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Money Matters

A monthly publication to keep our clients informed about current financial issues and trends

Inside this issue:

2016 Year End Report

You know you're deep into a longstanding bull market when you see things like average pedestrians keeping one eye on the market tickers outside of brokerage houses to see when the Dow Jones Industrial Average has finally breached the 20,000 mark. Who would have imagined record market highs at this point last year, when the indices ended the year in negative territory? Or when 2016 got off to such a rocky start, tumbling 10% in the first two weeks—the worst start to a year since 1930?

The markets eventually bottomed in mid-February and began a long, slow recovery, turning positive by the end of March, suffering a setback when the U.K. decided to leave the Eurozone and endured another hard bump right after the elections. In the end, everyone was surprised; the Dow finished at 19,762.60 for the year and the bull lives for another year.

This was the second year in a row that the final quarter provided investors with solid gains. A broad measure of the U.S. stock market, the Russell 3000 index, gained 4.21% in the final quarter, to finish up 12.74% for the year.

Large cap U.S. stocks were up with the Russell 1000 large-cap index closed with a 3.83% fourth quarter performance, and finished the year up 12.05%. The widely-quoted S&P 500 index of large company stocks was up 3.82% in the fourth quarter, finishing up 11.96% for calendar 2016.

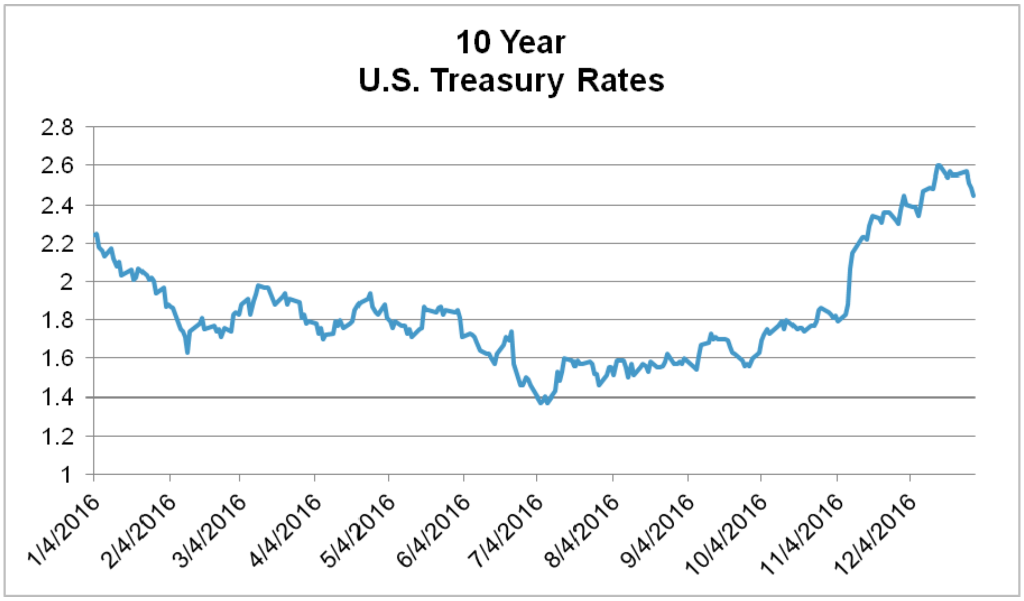
The Russell Midcap Index gained 3.21% in the fourth quarter, and was up 13.80% in calendar 2016. This was a year to remember for investors in small company stocks. The Russell 2000 Small-Cap Index finished the year up 21.31%.

International investments contributed a slight decline to overall portfolio returns. The broad-based EAFE index of companies in developed foreign economies lost 0.71% in the fourth quarter of the year, finishing the year up 1.0% in dollar terms. Emerging markets stocks of less developed countries, as represented by the EAFE EM index, gained 11.19% for the year.

Looking over the other investment categories, real estate investments, as measured by the S&P Global REIT index, lost 4.85% during the year's final quarter, but managed to finish up 6.90% for calendar 2016.

Last year, investors were wondering why they had energy exposure in their portfolios, when their statements showed the S&P Energy Sector index delivered a whopping 22.24% loss. This year, they may be wondering why they weren't more committed to the asset class, as the same index gained 27.18%, fueled mostly by a rise in crude oil prices.

