

Volume XXVI, Qtr III

THE HARBOR ADVISOR

Relatively Speaking -

The importance of relativity in investing and investment returns

We recently completed our annual portfolio redesign and in Harbor client conversations surrounding this process I am frequently asked why we compare portfolio returns to various benchmarks. This led me to think about the importance of relativity in investment returns and indeed the investment process. First, the process of comparison is one based on factual knowledge and the desire to know not only what individual returns are but how they compare to the universe of returns. How much is reasonable? Should I expect a higher or lower return from my investments?

The “why” is that markets are bound by physical limitations; overwhelmingly returns are comprised by the return or performance from the assets in which you invest. If US stocks are in the negative as is currently the case, the portion of your portfolio dedicated or invested in these assets will likely be negative as well. This is true for other asset classes such as foreign, small cap, real estate, and so on.

Knowing how the segments of your investment portfolio are performing when compared to the universe of returns here defined as benchmark returns, allows you to frame or put your investment performance in relative terms. This knowledge brings a greater understanding of your earnings and should ease uncertainty and stress.

Much is written about ways to beat the physics behind relative performance; hedge fund strategies, market timing, and options investing can all be designed to do so and claim success. The fact is that few ever succeed at all and fewer still for any length of time. That said, creating a diversified and properly allocated portfolio while keeping fees in check is the best way to ensure success in stock and bond market investing. Then periodically monitor and compare your returns to the universe of returns; if yours are similar you can be satisfied. If they are lower or greater further investigation is warranted as to why and consideration of any changes you might need to make. This should not be frequent as a rule. I have written that the biggest advantage an individual investor has is the ability to buy and hold which reduces your tax burden, investment cost and anxiety. Taking a long term view levels out the volatility in market pricing and is the preferred method of investing for successful investors.

Enjoy our beautiful fall -



October 1, 2015

Contents

Main Articles

Relatively Speaking/Benchmarks	1
Corporate Governance	2
Bucket Theory	3
Harbor Happenings	4

Individual Highlights

2015 Anniversaries - Einstein	1
Q3 2015 Market Recap	2
Fund Focus	2
Living Well/Living Smart	3
Restaurant of the Future	3
Market Closures	4

2015 Anniversaries

Einstein's Theory of Relativity – 100 years

In November of 1915, Einstein presented his Theory of General Relativity to the Prussian Academy of Science.



Third Quarter 2015 Market Recap

Significant events shook markets during the third quarter, beginning with the escalation of political and financial upheaval in Greece. In August, Greece was overshadowed by China's devaluation of its currency. China's intent was to move toward a more market-driven economy, but the drop surprised markets and was viewed as a signal of an economic slowdown. Chinese stocks plunged and the news sent aftershocks throughout global markets with commodities being hit particularly hard. The Chinese government quickly took measures to shore up its stock market by selling a portion of its holdings in US Treasuries. Uncertainty surrounding the Fed's plans to raise interest rates added to

market volatility. When the Fed finally decided not to increase rates, markets dropped as the decision was interpreted as confirmation of a weak global economy. Meanwhile, the US economy continued to improve. Growth in consumer spending, new home construction and employment remained steady.

Equity markets were down for the quarter. The S&P 500 was off 6.94%, the Russell 2000 down 12.22%, the MSCI EAFE down 10.75%. Bond markets posted gains for the quarter. The Barclays Aggregate Bond index increased 1.22%.

"It is only the farmer who faithfully plants seeds in the Spring, who reaps a harvest in the Autumn. B.C. Forbes

Fund Focus: SPDR S&P Aerospace & Defense ETF (XAR)

In this quarter's fund focus, we center our attention on the recently added SPDR S&P Aerospace and Defense ETF. Created in September of 2011, this exchange traded fund has already collected more than \$115 million in net assets under management in response to its outperformance of the S&P 500 since inception. Being an index fund, XAR seeks to track at least 80% or more of the holdings found in the S&P Aerospace & Defense Select Industry Index. XAR is comprised of 33 diverse US holdings, ranging in capitalization from micro (\$50m-\$2B) to giant (\$200B+). Within these 33 holdings, the top five concentrated positions are held in Precision Castparts Corporation, Lockheed Martin, Raytheon Co., Northrop Grumman Corporation, and TransDigm Group Inc. With continued advancements in technology, electronics, and materials, Harbor feels strongly about the growth opportunities for the aerospace and defense industry. This passively managed fund has a low expense ratio of .35% and aligns seamlessly with our interest in adding broad aerospace exposure to our portfolios.

