COMPASS ADVISORS

Investment Directions

SPRING 2014

Old Retirement Thinking

One of the economic challenges we face today is a reduction in the number of full time workers. In an effort to turn that around, employment statistics are tracked closely and reported endlessly. News panels speculate about the causes of employment and unemployment.

We also suffer from low retirement savings, limited Social Security funds and an aging baby boomer population. How will working folks be able to transition to retirement? Both personal and national savings seem to be inadequate.

Further, America as a nation is falling behind other countries in education and productivity. Most of us see America as the sole remaining super power, an economic engine with worldwide influence and an incubator for opportunity and growth. What is happening?

A New Perspective

Perhaps we are focusing on the wrong things. The world is changing around us; we need to change our thinking. The aging baby boomer population is not a burden on America, it is our secret weapon.

Do we have a better tool for leveraging our position in the world than our well educated, well trained people? This is admittedly a new way to look at the world, a better way to look at our people and our country.

Over the past 30 years the median age in Europe has risen from 34 to 43. In Japan it has risen from 39 to 46. Here in America our median age is growing older too but stands at just under 38. This represents a competitive advantage if we are willing to embrace it.

The "working rate" for older Americans has been rising for 20 years. Did you know that nearly half of all entrepreneurs in the U.S. are over 45? Older Americans are among the most successful and productive workers we have.[1]

Re-Thinking Retirement

In light of medical and technological advances, you can expect to live longer and accomplish more than your parents. Why are we expecting to retire at the same age? Why exit the track when our engines and tires are still in great shape? We have fuel in the tank and horses under the hood; why not continue to take joy in the journey?

When we work longer we often live longer. Our health can improve when we have passions to pursue and valuable work to accomplish.

We are talking about redefining retirement by postponing the "golden years" for a period of increased productivity and satisfaction. We can re-tool, re-commit and revise our expectations. We may drive on to better physical health, better mental health, better finances and more happiness.

Personally I have things I want to do and work I want to accomplish. My 88-year old aunt regularly goes dancing at the senior center with her 97 year-old husband and they love it. If you know the steps, if there is room on the dance floor and if the music is calling your name, why wouldn't you dance?

[1] *Wall Street Journal 3/10/14 - "America Needs To Rethink Retirement"*

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Quotes from Wise Folks

"Give me six hours to chop down a tree and I will spend the first four sharpening the axe."

Abraham Lincoln

"The only function of economic forecasting is to make astrology look respectable."

John Kenneth Galbraith

"There is nothing like returning to a place that remains unchanged to find the ways in which you yourself have altered."

Nelson Mandela

"Those are my principles.
If you don't like them I have others."

Groucho Marx

Habits of the Rich Habits of the Poor

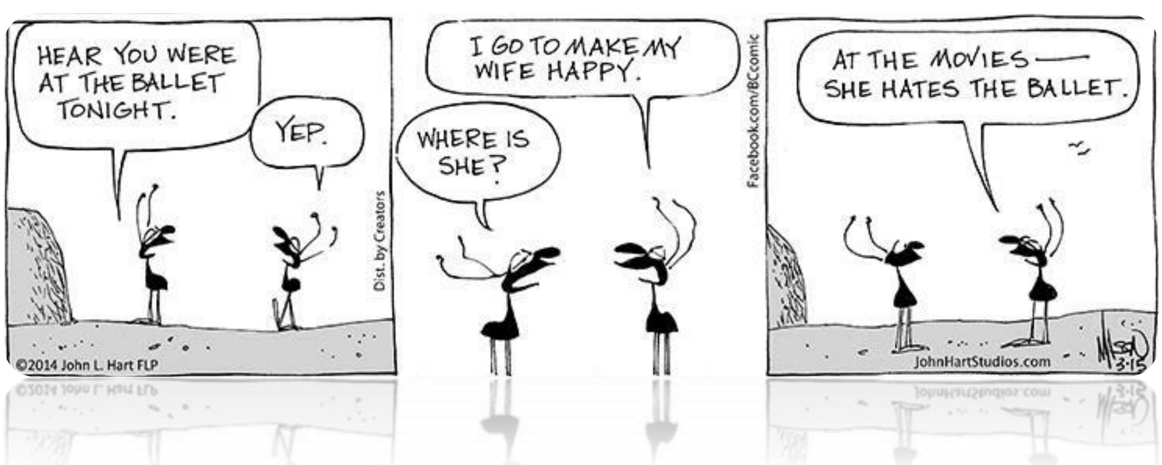
Gambling
23% of wealthy people gamble,
52% of poor people gamble.

