January 2015

Year-End Letter

By Martin Weil

"The highly abnormal is becoming uncomfortably normal."

~ Claudio Borio, Bank of International Settlements

The S&P 500 index of US stocks gained nearly 5% during 2014's final quarter and was the major asset class performance winner for a second year in a row with a 13.5% gain. Foreign stocks had a down year, with both developed and emerging market stocks declining by some 4%. In the positive camp, bonds gained nearly 6% during 2014, with especially strong performances by municipals. The truly momentous market development of the year had to be the dramatic (and as yet ongoing) collapse of global oil prices. The after-effects of this price implosion by the world's dominant commodity have likely only just begun.

Model Portfolio Performance[i]

Model Portfolio Performance
12/31/2014

	Risk Benchmark	4th Quarter	Year	Cumulative Since Inception	Annualized Since Inception
All Equity	100% Stocks	2.8%	5.6%	172.4%	6.5%
Growth	80% Stocks/20% Fixed Income	2.4%	5.5%	158.7%	6.1%
Balanced	65% Stocks/35% Fixed Income	1.8%	5.1%	161.3%	6.2%
Conservative	40% Stocks/60% Fixed Income	1.0%	4.4%	137.4%	5.6%
S&P		4.9%	13.5%	109.6%	4.7%

After positive performances in the fourth quarter, our four models returned between 4-5.5% for the full year. These returns are in line with each portfolio's benchmarks, after fees, except for our Conservative model in which we continue to retain an extra degree of risk-aversion. However, the 2014 returns of a globally diversified portfolio, including our own, do not show particularly well when compared to the out-performance by the S&P index.

Our best performing holdings during 2014 were Oakmark Select, up 15.4%, Primecap Odyssey Growth, up 13.9% and the Powershares RAFI 1000 ETF, gaining 13.6% for the year. Our other core US stock funds, whether Yacktman or the DFA Core Equity Fund, struggled to keep pace with the S&P index. Our foreign funds generally outperformed the negative returns of their benchmark indices. Our fixed income fund holdings, save for our Vanguard municipal bond funds, lagged their benchmarks by a percentage point, a rare occurrence.

YE Tax Updates

Clients may have noted that we executed multiple sales during November-December. The sales in taxable accounts were undertaken in order to capture unrealized capital losses to partially offset taxable gains incurred this year. Most of the positions liquidated for tax purposes were in foreign equity or fixed income holdings that will be replaced after a required 31-day delay has elapsed. In the interim, cash

positions in many accounts will be slightly higher than model allocations. This is the first year in many that realized capital gains will be of any consequence for clients with taxable accounts. The average taxable gain to clients is about 3% of total value of a typical account. This comes after several years of double-digit gains without material tax consequences.

Portfolio Update – January 2015

As of this writing, our portfolio models remain heavily overweight Large vs. Small Cap US stock. Within our foreign stock allocations, we are overweight Emerging Market equity. Within Fixed Income, we are overweight credit vs. interest rate exposure. Additionally, in our Conservative and Balanced models, a portion of the equity and fixed income benchmark allocations has been replaced by Multi-Asset fund allocations that include both. A smaller portion of fixed income is also replaced by Alternative Investments (Other). As noted, our Conservative model remains invested at a risk-level measurably below even the modest risk exposure of the benchmark for this portfolio.

MWI MODEL ALLOCATIONS	CONSERVATIVE		BALANCED		GROWTH		ALL EQUITY	
	Model Allocation	*Bench-mark*	Model Allocation	*Bench-mark*	Model Allocation	*Bench-mark*	Model Allocation	*Bench-mark*
FIXED INCOME	48%	*55%*	31%	*35%*	21%	*20%*	0%	*0%*
CASH	05%	*06%*	0%	*0%*	0%	*0%*	0%	*0%*
LARGE CAP US	23%	*27%*	34%	*41%*	50%	*48%*	62%	*58%*
SMALL CAP US	01%	*04%*	02%	*06%*	03%	*9%*	05%	*12%*
INTL/GLOBAL	08%	*08%*	18%	*18%*	26%	*23%*	33%	*30%*
MULTI-ASSET	11%	*0%*	11%	*0%*	0%	*0%*	0%	*0%*
OTHER	04%	*0%*	04%	*0%*	0%	*0%*	0%	*0%*

During the past year, we swapped a significant portion of our Large Cap US equity allocation from active to passive (DFA Core Equity & Powershares RAFI 1000 ETF) management. There are several reasons behind this change, with the first being cost. Expense ratios have become ever more important in this lower return environment and passive strategies have lower expense ratios than even our very low cost active managers. Secondly, several of our active managers have persisted in holding significant cash positions and this has been a drag on their returns the past 2-3 years. And finally, passive strategies are typically more tax-efficient for taxable accounts. In spite of this shift to the use of passive strategies, we retain a strong belief in our core active US equity managers – at Oakmark, Primecap and Yacktman among others, who share our fundamental commitment to smart, client-centric, money management.

