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CA Financial Services
828 8th Avenue
Lewiston, ID 83501
(208) 746-3270 phone
www.cafinancialservices.com

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2001 Sixth Ave., Suite 2801 • Seattle, WA 98121 • www.KMSfinancial.com
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Is It Really *All* About the Fed?

These days it seems that all investment discussions gravitate toward the timing and impact of the Federal Reserve curtailing ("tapering") its quantitative easing (QE). That program has seen the Fed buy tens of billions of Treasury securities and federally backed mortgage bonds monthly. Will interest rates surge when the tapering begins?

The short-run market reaction certainly could deal some pain to bond investors, but the economists at First Trust Portfolios suggest that the fundamentals are not that scary. For all the debt the Fed has purchased, its current holdings of marketable Treasury debt still represent only about 18% of the total outstanding. The recent peak share held by the Fed was 20% in 2002, and it was 17% in 2008 well before QE really got rolling.

Over the past 38 years, marketable Treasury debt outstanding has risen $9.3 trillion, an average of $242 billion per year. Over that time the nation's annual gross domestic product (GDP) averaged $8.1 trillion, so the market absorbed added Treasury debt at an average pace of 3% of GDP per year. Of course today's GDP is more than $16 trillion, and the federal deficit for fiscal 2013 came in at just over 4% of GDP.

Whatever action the Fed takes is apt to be more attenuated than abrupt. Neither Fed policies nor interest rates exist in a vacuum. If the Fed has demonstrated anything the past five years it's a commitment to using monetary tools and interest rate controls to try to support markets and foster economic growth. Whether all that turns out to be for the long term greater good is a question for… the long term. ■

Energy Renaissance Broadens Its Reach

Two years ago we featured the remarkable prospect of the U.S. becoming a net *exporter* of such petroleum products as gasoline, diesel, and other oil-based fuels. The relatively new technologies of hydraulic fracturing (fracking) and horizontal drilling were starting to alter the global energy equation.

Now the U.S. is reportedly passing Russia as the world's largest *producer* of oil and gas combined. Oil-related exports are running over three million barrels a day, triple the level in 2006. Meanwhile, petroleum imports have dropped 30%, and some of that crude is being refined into products for export. The U.S. is now a leader in both the raw materials and the value-added products critical to the global economy.

Other countries, including Russia, are believed to hold significant oil and gas reserves that could be profitably recovered with the newer technologies. But the U.S. has a lead in technology as well as other advantages. A strong tradition of contract law and private ownership of mineral rights encourages investment and competitive development. The ability to move oil and gas to refineries and end users is relatively well developed, and this production surge is occurring amidst the world's largest, most diversified economy.

Investors have taken note, and the energy and natural resources fund sectors have done well recently. But an exciting investment story does not guarantee big gains. Sector stocks can get ahead of themselves, and success in the energy sector creates its own challenges.

Drilling in shale is relatively expensive, and price declines have greater impact on high-cost producers. Transport factors make natural gas more of a local or regional market, and surging domestic production has driven a huge price drop. U.S. gas is now priced 70-75% *below* what much of the developed world pays. That energy cost advantage is a boon to U.S. manufacturers and an enticement to siting new plants here. Oil trades in a tighter price range globally, but that price has slipped lately, especially in the U.S. with its production surge.

Experts differ on the sustainability of production from shale. And the newer drilling technologies have raised environmental concerns. Producers face ongoing legal challenges and more regulation. Nevertheless, *The Wall Street Journal* recently noted that big global players have slated half a trillion dollars' worth of projects for exporting North American natural gas.

The changed equation for global energy has macroeconomic and geopolitical implications. U.S. production has eased supply challenges and lowered costs for other net importers, while traditional oil and gas exporters may lose some of the financial and political clout they've enjoyed. Cheap North American gas has driven down the price of

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***Growth* in Crude Oil and Liquid Fuels Production** *(in millions of barrels per day)*

	Actual 2012	----- Projected ----- 2013	2014
North America	1.230	1.475	1.132
OPEC Countries	1.309	–0.766	–0.033
Russia and Caspian Sea	0.088	0.074	–0.114
Latin America	–0.039	0.094	0.183
North Sea	–0.282	–0.109	–0.034
Other Non-OPEC	–0.520	0 016	0.315

Source: Energy Information Agency

Will Stock Selling by Boomers Tank the Market?

For the better part of two decades some market sages have warned that stocks could face a stiff, steady headwind as retiring baby boomers trim their equity holdings in favor of more conservative allocations and start spending their nest eggs. It's the flipside of the view that the great bull market of the 1980s and '90s was partly fueled by the boomers surging into the prime earning and saving phase of their lives.

Demographics certainly can influence markets, but it's probably more of an indirect effect tied to the relative dynamism of the national economy. Recent studies question the idea that retiring boomers will tank stocks. Several years ago the U.S. Government Accountability Office determined that demographic variables account for less than 6% of the stock market's variability of returns. A more recent study by the Vanguard mutual fund company cited several key factors that counter the boomer-sell-off scenario.

