



NEW ENGLAND GUILD WEALTH ADVISORS

INVEST IN CONTEXT

Market Spotlight

Returns as of 6/30/14

Index	2 nd QTR	Annual		
	YTD	3 YR	10 YR	

S&P 500 (inc. div.)	5.2%	7.1%	16.6%	7.8%
Russell 2000	2.1%	3.2%	14.6%	8.7%
MSCI AC World xUS	5.0%	5.6%	5.7%	7.8%
MSCI AC World	5.0%	6.2%	10.3%	7.5%
REITs	7.1%	16.4%	10.7%	8.5%
Barcap Agg. Bond	2.0%	3.9%	3.7%	4.9%
90 Day T-Bills	0.0%	0.0%	0.1%	1.6%

After a rocky start, the quarter eventually made up for domestic equities' earlier losses. As winter finally lost its chokehold on the U.S. economy, investors grew increasingly comfortable with the Fed's slow-and-steady approach to tapering monthly bond purchases. As a result, they were willing to take on risk again, handing the S&P 500 new record highs. Small cap stocks, which suffered the most in April, managed to climb back to positive territory for the year. Brewing crises in emerging markets stabilized, pushing international equity returns higher; while REITs continued to outperform. Bond investors confounded expectations, sending the benchmark 10-year Treasury yield down as demand pushed prices up. Volatility in financial markets remained low.

Cuts in exports, business investments/inventory, and state/local government spending resulted in disappointing economic growth. However, corporate earnings remained solid. Merger and acquisition activity was up 40% globally; while dividend increases and share buybacks were notable. The housing market improved; U.S. manufacturing strengthened; and retail sales gained. Unemployment inched down to its lowest level since September 2008, 6.3%. Outside the US, economic growth remained mixed.

Continued debate on the Fed's normalization process (and discussions around inflation); geopolitical hot spots; and the pace of global economic and earnings growth, will bear watching in months ahead.

Data Source: Broadridge Investor Communication

Do Investment Advisors Add Value?

Vanguard recently published a white paper entitled, "Putting a Value on your Value: Quantifying Vanguard Advisor's Alpha." It is basically an empirical study to determine how much value investment advisors who follow 'best practices' in wealth management add to client portfolios relative to the experience of an 'average client'. In short, Vanguard concludes that advisors can potentially add **"about 3%"** to what clients might experience on their own. This increase in potential return shouldn't be viewed as an annual value-add. Since some of the most significant opportunities to add value occur during periods of market duress or euphoria when clients are tempted to abandon their well thought-out investment plan, it is likely to be more intermittent.

Vanguard's conclusions are based on analysis of its own client database, mutual fund industry and market data, and commonly accepted behavior practices of investors. Needless to say, we are pleased with the results of this study. Not only is Vanguard greatly respected for the integrity of its research, and particularly for its efforts to serve the best interests of its investors, but also for the plain talk manner it uses to explain complex investment issues. We think their study serves two essential purposes: it identifies areas that are as important to investor wealth creation as gross investment performance and, by so doing, it also identifies the critical areas upon which an investor should focus in evaluating and selecting an investment advisor.

Vanguard based their findings on seven Modules. Each displays a range of value they believe an advisor can add by incorporating wealth management best practices. The Modules encompass both investment-oriented and relationship-oriented strategies and services.

value added
> **0.0%**

Module I (Asset Allocation) speaks to the importance of establishing an investment plan with specific reference to asset allocation targets. Because a plan is unique to each investor's time horizon, risk tolerance and financial goals, it is difficult to empirically quantify its 'value-added'. Rest assured, however, that this action, as it applies to the totality of an investor's financial situation, is critical for assessing the implications of a plan for the future well-being, for assuring compliance of a plan by a manager/advisor, and for evaluating progress of a plan toward future goals.