In the bond markets, it's possible that the decades-long bull market, which basically means declining interest rates, has ended and the fixed-income world is experiencing risings rates. The Barclay's U.S. Aggregate Bond market index, lost 2.98% in the fourth quarter, but ended up 2.65% for 2016. Despite the nudge by the Federal Reserve Board, the moves on the surface have not exactly been dramatic. Over the past year, rates on 10-year Treasury bonds have risen from 2.25% to 2.44%, but as the chart below indicates, it was anything but a smooth ride during 2016. The 10 year U.S. Treasury rate bottomed at 1.37% on July 5, 2016 the lowest rate ever.



As always, there were many unpredictable anomalies in the investment world. In the international markets, anyone lucky enough to have speculated on the Brazilian Bovespa index would have reaped a gain of 68.9% this year, despite all the headline drama around the Zika virus and political uncertainties that were reported on during the Olympic games. Russian stocks were up 51% for the year, despite the recent sanctions from the U.S. government and the lingering international sanctions related to the invasion of the Crimean peninsula.

What's going to happen in 2017? Short-term market traders seem to be expecting a robust economic stimulus combined with lower taxes and deregulatory policies that would boost the short-term profits of American corporations. But it is helpful to remember that we are entering the ninth year of economic expansion, making this the fourth longest since 1900. In addition, growth has not exactly been robust; the U.S. GDP has averaged just 2.1% yearly increases since the Great Recession, making this the most sluggish of all post-World War II expansions.

Slow and steady has not been a terrible formula for workers or stock investors. The unemployment rate has slowly ticked down from a post-recession peak of 10% to less than 5% currently. U.S. stock indices are posting record highs with double-digit gains, and that Dow 20,000 level, while essentially meaningless, is still catching a lot of attention.

It's clear that the new President-elect wants to accelerate America's economic growth, but the policy prescription has not always been clear. Will we rip up longstanding trade agreements, cut back on immigration quotas and deport millions of workers who crossed the border without a visa? Will there be a wall built between the U.S. and Mexico? Will the government pay for huge infrastructure projects, at the same time reducing taxes and thus raising the national debt? Will Congress raise the debt ceiling without protest if that happens? Will the Fed raise rates more aggressively in the coming year, or cooperate with the President-elect in his efforts to drive the economy into a faster lane?

At the same time, there are many unknowns around the globe. China's economic growth has stalled for the second consecutive year, and you will soon be reading about a banking crisis in Italy that could force the country to leave the Eurozone—potentially a much bigger blow to European economic unity than Brexit or a still-possible Grexit. Russian hackers may have ushered in an era of unfettered global intrusions into our Internet infrastructure, and there will surely be a continuation of ISIS-sponsored terrorism in Europe and elsewhere.

Every year of this longstanding bull market, we have to look over our shoulders and wonder when and how it will end. With the January downturn and so much uncertainty at this time last year, nobody could have predicted double-digit returns on U.S. stocks at year-end. Next year could bring more of the same, or it could fulfill the dire predictions many have made during the election cycle, including both Democrats and Republicans who believe the country is in worse shape than the numbers would indicate.

What we have learned over the past few years is that the markets have a way of surprising us, and that trying to time the market, and get out in anticipation of a downturn, is a loser's game. At the county fair, when we get on the roller coaster, we don't bail out and jump over the side at some scary point on the track; we hang on for the ride.

The history of the markets has been a general upward trend that benefits long-term investors. That inclination, and a few hard bumps along the way, is probably the best outcome to expect.

Calendar Facts

Happy new year! Did you ever wonder how January 1 became the day when one year ends and another begins? Or why this handoff from one year to the next takes place a few weeks after the shortest day of the year? Why are there 12 months instead of, say, 25 or 50?

We have just entered the 432nd year of what is known as the Gregorian calendar, which was introduced by Pope Gregory XIII in the 1600s but was only adopted in England in 1752. The new calendar replaced the Julian calendar, which, on introduction in 46 B.C., corrected problems with the previous calendar system by creating an initial calendar year with 445 days--what later became known as the "year of confusion." Before that, the Egyptian calendar—the original prototype of our current calendar system--was invented as a way to track the annual rising of the Nile River, which was critical to Egyptian agriculture.