Corporate Governance

Often in today's business environment, companies are making headlines for the wrong reasons. Fraud, corruption and unethical practices are just some of the mishaps we see, but are certainly not limited to. Wrongdoings can be enough to sink the ship, as exemplified by companies like Enron and WorldCom. How could such powerful and seemingly unsinkable entities let these wrongdoings slip through the cracks? The answer is corporate governance, or lack thereof.

As defined by businessdictionary.com, corporate governance is "the framework of rules and practices by which a board of directors ensures accountability, fairness, and transparency in a company's relationship with its stakeholders."¹ Increasingly, corporate governance is becoming equally as important to a company as its core operations. Companies highlighted for factors such as a diverse board, sustainability, environmental regulations, and positive employee work environment are receiving a boost from investors and consumers alike. It is no longer acceptable to just produce products that satisfy the bottom line. Users and stakeholders are looking to do business with companies that exhibit concern and awareness to those around them as well. As exemplified in a 2014 study conducted by the Committee Encouraging Corporate Philanthropy (CECP), "among companies giving at least 10% more since 2010, median revenues increased by 11% while revenues fell 3% for all other companies."¹ This shows a clear correlation that doing the right thing as a company bodes well in the wallets of shareholders. Google, for example, was the highest rated company in the Reputation Institute's 2014 Corporate Social Responsibility ranking¹ based on its success in governance, citizenship, and employee workplace. Since the publication of the report in December and as of September 2015, the stock has gained more than \$90. At Harbor, we continue to see the growing benefits of investing in companies that are stewards of the world in which we live.

Corporate governance is a continual balancing act between the interests of all stakeholders in a company. By shifting focus away from maximum stockholder returns at all costs, and more towards an equitable environment that seeks to make decisions for the long term and for those representing all sides of the table, companies are generating more value today than ever before.

¹ <http://www.businessdictionary.com/definition/corporate-governance.html>

² http://cecp.co/pdfs/giving_in_numbers/GIN2014_Web_Final.pdf

³ <http://www.rankingthebrands.com/PDF/CSR%20Global%20RepTrak%202014,%20Reputation%20Institute>.

The Bucket Theory of Cash Flow Management (AKA Budgeting)

Given negative connotations surrounding the word budget I think we should change the name - cash flow management comes to mind. That said, the word budget has been around for a while having stemmed from the late middle English word “bouge” which incidentally is borrowed from the French. The word originally meant pouch or wallet and later its contents. Governmental use of the word referred to “to open the budget” in the mid 18th century. By the late 19th century it was extended to private finances. I think the pouch reference segues nicely to my bucket theory of cash flow management. I have used this theory for many years thinking that money or capital is best divided into separate accounts or ‘buckets’. My grandmother used envelopes which is also a very effective strategy. Given the fungible nature of cash, you may ask, “What is the benefit of separating it into buckets?”

First it acknowledges that there are different uses for your money - near term for immediate needs such as housing, food, clothing, medical care and transportation. Medium term is for a car, new home, or a vacation and long term for education, retirement, sabbaticals and less frequent perhaps more far reaching or longer duration trips. The way you save for these items differs too. Funding your near term bucket may mean simply depositing your paycheck and spending it. Medium term can be a monthly withdrawal from that account to another account invested in fairly conservative assets that yield more than cash but don’t carry a lot of volatility. The long term bucket can be funded with a payroll deduction as in the case of a company retirement plan or from your other savings account to a brokerage account. These assets should be invested for the long term, preferably equities (stocks), heavily weighted on the equities side for the younger set and slightly more conservative or fewer equities for the older group. In order for this to work you must arrange your cash flow in a way that you do not spend everything that you earn. Some hints on how best to accomplish this will be provided in next quarter’s newsletter. (To be continued)