value added
-.45%

Module II (Cost-effective implementation) addresses the issue of the many costs that reduce gross investment returns to investors. These go well beyond fund expense ratios. They also include fund trading costs, fund fees (sales fees, back-end loads, surrender charges), fund transaction costs, asset management fees, and, importantly, tax costs. If anything, we think the Vanguard analysis may understate the impact of these costs.

continued on page 2

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value added
.35%

Module III (Rebalancing): Most individual investors do not even think of rebalancing their portfolios (note: this is very different from 'market timing'). This is because they either a) don't have a plan with asset allocation targets to rebalance to, or b) don't know what their current asset allocation is because their portfolio is comprised of many accounts that are scattered among many managers, or c) never get around to it. Vanguard notes that as a consequence of not rebalancing, a portfolio strays from its target asset mix, thereby taking on too much risk (stocks outperform and become a much larger share of asset allocation), or too little risk for the opposite reason.

value added
1.50%

Module IV (Behavioral Coaching) is the largest single source of incremental value added by an advisor. It is simply providing the discipline to keep the individual investor from emotional overreaction. Study after study has shown that individual investors 'market time' at the wrong time – they move into stocks (or bonds or commodities, or gold, or cash) after an asset class has outperformed other asset classes, and vice versa. They do the same thing in the selection of individual stocks and funds. Despite all the warnings that "past performance is not indicative of future results", individual investors disregard this. Studies by Dalbar and others suggest the cost of this behavioral pattern is actually much greater than the 1.5% estimated by Vanguard. It is not that advisors are so smart that they overcome this weakness; rather, it is that good advisors: a) are disciplined to adhere to a thoughtfully developed investment plan, and b) know what they don't know (which is how to market time).

value added
0 to .75%

Module V (Asset Location) is another consideration most individuals don't think about. It relates mostly to tax efficiency, i.e., higher taxed assets like bonds and REITs are

value added
0 to .70%

better held in tax-sheltered accounts while more tax efficient assets like stock or municipal bonds should be disproportionately held in taxable accounts provided that other considerations (like liquidity, volatility) are satisfied as well.

Module VI (Withdrawal Order): As with the prior module, this is also a tax sensitive issue often ignored by individual investors. Vanguard notes that this consideration is a function of the breakdown of assets between taxable and tax-advantaged accounts as well as the investor's marginal tax bracket. In general, one should defer paying taxes (as on an IRA withdrawal) as long as possible. Therefore, draw down taxable asset accounts first when funds are required from the portfolio.

value added
> 0.0%

Module VII (Total Return vs. Income Investing) speaks to the common misconception that one should only spend 'income' earned within the portfolio while letting 'capital appreciation' raise the portfolio's value over time. This thinking can result in seeking higher yielding assets when more spending is needed, thereby potentially creating a divergence from the 'best' asset allocation for the long term as determined by the Investment Plan.

We might have wished that some other modules had been included in the Vanguard study such as gifting strategy, or estate planning, or coordination with legal, tax and insurance advisors. To a certain extent, however, these benefits are incorporated within other modules. They are difficult to quantify as well. But, in summary, we think Vanguard has, once again, done a significant service both to individual clients and to advisors by this publication. This summer they will publish an abbreviated version for the investment public which we look forward to sharing with you.

Excursion: Visit LOST ACRES VINEYARD in North Granby, CT to enjoy a glass of wine while you listen to great music and view award winning artwork by local artists in the tasting room. While grape growing and wine making is the central activity of the farm, they also raise pigs and chickens; share their love of horses with visitors by giving private horseback tours of the vineyards; and maintain flower and herb gardens that provide ingredients for their cheese and antipasto plates served at outdoor tables or indoors.

80 Lost Acres Rd., North Granby, CT 06060 Hours: Fri. and Sat. 11- 6; Sun. 12- 5 www.lostacresvineyard.com (860)-324-9481

OUR FIRM CONTINUES TO GROW BY REFERRALS FROM OUR CLIENTS. THANK YOU FOR RECOMMENDING US.

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