The common thread of these calendars—and the Mayan, Chinese and Greek calendars--is that they are based on the fact that the moon goes through 12 cycles of full to new each year, which is where the idea of 12 months ("moons") came from. Alas, the Gregorian calendar preserved some of the quirks of the Julian calendar: as you know, the months are of different lengths, holidays fall on different days of the week from year to year and there is the messy necessity to include an extra day each leap year. The new calendar did manage to preserve the 7-day week, which facilitated the observation of the Sabbath every seventh day—virtually a requirement for any calendar that would be adopted in the West.

You might be surprised at the number of proposed "new and improved" calendars that have emerged over the years. The Raventos Symmetrical Perpetual Calendar and Colligan's Pac calendar both feature 13 months of 28 days each, while the Symmetry 454 Calendar eliminates the possibility of having the 13th day of any month fall on a Friday. Eastman Kodak founder George Eastman proposed an International Fixed Calendar which manages to have the numerical days of each month fall on the same weekday; for example, the 15th day of each month would always be a Sunday. The idea was to facilitate business activities such as scheduling regular meetings, and make it easier to accurately compare monthly and quarterly statistics.

Will we see a shift to one of these new and improved versions of our calendar system? Probably not. After all, the U.S. has failed to adopt the metric standard of measurements, despite it being the universal system for scientific inquiry around the world. In the end, a messy system we're all familiar with tends to be preferable to a tidy one that forces us to change our habits.

Peak Behind the Curtain

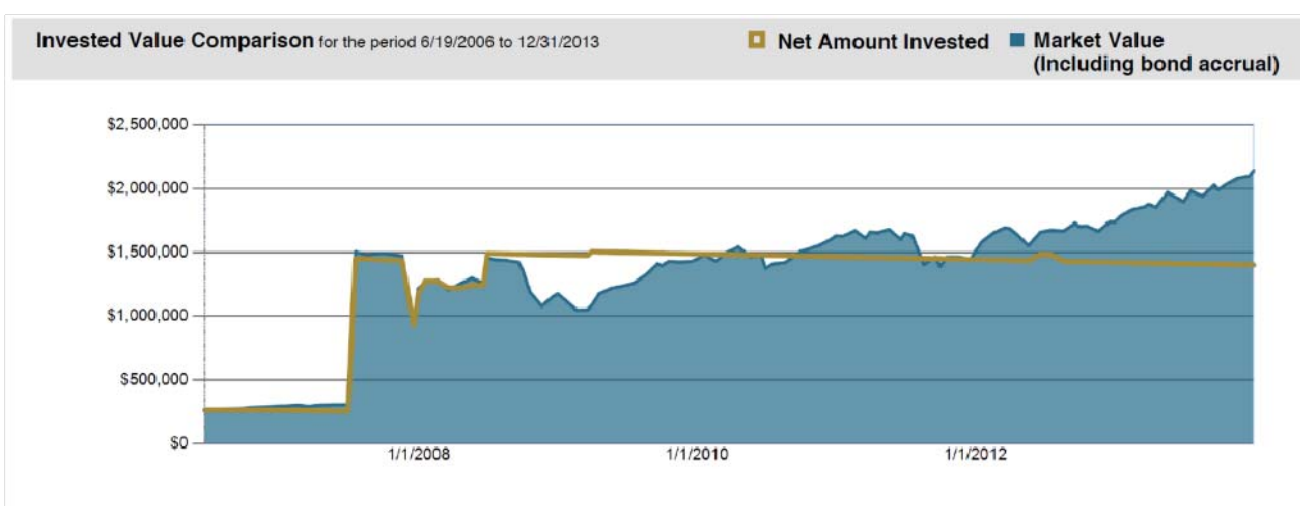
Over the coming year, we are embarking on a major internal software upgrade with the goal of enhancing our client experience. We believe the changes will offer more insights into your portfolio and explain information in different formats. This will also create internal efficiencies for us to gain capacity, allowing us to focus more on the important financial aspects of your lives.

In these newsletters, we'll highlight areas so you are familiar with the changes before you actually experience them. We will also allocate time in our meetings to discuss the themes in more depth. We plan to create focus groups to obtain direct feedback from clients on what information they want to see pertaining to their investments. In addition, later in the year, we will offer seminars to guide you through the new features. We hope you will participate to drive how The Harbor Group can best serve you.