TECHNOLOGY NEWS: Restaurant of the Future

A new fast-food restaurant in San Francisco, Eatsa, looks like it came straight from an episode of “The Jetsons.” There is no counter with order takers, no host to seat you, and no wait staff delivering food. Customers waiting in line view a menu on a flat-screen monitor with various quinoa bowls, then they move to an iPad where they tap in the order, customize it, and pay. The customer’s name then appears on another screen with a number corresponding to the cubby where their order will soon appear. When the customer taps their fingers on the glass, the cubby opens and the food awaits, seemingly deposited by an invisible elf.

Eatsa is not the first serverless restaurant America has seen: In Philadelphia in 1902 and Manhattan in 1912, Horn & Hardart Automats became an American icon and first major fast-food chain. It was a combination vending and cafeteria-style fast food eatery. By the 1970’s, Americans had moved to the suburbs and a late-night McDonald’s snack was less expensive than a downtown Horn & Hardart, which eventually went out of business.

At Eatsa, a staff of five or six humans currently prepare the food, although they are never seen by customers, and there is one attendant on hand in the dining area for the technologically challenged. However, the owner hopes to one day automate these processes as well, if it is more economical than paying people to do the job. With so many pushes to increase the minimum wage, the industry could move toward a more robotic future and do away with their staff completely.

Colorado Retirees Save with Property Tax Exemption

Colorado was recently ranked #2 by Bankrate.com as one of the best places to retire. This is based on numerous factors including weather, cost of living, health care quality, crime rate and overall “senior well-being”. There are also some nice financial benefits to living in Colorado when retired.

The Senior Property Tax Exemption is available for Colorado citizens who are 65 or older, and who have lived in their home for at least 10 years prior. The application must be filed by July 15 of the year for which exemption is requested. Fifty percent of the first \$200,000 of actual value of the applicant’s primary residence is exempted. For example, if your home was valued at \$500,000, the exemption would reduce the taxable value to \$400,000.

Contact your county assessor office to apply for this exemption. You only need to apply once and it remains in effect for subsequent years, as long as the property ownership and occupancy do not change.

Back to that list of the best places to retire . . . surprisingly the retirement hot spot Florida ranked around the middle of the list, in 28th place.

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Images: Nat Arnett

Harbor Happenings

Harbor Welcomes Jennifer Baham!

We are happy to announce that Jennifer Baham has joined Harbor's team as Client Service Manager. She is responsible for providing overall client service, account maintenance, and financial planning updates. Prior to joining Harbor, she worked at a local Ameriprise Financial office for 9 years as Operations Manager and Financial Planning Coordinator. She is also a licensed paraplanner (FINRA Series 7 & 66).

Please join us in welcoming her to Harbor!

Year End is Around the Corner!

Year-end continues to get more challenging for the financial industry with more delays and red tape every year. Consider acting now to make sure everything needed is completed before the end of the year. Possible tasks:

- If applicable, take your required distribution from your IRA or inherited IRA.
- Make a contribution to your child's 529 account.
- Consider any estate planning that might need to be done before year-end and phone your attorney for an appointment.
- Discuss with your accountant whether or not you might be eligible to contribute to a Roth or Traditional IRA for 2015 and, if needed, contact us to open the account.
- Take care of any gifting, transfers of stock or cash that might need to be done by year-end.

Please contact our office today if we can help with any of these items. Thank you!

2015/2016 Office Closures

Our office is closed on the following New York Stock Exchange holidays in 2015 and 2016: Thursday, November 26 - Thanksgiving Day; Friday, November 27 - half day; Thursday, December 24 -half day, Christmas Eve; Friday, December 25 – Christmas Day; Friday, January 1 – New Year's Day; Monday, February 15 – Washington's Birthday.