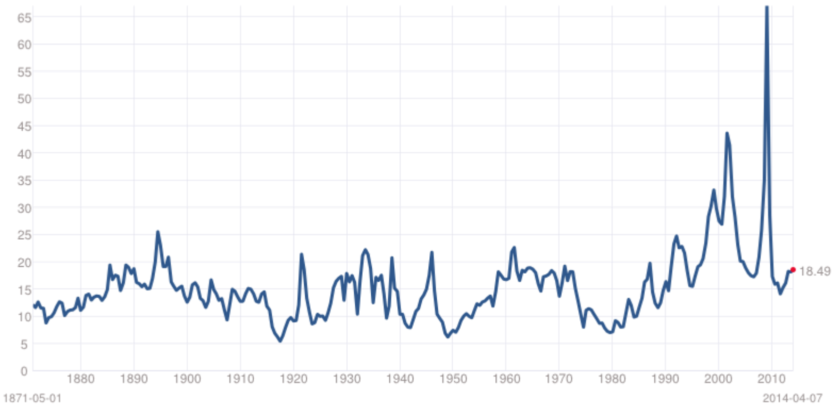
Each of our four models rose 1.5% during the quarter, an unusual occurrence given the divergent risk exposures of the portfolios. Our trailing twelve-month model returns range from 5% for Conservative to 14.6% for All Equity. These results trail their benchmarks for the period due to the relative underperformance of our models during 2013's last quarter. Our goal remains that each model will match or exceed the performance of its respective benchmark over a full market cycle.

Portfolio Update

MW Investment Strategy has been approved, after a lengthy qualification process, to use funds from Dimensional Fund Advisors. DFA sponsors vigorously disciplined "enhanced index" mutual funds that are widely employed by institutional investors. The addition of DFA will allow us to reduce the number of positions in a typical client account, while maintaining overall portfolio diversification. DFA funds have among the lowest expense ratios in the industry, and their use will reduce even further the already low average expense ratios of our models.

Bubble, Bubble, Toil and … not quite yet Trouble

On the heels of last year's exceptional gains in the US stock market, the financial media has turned its attention to whether or not a bubble has been forming in stock prices. Fueled by the unprecedented policies of the Federal Reserve, prices for all variety of assets have risen dramatically since the financial



crisis. As of April 1, US stocks are materially above historical average valuations, measured by the trailing Price/Earnings ratio of the S&P index. But current P/E valuations, as seen in the chart[1], are nowhere near the extremes of 2000 or 2008. Little in the current stock market environment demonstrates the classic hallmarks of a bubble. Both recent market bubbles – the Dotcom in the late 1990s and real estate in the 2000s - were accompanied by a widespread mania to acquire assets for gain regardless of price, regardless of risk. Simultaneously, in both instances, there was a tidal wave of borrowing to finance asset purchases. A rational observer of the current market would not find either of these at work to any significant degree.

This is in no way to suggest that "all is clear" and that investors should expect a repeat of 2013's stock market performance. Today's high valuations suggest that returns will be muted over the full market cycle for many years yet to come. However, the conditions are not obviously present that would lead to a wholesale market collapse, such as we have endured twice in the past 15 years.

High Frequency Trading, Dark Pools and Other Distortions

"The markets are rigged." So states Michael Lewis in his new book Flash Boys and in numerous media appearances starting with his recent stint on 60 Minutes. Yes they are. And they always have been. There will always be someone - be it a floor trader, a corporate insider, an investment banker - someone with better and timelier knowledge than the average retail or even institutional investor. There simply cannot be a large-scale system of institutional markets without that. That is why we have rules – imperfect as they are – to attempt to damper the inevitable distortions brought about by the systemic unevenness of complex markets. Since the advent of the Securities Exchange Commission and the institution of rigorous securities laws in the 1930s, the US has done an enviable job of managing these disparities, making our markets a fair place to transact business. However, the playing field has changed, as will happen over time. Regrettably, oversight and regulation have not only not kept pace with technological revolution, these protections have been steadily dismantled over the last two decades.

Market advocates pay homage today to the ideals of efficiency and deregulation. In my view, this is a serious error of judgment. Engineers will tell you that in designing a system, efficiency is a second order attribute that should only be pursued after the stability of a system is assured. High Frequency Trading –

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[1]S&P Price/Earnings ratio with reported earnings from http://www.multpl.com/

essentially one set of institutional traders stealing pennies from another set of institutional traders – defies this basic engineering concept and is inherently destabilizing. Dark pools are another manifestation of deregulation and are a serious threat to the ideals of fair and transparent markets. I trust that the media attention given the Lewis accusations will provoke sufficient public demand that the exchanges, SEC and Congress will put remedies in place to rein in these practices.