Yes, the boomer generation is large: 76 million U.S. births from 1946 through '64. But the rate at which they retire and the manner of doing so will vary widely. Besides, there were 50 million Gen-Xers born from 1965 through '76, and 70 million Gen-Yers born 1977-2002. The supply of workers/savers/investors doesn't exactly end with the boomers. In fact the U.S. has one of the better profiles among large nations with respect to the growth of the 15-64-year-old population.

Yes, as of 2010 boomers owned nearly 47% of U.S. equities. But that's not statistically different from the share their parents' generation held 20 years earlier. Older folks generally own more financial assets than younger folks. Nothing new about that. And in trying to gauge the selling pressure that might come to bear, it's worth noting that the wealthiest 20% of boomers hold 96% of the equities held by their age cohort, and 77% is held by the wealthiest 5%. Will these folks need to dump stocks to make ends meet?

Yes, boomers could start leaning more conservative in their portfolio allocations. But with interest rates so low, will that really play out as a big shift from stocks to bonds? Besides, global demand for U.S. stocks has risen markedly over time. Thirty years ago foreign holders owned only about 7% of the U.S. stock market; today they own more than 20%.

Yes, the nation is seeing demographic changes and longer life expectancy. But using extensive data from the International Monetary Fund, MSCI, and FTSE, Vanguard analyzed cross-country changes in the relative number of retirees versus inflation-adjusted stock returns from 1980 through 2011. They found no correlation between the two.

It is always tempting to latch on to one or another statistic or factor as the determinant of tomorrow's investment environment. But over time markets are driven by more factors than can be parsed and prioritized with absolute precision. And those factors that weigh negatively on stocks help create the opportunity to capitalize on those factors that weigh positively. ■

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U.S. Energy Revolution

coal, which is displacing some Russian gas for European utilities. But China's oil imports are surging, so producers can look to many buyers.

Implications are positive for the dollar as oil and gas imports have long accounted for a big piece of the U.S. current account deficit. Railroads are reaping profits from moving oil and a host of materials and equipment involved in development and production. The positive feedback loop of technological innovation, infrastructure investment, and high-wage employment opportunities reaches out across many sectors of the economy.

Investors can look to a wide range of targeted investment choices in energy as well as the broader implications for U.S. growth. But at this point the story is hardly a new one, and portfolio managers have the challenge of trying to determine which of those investment plays have the greatest room to run. ■

Investment Performance Review	TOTAL RETURN * (dividends and capital gains reinvested)			
Selected Mutual Fund Categories *	--- Annualized thru Dec. 6, 2013 ---			
	1 yr.	*3 yr.*	*5 yr.*	*10 yr.*
Large-Cap Stocks (Core)	29.3 %	14.8 %	17.3 %	7.2 %
Mid-cap Stocks (Core)	33.6	14.4	21.3	8.9
Small-cap Stocks (Core) †	36.9	14.9	21.5	9.2
Foreign Stocks (Multi-cap) †	19.5	7.0	14.2	6.7
Emerging Market Stocks †	2.9	– 1.5	16.4	10.9
Natural Resources	24.4	6.0	17.4	11.8
Real Estate Related	4.3	9.5	19.1	8.1
Flexible Portfolio	8.9	6.3	11.8	6.3
General Bond	– 1.3	5.3	8.2	6.2
Int'l Fixed Income †	– 3.8	2.4	6.2	4.8
High-Yield Taxable Bond †	7.1	8.2	17.6	7.3
General Municipal Debt	– 5.8	4.2	7.0	3.5

* Source: Lipper, as reported in the online *Wall Street Journal*, December 7, 2013.
Past performance is NOT indicative of future results.

† Small-cap stocks and high-yield (lower rated) bonds pose more risk and price volatility than those of larger, established companies. Securities of companies based outside the U.S. may be affected by currency fluctuations and political or social instability to a greater extent than U.S.-based companies.

Global Growth Back on the Menu

It's been six rather long years since we talked about a broadly expanding global economy. Now those indicators seem to be lining up again. Of course the U.S. has been expanding for four years even if it hasn't always felt like it. The third quarter's annualized growth rate was recently pegged at a surprisingly strong 3.6%. The U.K.'s economy has picked up as well after a run of austerity measures.

Europe's downturn was more prolonged and especially deep in the peripheral economies of Greece, Spain, and Portugal. But with labor costs and property values having adjusted in those countries, a continental turn-around appears to be at hand. Earlier this year there was concern about a slowdown in China. But the latest numbers indicate continued expansion, albeit at a more modest pace than for much of the past couple decades.

November's Global Manufacturing Purchasing Managers Index Overview showed a diverse list of key nations in "accelerating expansion" mode, including India, South Korea, Japan, Singapore, South Africa, the Eurozone, Hungary, Poland, Turkey, along with the U.S. and the U.K. Russia and Brazil have slipped, but both are major commodities exporters whose broader economies should benefit from global expansion… hopefully a long one. ■

Charity Begins at Home, Increasingly

Are family demands impeding your retirement plans? A recent report from a major brokerage firm suggests that economic challenges have many baby boomers extending more financial support both to aging parents and young adult children.