Exercise
76% of wealthy people exercise aerobically four days a week while only 23% of poor people do.

Goal Setting
81% of wealthy maintain a to-do list vs. 19% of poor (67% of wealthy write down their goals vs. 17% of poor).

Self Improvement
88% of wealthy people read 30 minutes or more each day for education or career reasons vs. 2% of poor.

Source: Thomas Corley, Rich Habits: The daily Success Habits of Wealthy Individuals, 2010. Corley looked at 149 measures of wealthy people (defined as those with annual incomes over$160,000 and assets of more than $3.2 million) and poor people (income under $30,000 and assets under $5,000).



Oil Company Secrets

Recently the price of gas at the pump has been inching upward making it more expensive to fill our tanks. Ever wonder why gas costs so much? It is a complicated business and prices can be driven up by forces most of us seldom think about.

Crude Oil

The biggest driver of cost in a gallon of gas is crude oil. According to the U.S. Energy Information Administration (EIA), more than 75% of the price of a gallon of gas is set before the oil is even refined. That is more than \$2.50 for a \$3.50 price at the pump.

Like any commodity, the price of crude oil moves up and down with change in supply and demand – or even a possible change in supply or demand. If there is tension in the Middle East, prices often go up over worry that supply may be disrupted. OPEC, the Organization of Petroleum Exporting Countries, has a heavy influence; they can also impact the supply and therefore the price of crude oil.

Refining and Marketing

Refining the crude into gas adds about 6% to the price or about 21¢ of a \$3.50 gallon of gas. The refining of our gas happens mostly in Texas and the Gulf States. Here the price of a gallon of gas can be impacted by hurricane season since hurricanes can disrupt supply. In summer the price to refine oil into gas becomes more expensive due to the 1990 Clean Air act required additives to reduce pollution.

Marketing and distribution adds another 21¢ or so per gallon, this is the cost to brand it by an oil company, provide a pretty service station and transport the gas to the pumps. This is the stage where the oil companies make their money.[1]

[1] *EIA Report, January 2012 as reported in Wall Street Journal 8/2/12 – "Who Really Gets Rich Off High Gas Prices"*

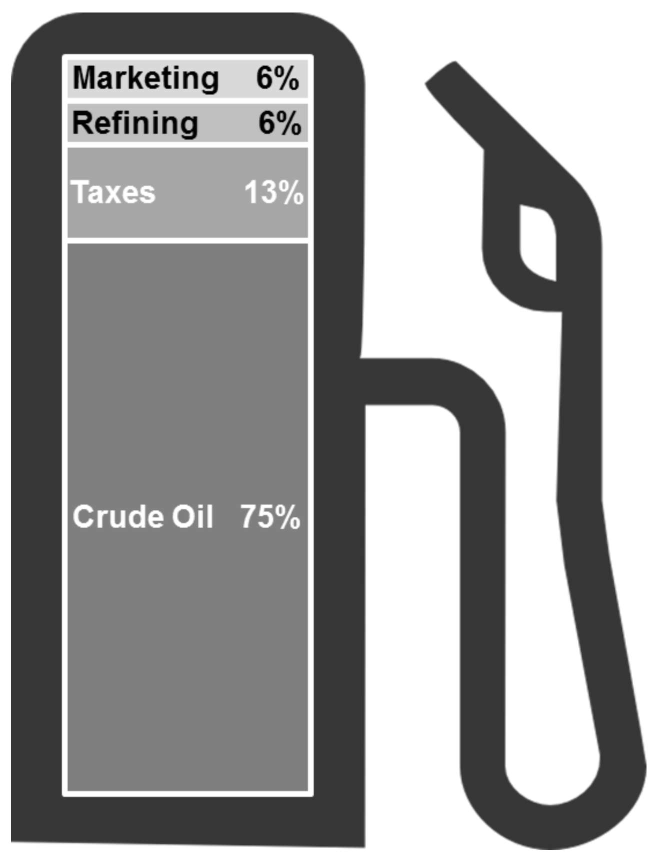
[2] *American Petroleum Institute, April 2012 as reported at taxfoundation.org*