What I Am Up To in the Next Few Months

Though just April, I am looking ahead to my summer project. Business slows down a bit during July and August, and I like to spend several weeks looking at ways to improve my service delivery to clients.

Top of my list for 2014 is identifying a way to safely provide clients with a dynamic statement of their combined assets and liabilities. My most recent Client Satisfaction Survey showed a strong desire by clients to be able to see their personal balance sheet information - assets, liabilities and net worth – in one place. I will be running a trial of at least one of several potential solutions in the coming months.

More important is an overdue task – to have a solid succession plan in place. While I have no plans of scaling back my professional commitments, it was apparent to me as I sat 8000 miles away in Cambodia last month, that I owe it to clients to make sure they are taken care of in the event anything should happen to me, on a trip such as that one, or even here at home. For many years, I had a contingency plan in place with another advisor, until he left the business at the end of 2013. I need to replace that arrangement, and I make this commitment to all my clients that I will have a new and even better contingency plan in place by the end of 2014.

2013 was a great year as my business grew by some 20%. If you know of someone who would be a fit as a client and have not yet referred them, 2014 would be a good time to do so. As I have some of the greatest clients I can think of, anyone who is like you and may be interested in considering a new financial professional is certainly someone I would like to speak with.

Management Fee Deductibility

Investment management fees are typically deductible for income tax purposes, when these fees are paid with after-tax dollars. We often debit fees on a pro-rata basis both from a client's investment (after-tax) and IRA (pre-tax) accounts, as this maximizes their tax advantage. However, only that portion of fees paid with after-tax dollars is deductible and this is the amount reported on your brokerage 1099(s). Fees paid through an IRA, or other retirement account, are a pre-tax expense and effectively already deducted from taxable income.

[i] **Model Portfolio Performance Disclosures:**

a) Performance shown is for our portfolio models and is not a composite of the performance of actual client accounts. While our goal is that each client account will closely mirror the holdings and performance of our models, client account performance may, and does, vary according to several factors. Some of these are listed below.
b) All MWI managed client accounts are based on one of four diversified model portfolios, composed of no-load mutual funds, exchange-traded funds and other publicly traded securities. These four models are geared to different levels of investor risk tolerance. New accounts are invested following one of these models, typically using dollar-cost averaging over a period of months, not to exceed one year. Once an account is fully invested, it is expected to track the performance of its underlying model. Exceptions to this include accounts with restrictions such as: client-directed retention of legacy holdings and/or excess cash, substantial withdrawals or additions. Accounts smaller than $100,000 are restricted by purchase minimums at certain mutual funds. As a result, these accounts will not hold all the model portfolio positions and their performance may differ somewhat from these models. Accounts employing municipal bond funds in place of the taxable bond funds used in models may slightly underperform on a pre-tax basis. In addition, there have been periods, and may again be in the future, when our evaluation of economic and/or market conditions leads us to manage client account allocations in a materially different manner than is shown in our models. At these times, actual client performance may vary from that of our models.
c) Benchmarks for each model are created to represent the neutral asset allocation for each portfolio. The Vanguard S&P 500 index fund is used to model the S&P 500 index total returns. This fund, the iShares Russell 2000 index, Vanguard Total International and Total Bond index funds are the components we use for our benchmarks.
d) Net of fees: The performance for MWI model portfolios is calculated net of our maximum annual management fee, and brokerage charges, if any. The returns of the portfolio benchmarks do not include any fees or charges other than those of the index vehicles employed in the benchmark. All returns assume dividends and income are reinvested.
e) Rebalancing: Model portfolios are routinely rebalanced every six to twelve months on the last day of a quarter. Actual client accounts may be rebalanced as needed. With tax-efficiency a part of our decision criteria, taxable accounts may be rebalanced less often and/or less completely than retirement and other accounts not subject to current taxation. This may result in performance discrepancies between taxable and non-taxable accounts managed following the same portfolio model.
f) Model allocation changes: Changes to our model allocations can and do occur at any time. When a model is changed, allocations to client accounts are changed as soon as is practical. However, changes to the model portfolios are only recorded for performance purposes on the last day of any quarter.
g) Closed funds: From time to time, mutual funds that form part of MWI model portfolios close to new investors. Clients already owning closed funds in their accounts will generally continue to hold and/or add to their positions. New client accounts will be invested in alternate funds. At year-end, MWI will substitute in its models for any funds that have closed during the year with the alternate funds available then to new clients. As a result, performance disparities may develop between older and newer client accounts, and between older client accounts and current model performance.
h) Historical performance is <u>not</u> a guarantee of future results. While the performance period since January 1999 includes both rising and falling stock markets, there can be no assurance that the portfolios will perform as well under future market conditions.