The survey of nearly 3,000 affluent respondents (age 50 and over) found that 20% had at least one adult child currently living with them in their homes. And 68% have extended financial support to grown children within the past five years. Only a third of the sample felt "ready for retirement" assuming no negative life surprises.

This is a delicate balancing act. What is all the saving and success for if not to help family? But where do the lines get drawn, and what might be the effect on relationships that are central to our lives? Even couples who are used to being in sync on financial matters can find this a new source of considerable tension.

The importance of keeping critical financial plans on track should not be minimized. Helping others on any sustained basis depends on maintaining one's own financial stability and margin for error. A bit of candor with family members seeking your help is important too. ■

Do You Know Who Gets Your 401(k)?

When it comes to 401(k) accounts, participants tend to focus on investment results, the company match, tax savings, and progress toward retirement. All of that's important, but one detail may be overlooked: Who's your beneficiary?

Lack of beneficiary designations may be more common with the rising popularity of auto-enrollment in 401(k) plans. Many participants intend a spouse to be the beneficiary, and that is the default if no beneficiary is specified. Generally the spouse must be the primary beneficiary unless he or she signs away this right.

But often there isn't a spouse, or a couple's strategic planning makes it more appropriate for someone else to be the primary beneficiary for that particular asset. Beneficiaries can include children, grandchildren, other relatives, friends, trusts, charities, etc. And even if a spouse is the primary, there's the matter of *contingent* beneficiaries.

For many Americans a 401(k) represents their largest asset, or at least their largest financial asset. As life's events (divorce, birth of children, grandchildren, etc.) play out, it is important to review the beneficiaries on any retirement accounts, annuities, etc. Contact your advisor or plan administrator if you think you might be due for an update. ■

It's Your Email, but Is It *You*?

You probably heard the news the other day that some two million passwords for popular email and social web services were compromised by "malware" (a malicious software program) surreptitiously installed on peoples' computers.

It brings to mind our coverage a year ago of the importance of using secure passwords, rotated periodically, for any sites where you reveal personal information. Analysis of the latest major hack indicated that the most common password used by the victims was 123456. And nearly half of the passwords employed just one type of character such as all lower-case letters or all numbers – an invitation to easy hacking.

Your email can be a portal to a great deal of information on you and an easy avenue for someone to impersonate you online. Brokerage firms across the industry have seen a proliferation of scams in which a hacker constructs convincing email messages to a victim's advisor or financial institution. These emails often request that funds be wired to a "third-party" account for reasons that correlate with information gleaned from the victim's email.

Basic email security is your front-line of defense. But custodians also have tightened requirements and procedures related to requests for funds, especially requests to wire money to a "third-party." We all want maximum *convenience* when *we* need money from our accounts, but maximum *security* when a scammer wants the same thing. We may have to sacrifice a bit of the former to help ensure the latter. ■

Tax Season to Start Later as Shutdown Delayed IRS's Work

The Internal Revenue Service has had a challenging 2013, from last spring's scandal over playing political favorites to this fall's government shutdown. Taxpayers might have anticipated the agency's recent announcement that the start of the filing season for 2013 returns will be delayed a week or two.

The government's 16-day shutdown came during the peak period for final programming and testing of more than 50 systems the IRS uses to process nearly 150 million tax returns. And even if IRS officials were surprised by that disruption, recent events certainly have reinforced the importance of making sure systems are adequately tested.

The original start date for the IRS to accept and process 2013 individual returns was January 21st. Now it's expected to be no earlier than the 28th and perhaps as late as February 4th. But for taxpayers, the filing deadline remains Tuesday, April 15th. Government shutdowns are no excuse for the rest of us.

Tax preparers have some new wrinkles this year. We won't dwell on the changes introduced by the American Taxpayer Relief Act – we did that last spring – but for upper-income filers they include a phase-out of the personal exemption, a limit on itemized deductions, the Medicare surtax on investment income, and, well, if you fit the profile, you get the picture.

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Trimming Some Costs on Capitol Hill

Recently, in promoting the value of tax-deferral, an investment sponsor noted that over the past 15 years the federal government spent $5.25 million on hair care for U.S. Senators. That average - $3,500 per year, per Senator - may seem a bit extravagant, but let's not be penurious. In an era of 24-by-7 cable news, these folks have reason to be looking their well-coiffed best at the drop of a… hat.

Not only does today's Senate include more women, but a good head of hair appears to have become a key political advantage for the guys as well. We live in a superficial age; one can't risk having a shaggy mane dilute the impact of a pithy sound bite. Besides, trimming this particular perk wouldn't shave so much as a whisker off the $90 billion gap between Democrats and Republicans on annual spending. That's a much hairier negotiation.

All that said, the original point about tax-deferral is a good one. Affluent taxpayers face higher rates on investment income this year, and there's still a time to check on whether you're taking good advantage of *your* 2013 tax-deferral opportunities. ■

For information on our investment services, please contact:

CA Financial Services

208-746-3270 phone

208-743-9514 fax

www.cafinancialservices.com