One example that we will highlight in this newsletter is our quarterly reporting process. Our new quarterly reports will be consolidated to a dashboard style overview with supporting details behind the summary. Graphical representations will be utilized, rather than strictly numbers, to visually interpret the data we are reporting to you. This can show historical trends in a format that we simply cannot offer now with our legacy systems. An illustrative sample is included below. In the more distant future, as you get comfortable with the new systems, you'll be able to run these reports on-demand, dynamically via our enhance website portal and mobile app.

Lastly, on the reporting front, performance will be provided on a time-weighted return (TWR) to mitigate the distortion of cash flows and to allow an accurate comparison of mutual funds returns and benchmarks, all of which are standardized reported utilizing TWR. We currently report an internal rate of return (IRR), and while this does represent how you actually performed, since some clients deposit and withdraw monies from their portfolio, the IRR can get wildly distorted and it does not provide an accurate representation of our long-term performance.

As we roll out these new features, we are here to answer any questions, so please reach out if you experience any confusion. While change can bring a sense of groundlessness, our goal is to ultimately help enhance your experience to bring more clarity and ease to your finances.



Is Home Ownership Finally Rising?

One economic statistic that you probably haven't seen much of in the press is the home ownership rate. Quietly, the percentage of American families who own their own home (versus rent) has fallen to 62.9% in the second quarter of 2016—the lowest figure in 51 years, according to the U.S. Census Bureau. Young people are struggling to afford houses due to tight mortgage credit, and they're also finding that it's not easy to save for a down payment while paying off college loans. Contributing to the decline: a lack of new starter homes due to a construction lag following the Great Recession.

But there are reasons to believe that the rate may go up in the future. One is the formation of new households: 1.1 million in the third quarter, up from 944,000 in the three months ending in June. About half of the new households chose to be owners rather than renters, which could be due to skyrocketing rental rates around the country. For the first time since 2006, the home ownership rate went up in the quarter ending September 30, to 63.5%.

Quarterly Benchmarks

	4Q	YTD	1 Year	3 Year	5 Year
Fixed Income					
3-Month T-Bill	0.07%	0.21%	0.24%	0.10%	0.09%
Citigroup World Government Bond Index	-8.53%	1.60%	1.60%	-0.84%	-0.99%
Barclays 7 Yr. Muni Bond Index	-3.67%	-0.50%	-0.50%	2.92%	2.38%
Vanguard Total Bond Market Index Fund	-3.17%	2.60%	2.60%	2.94%	2.14%
Large Cap					
Vanguard 500 Index Fund	3.82%	11.93%	11.93%	8.84%	14.62%
Mid Cap					
Russell Mid Cap Index	3.21%	13.80%	13.80%	7.92%	14.72%
Small Cap					
Russell 2000 Index	8.83%	21.31%	21.31%	6.74%	14.46%
International Equity					
Vanguard Developed Markets Index	-1.44%	2.45%	2.45%	-1.19%	6.90%
Vanguard Emerging Market Stock Index Fund	-3.85%	11.73%	11.73%	-1.64%	1.44%

Retirement Contribution Limits Unchanged

In case you missed it, the contribution limits to your 401(k) plan, IRA and Roth IRA—set by the government each year based on the inflation rate—will not go up in 2017. Just like 2016, you will be able to defer up to $18,000 of your paycheck to your 401(k), and individuals over age 50 will still be able to make a "catch-up" contribution of an additional $6,000. (The same limits apply to 403(b) plans and the federal government's new Thrift Savings Plan.) Your IRA and Roth IRA contributions will continue to max out at $5,500, plus a $1,000 "catch-up" contribution for persons 50 or older.

SEP IRA and Solo 401(k) contribution limits, meanwhile, will go up from $53,000 this year to $54,000 in 2017.

The government has made small changes to the income limits on who can make deductions to a Roth IRA and who can claim a deduction for their contribution to a traditional IRA. The phaseout schedule for single filers for 2016 starts at $117,000 and contributions are entirely phased out at $132,000; for joint filers the current range is $186,000 to $196,000. In 2017, the single phaseout will run $1,000 higher, from $118,000 to $133,000, and the joint phaseout threshold will rise $2,000, to $188,000 up to $198,000. Single persons who have a retirement plan at work will see the income at which they can no longer deduct their IRA contributions go up $1,000 as well, with the phaseout starting at $62,000 and ending at $72,000. Couples will see their phaseout schedule rise to $99,000 to $119,000.

