

Volume XXVII, Qtr III

# THE HARBOR ADVISOR

## Combating Uncertainty – Long-Term Trend Focus

I have written and communicated the importance of taking a long-term view of your financial plan and most readers of this newsletter have heard and taken part in discussions centered around the importance of a long-term view of investing. The current discourse on the effect the presidential election will have on the markets reminds me of the relatively short-term effect we think either candidate's election will have on stock and bond market pricing. In turn, I am reminded of the longer-term trends in investing that can have a big effect on your returns. We have these discussions relative to the investments you own. For example, the inclusion of light weight industrial materials (drone technology, airplanes), security systems (the growth in home and personal security) and medical companies (to take advantage of advances in technology and the ageing demographic). A discussion around these trends is in order lest we fall into the trap of focusing too much on the short term.

Some positive long-term trends we believe can be capitalized on are the digital era, cloud computing, artificial intelligence, virtual reality, cybersecurity, and, as mentioned, personal security. There are many opportunities for investment in and around these sectors.

Potentially negative trends that concern investors are health care, specifically the Affordable Health Care Act - what long term effect will it have? Will the legislation itself be in place in 5 years? Will there be meaningful Social Security reform? What investments and trends will come from a population that is being tasked with providing their own funds for retirement? What effect will the United States ageing major infrastructure have on our economy, investments, materials and commerce? One can make the argument that opportunities abound in the areas of concern as well. Again, a long term view is necessary.

Investing awareness is a balance. In order to gain a full perspective we suggest a healthy focus on short-term events and then a check of the longer-term trends chosen to place in your portfolio. Experience tells us that this balance encourages the investor to hold positions for the long-term resulting in a more productive (read profitable) portfolio.

This month's newsletter is chock full of interesting articles: self-driving cars are here, we delve into our investment hedge policy and offer a reminder to take care of year end items before they become last minute.

Enjoy our lovely fall!



October 7, 2016

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## 2016 Anniversaries

**The Attack on Pearl Harbor  
75 years  
December 7th, 1941  
A date that will live in infamy.**



## Third Quarter 2016 Market Recap

Markets were relatively calm during the third quarter, especially compared to the extreme volatility caused by the Brexit vote at the end of the second quarter. Strong US economic data had a stabilizing effect on global markets. Financial stocks recovered, reflecting investor confidence in the economy and the investment in riskier assets. Markets reacted to a possible interest rate increase in September but the Fed opted to postpone its decision until the fourth quarter. Elsewhere in the world, Japan restructured its monetary policy in hopes of jump-starting its economy. Emerging markets had a good quarter. The impeachment of Brazil's president was seen as a positive indication that the country was on course to resolving some of its political

challenges. The increase in commodity prices was also viewed with optimism.

Not all economic news was rosy around the globe though. The UK's decision to exit the EU added to political uncertainty and concerns for the economic outlook for the entire Eurozone. As a result, the Eurozone grew at a slower pace than expected.

All of our major indexes were positive for the quarter. The S&P 500 +3.31%, Russell 2000 +8.66%, MSCI EAFE +5.80% and the Barclay's Aggregate Bond +0.46%.

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*"I cannot endure to waste anything so precious as autumnal sunshine by staying in the house." Nathaniel Hawthorne*

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### Fund Focus: MetroWest Total Return Bond (MWTIX)

The third quarter's fund focus will center on MetroWest Total Return Bond Fund, MWTIX, a great new addition to the portfolio. MWTIX is an intermediate-term bond fund, meaning it invests in bonds which mature in the next 3-10 years, with an average portfolio maturity of 6.37 years. This fund invests primarily in AAA (the highest rated) bonds, with more than two-thirds of the portfolio holdings being AAA rated. MetroWest Total Return Bond Fund has had a strong record of success, earning it a 5-star Morningstar Gold analyst rating, something only four other intermediate-term bond funds were able to accomplish. Fund managers Tad Rivelle, Steve Kane, and Laird Landmann have worked as a team for over 20 years, loyalty rarely seen in the investing world today. This synergy between managers has helped MWTIX perform at a high level over the past 10 years, being ranked in the top 10% of its peer group for both five and ten year returns. Harbor feels strongly about the addition of MWTIX and continues to like the intermediate-term bond space for its yield and diversification benefits.

## Hedging

"Hedging" is something that individuals and investors do on a daily basis, whether they know it or not. Hedging, both in the real world and the investing world, revolves around the concept of limiting risk. By living in a house, you face a risk that your house could suddenly burn down. By purchasing homeowners insurance, you "hedge" your financial risk of a fire. You pay money to an insurance company through a premium (think of this as a negative investment), but if your house does happen to burn down, the insurance company must pay you an amount based on the coverage you have paid for (a positive investment). By being hedged, you protect yourself against the risk of losing your home and possessions.

The same theory applies in the investing world. Hedging a portfolio, or specific position, all revolves around limiting risk against a negative event. Investopedia defines hedging as, "strategically using instruments in the market to offset the risk of any adverse price movements." This relates to the tradeoff between risk and reward that investors must face. By limiting the risk of an investment, you are essentially agreeing to accept a slightly lower return, because you paid to limit your risk.

Hedging can be done in almost an infinite number of ways but is primarily done by making investments in instruments that have negative correlations. A negative correlation means that as one item goes up, the other goes down and vice versa. Most commonly, investors use derivative instruments, both options and futures, to hedge. Derivatives are the most effective way to hedge a position or portfolio because of their low cost, efficient marketplaces.