At year-end, we sold Osterweis Strategic Income and replaced it with Guggenheim Total Return. The

performance of the Osterweis fund, first purchased in 2010 as part of our strategy to hedge against expected increases in interest rates, has frankly been a disappointment. Not only have interest rates not risen, but the fund did not perform as expected during what could be a trial run for eventual rising rates - 2013's "taper tantrum[1]." The two funds are not wholly comparable as the Guggenheim is a riskier offering. We are looking for an additional fund that is lower risk than the Guggenheim to add to Conservative accounts and may even consider buying back a smaller position in Osterweis in 2015.

Looking into the Mist

Claudio Borio's quote at the top of this letter refers to the fact that some six years after the most serious banking crisis in contemporary history, the world's developed financial systems are still on a form of life support. The Federal Reserve and other major central banks continue to provide unprecedented monetary stimulus to the global economy. Sooner or later this stimulus, which saved the global system in 2009, but has since fueled the rise of asset markets, will need to be withdrawn. When that comes, be it in 2015 or later, be it gradual or sudden, history shows that equity markets typically suffer. I will admit however that the situation we find ourselves in today is a very long ways from "typical."

In the face of uncertainty, our job is to insure clients are invested in a manner that is prudent in the present environment and is also consistent with their longer- term goals. This is remarkably simple to accomplish in theory but far less so in practice. It is all too enticing to lose sight of these longer-term goals in the face of a constant barrage of headlines, warnings, and shorter-term market action.

With my best wishes for 2015.

Martin

Investment Book Recommendations by Jason Zweig

Anyone with investment assets, be these in retirement or taxable accounts, would be well-served by a program of continuous self-education. Educated investors make better investors, and better clients as well. Jason Zweig, one of my favorite commentators, offers this following list and commentary. You could do a lot worse.

> ***Why Smart People Make Big Money Mistakes and How to Correct Them*, by Gary Belsky and Thomas Gilovich.** In clear, simple prose, Messrs. Belsky and Gilovich explain some of the most common quirks that cause people to make foolish financial decisions.

[1] The May 2013 announcement by its then Chair Ben Bernanke that the Federal Reserve would begin to "taper its bond purchases" set off a firestorm of market disruptions with bond yields rising sharply and their prices correspondingly declining.

***Against the Gods: The Remarkable Story of Risk*, by Peter L. Bernstein.** The late polymath Peter Bernstein poured a long lifetime of erudition and insight into this intellectual history of risk, luck, probability and the problems of trying to forecast what the future holds.

***Common Sense on Mutual Funds*, by John C. Bogle.** The founder of the Vanguard Group and father of the index-fund industry methodically sorts fact from fiction.

***Triumph of the Optimists*, by Elroy Dimson, Paul Marsh and Mike Staunton.** Neither light reading nor cheap, this book is the most thoughtful and objective analysis of the long-term returns on stocks, bonds, cash and inflation available anywhere.

***Surely You're Joking, Mr. Feynman!* or *What Do You Care What Other People Think?*, by Richard Feynman.** These captivating oral histories of the great Nobel Prize-winning physicist ostensibly have nothing to do with investing.

***The Intelligent Investor*, by Benjamin Graham.** Originally published in 1949, called by Warren Buffett "by far the best book on investing ever written."

***How to Lie With Statistics*, by Darrell Huff.** This puckish riff on how math can be manipulated is only 142 pages; most people could read it on a train ride or two, or in an afternoon at the beach.

***Thinking, Fast and Slow*, by Daniel Kahneman.** Successful investing isn't about outsmarting the next guy, but rather about minimizing your own stupidity.

***Manias, Panics, and Crashes*, by Charles P. Kindleberger.** In this classic, first published in 1978, Kindleberger looks back at the South Sea Bubble, Ponzi schemes, banking crises and other mass disturbances of purportedly efficient markets.

***Buffett: The Making of an American Capitalist*, by Roger Lowenstein.** This book remains the most comprehensive and illuminating study of Warren Buffett's investing and analytical methods, covering his career in remarkable detail up until the mid-1990s.

***A Random Walk Down Wall Street*, by Burton G. Malkiel.** In this encyclopedic and lively book, Mr. Malkiel, a finance professor at Princeton University, bases his judgments on rigorous and objective analysis of long-term data.

***Sceptical Essays* or *The Scientific Outlook*, by Bertrand Russell.** Russell is Mr. Buffett's favorite philosopher, and these short essay collections show why.

***The Snowball: Warren Buffett and the Business of Life*, by Alice Schroeder.** With unprecedented access to Mr. Buffett, Ms. Schroeder crafted a sensitive, personal and insightful profile, focusing even more on him as a person than as an investor.

***Where Are the Customers' Yachts?*, by Fred Schwed Jr.** First published in 1940, this is the funniest book ever written about investing—and one of the wisest.

***The Money Game*, by 'Adam Smith.'** In this marvelously entertaining book, Goodman skewers the pretensions, guesswork and sheer hogwash of professional money management.

[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 not 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.