Ransomware

One of the newest types of computer infections is a new take on an older infection that was called ransomware. Once the computer was infected, your two options were to pay the ransom or reinstall Windows. You could use tools to recover your files on the hard drive, but it would cost valuable time and money. This was all under the implied premise that once you paid the ransom, the hackers would actually release your computer.

The newest form of this attack has taken on a very damaging twist. Now, not only does the computer get locked down, but files on your shared network drives are also encrypted and rendered unusable without the decryption key. The hackers demand payment, usually in the form of bitcoin or an anonymous wire transfer, to release the decryption key and get your files back. Again, this is all under the assumption that the hackers actually send the decryption key back to you. It is alarming to think that your files, and possibly your network, can be rendered useless.

So what can you do? First and foremost, ensure that you are running an antivirus solution and you keep it up to date. There are numerous free and paid antivirus solutions out there. One of the most common ways for these viruses to be relayed is email, so make sure that you do not open attachments that you are suspicious of. If in doubt, contact the sender and verify the email is valid before opening the attachments. This is one of the best defenses against any virus because even antivirus software can miss an infection.

What It Means to Be a Financial Caregiver for Your Parents

If you are the adult child of aging parents, you may find yourself in the position of someday having to assist them with handling their finances. Whether that time is in the near future or sometime further down the road, there are some steps you can take now to make the process a bit easier.

Mom and Dad, can we talk?

Your first step should be to get a handle on your parents' finances so you fully understand their current financial situation. The best time to do so is when your parents are relatively healthy and active. Otherwise, you may find yourself making critical decisions on their behalf in the midst of a crisis.

You can start by asking them some basic questions:

What financial institutions hold their assets (e.g., bank, brokerage, and retirement accounts)?

Do they work with any financial, legal, or tax advisors? If so, how often do they meet with them?

Do they need help paying monthly bills or assistance reviewing items like credit-card statements, medical receipts, or property tax bills?

Make sure your parents have the necessary legal documents

In order to help your parents manage their finances in the future, you'll need the legal authority to do so. This requires a durable power of attorney, which is a legal document that allows a named individual (such as an adult child) to manage all aspects of a person's financial life if he or she becomes disabled or incompetent. A durable power of attorney will allow you to handle day-to-day finances for your parents, such as signing checks, paying bills, and making financial decisions for them.

In addition to a durable power of attorney, you'll want to make sure that your parents have an advance health-care directive, also known as a health-care power of attorney or health-care proxy. An advance health-care directive will allow you to make medical decisions according to their wishes (e.g., life-support measures and who will communicate with health-care professionals on their behalf).

You'll also want to find out if your parents have a will. If so, find out where it's located and who is named as personal representative or executor. If the will was drafted a long time ago, your parents may want to review it to make sure their current wishes are represented. You should also ask if they made any dispositions or gifts of specific personal property (e.g., a family heirloom to be given to a specific individual).

Prepare a personal data record

Once you've opened the lines of communication, your next step is to prepare a personal data record that lists information you might need in the event that your parents become incapacitated or die. Here's some information that should be included:

Financial information: Bank, brokerage, and retirement accounts (including account numbers and online user names and passwords, if applicable); real estate holdings

Legal information: Wills, durable powers of attorney, advance health-care directives

Medical information: Health-care providers, medication, medical history

Insurance information: Policy numbers, company names

Advisor information: Names and phone numbers of any professional service providers

Location of other important records: Social Security cards, home and vehicle records, outstanding loan documents, past tax returns

Funeral and burial plans: Prepayment information, final wishes

If your parents keep some or all of these items in a safe-deposit box or home safe, make sure you can gain access. It's also a good idea to make copies of all the documents you've gathered and keep them in a safe place. This is especially important if you live far away, because you'll want the information readily available in the event of an emergency.

Don't be afraid to get support and ask for advice

If you're feeling overwhelmed with the task of handling your parents' finances, don't be afraid to seek out support and advice. A variety of local and national organizations are designed to assist caregivers. If your parents' needs are significant enough, you may want to consider hiring a geriatric care manager who can help you oversee your parents' care and direct you to the right community resources. Finally, consider discussing the specifics of your situation with a professional, such as an estate planning attorney, accountant, and/or financial advisor.

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