Harbor doesn't explicitly hedge individual positions, but rather creates a portfolio that is hedged. This means that there are negative correlations that exist between individual securities, and a diversification benefit that is similar to a hedge. Also, many of the funds Harbor invests in are hedged. For example, Harbor's core growth and income portfolio is 46% allocated to hedged investments, or investments that have the ability to hedge.

The advantage to hedging is limiting risk. The downside of hedging is the cost of this protection. Just like insurance, you pay to be protected. If your house never catches fire, you ended up paying for something you didn't need, which is sometimes hard to swallow. If investors had a crystal ball and could see into the future, hedging wouldn't exist, but for now, hedging remains a great way to protect your hard earned dollars.

## Planning for Special Needs

As a parent or caregiver of a child with a disability, one of the biggest concerns you may have is the amount of money that will be needed to support him/her during your lifetime and beyond. This requires a new set of considerations and a well thought-out strategy.

Government programs are available for adults with disabilities to provide some benefits. If income and asset ownership requirements are met, Social Security income, Medicaid, vocational rehabilitation and subsidized housing may be available.<sup>1</sup> In order to maintain the adult child's eligibility for government benefits, special attention must be given to gifting. It is important that all involved in the life of a special needs person understand gifting rules so that eligibility for Social Security and/or Medicaid is not negated.

A special needs trust may be helpful in providing for care over and above what the government benefits provide. It enables assets to be available while allowing the special needs person to receive needs-based benefits from Social Security and Medicaid. There are no limits on the amounts that can be held in the trust; those assets will not be counted toward the eligibility requirements for government benefits.

Should a special needs person already own assets in his/her own name that exceed the allowable limit, a first-party special needs trust, known as a Payback Trust, may be established. A Payback trust can also be established if there has been incorrect titling on assets, such as designating the special needs person as a beneficiary on a life insurance policy. With this trust, the state requires that it be reimbursed for benefits that were paid during the special needs person's lifetime after that person dies.

We understand that navigating the system to plan for your loved one may be new territory. It requires an understanding of the law and government benefit programs but there are a number of helpful resources including the Social Security Administration. We also recommend that you discuss your particular situation with an attorney who specializes in special needs. We can refer you to an attorney for more detailed legal advice.

<sup>1</sup> "Why Use a Supplemental Needs Trust?", [www.nsn.com/frequently.htm](http://www.nsn.com/frequently.htm).



### TECH NEWS: Self-Driving Cars

Self-driving cars sound like something out of a science fiction movie, but Uber is turning it into reality. Testing has begun in San Francisco and Pittsburgh. In San Francisco, black Ford Fusion Hybrids have been spotted driving with sensors and cameras attached to collect digital situational data. In Pittsburgh, self-driving vehicles (with a safety driver at the wheel) have started picking up volunteer passengers as part of their pilot program.

Uber announced a partnership with Volvo to help each other develop self-driving technology. About 100 self-driving Volvo SUVs are planned in the Pittsburgh area.

Detroit may also become a testing ground for Uber. Michigan is one of only eight states that has legalized the testing of self-driving cars on public roads and Uber is planning to open a facility in Detroit. Their hope is that this outpost will further facilitate partnerships with the automakers and suppliers there.

And it's not only Uber that is pursuing this new technology. Ford, Faraday Future and Google – in collaboration with Chrysler, have all announced plans to begin testing of their own. Apple is also rumored to be working on a vehicle. And Lyft has recently started testing self-driving Chevy Bolts in Phoenix.

Supporters of the new technology argue that self-driving cars will save lives, reduce pollution and reclaim land. Skeptics cite accidents and high regulatory and insurance issues as possible speed bumps. Regardless, Uber, Ford, BMW, Google and Lyft have all cited 2021 as the date when self-driving cars could constitute the bulk of vehicles in urban centers.

## Living Well/Living Smart

### Beat the Year End Rush!

With only a few months left in the year, 2017 will be here before you know it. Now is a great time to get a jump start on those year-end financial tasks:

- Maximize any tax deferral options: 401K, 457, 403B and college savings plans
- If applicable, make sure to take your required minimum distribution from any IRAs or inherited IRAs before year end
- Review your beneficiaries to make sure they are still up to date
- Consider charitable contributions that you would like to make for the year
- Confirm with your accountant that you have maximized your deductions for the year
- Update your budget and savings goals
- Review your tax withholding elections
- Check for unused services in your Flexible Spending Account that won't roll into next year. This could include things like eye exams, annual checkups and dental cleanings

And if there's still time:

- Review your will and trust documents to make sure they are still current
- Check the batteries in your smoke alarms and carbon monoxide detectors
- Update insurances to cover any new purchases or collectibles

If you are an over-achiever and have already done all of this, give yourself a pat on the back, relax and enjoy the holidays!

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Images: Nat Arnett

## Harbor Happenings

### **Harbor on Facebook**

Visit us on Facebook! See the latest happenings at Harbor and get tips and financial information from market experts. <https://www.facebook.com/harborfin>

### **Wise Women, Smart Investors**

Our women and investing events held in September in both Boulder and Denver were well attended and well received. We plan to offer an evening presentation for those who could not attend.

### **Privacy Policy and New ADV Available**

A full copy of Harbor's updated ADV (the form used by investment advisors to register with the SEC) is now available on our website. Please notify us if you would like a hard copy sent to you by mail.

### **2016/2017 Office Closures**

Our office is closed on the following New York Stock Exchange holidays in 2016 and through the beginning of 2017: November 24, Thanksgiving; November 25, half day; December 26, Observance of Christmas; January 2, Observance of New Year's Day; February 20, President's Day.