Federal and Local Taxes

By adding crude oil, refining, transportation and marketing we have accounted for about \$3.00 of a \$3.50 gallon of gas. The remaining 50¢ or so is the gas tax charged by federal and state governments. The federal tax is 18.4¢ per gallon; the state portion varies by state. Alaska has the lowest gas tax at 26.4¢ total tax per gallon and California the highest at 71.9¢ total tax per gallon. Here in Washington State we pay total state and federal gas taxes of 55.9¢ per gallon.[2]

So what drives the price of a gallon of gas? According to the U.S. Department of Energy, first is the price of crude oil next is taxes, third is refining and fourth is marketing and distribution. What makes the price of gas rise or fall? Usually supply and demand but it can also be moved by changes in regulation, taxes, production or delivery costs.

Gas Price Breakdown



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Pleasant and Unpleasant Surprises

One of the goals of investing is to try to avoid unpleasant surprises. In my many years in this industry no one has ever complained about pleasant surprises. This article is an attempt to identify and address potentially unpleasant surprises.

We live our lives one day at a time and those days grow into years and eventually into decades. The most serious unpleasant surprises are the ones that span decades.

Weather vs. Climate

It may rain today or it may not, either way we have learned to deal with that uncertainty.

While we may be fine with one rainy day, if the rain lasts long enough it begins to look like a rainy climate which may cause us to re-think where we live. It is important to recognize the difference between short-term events and longer-term trends.

In the investment world this may best be illustrated using three common asset classes: Cash, Bonds and Stocks. Each may perform differently in the short term than in the longer term.

From 1978 to 2013 there were 36 single year periods. The best performing asset class was Cash in 4 of those years, Bonds in 9 and stocks in 23.

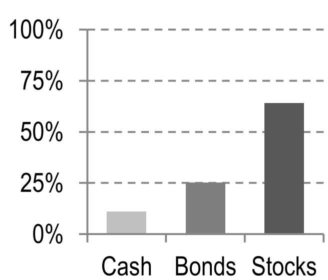
For that same span of years there were 34 rolling five-year periods. Cash performed best in only one of those while Bonds were the best in 10 and Stocks took the prize in 23.

Finally, there were 29 rolling ten-year periods in the years noted. Cash was not the best performer in any of those decade-long periods; Bonds were the top performer in 5 and Stocks in 24.[1]

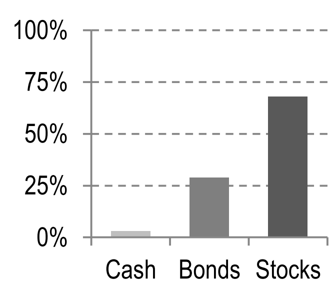
1st - Goals
2nd - Investment Mix

As we chart our course toward our investing goals we must take time into account. If your goals are short term, shorter-term performance is the most important. If your goals are longer term, longer-term performance becomes more important. To avoid unpleasant surprises I recommend your investment mix reflect your personal time horizon.

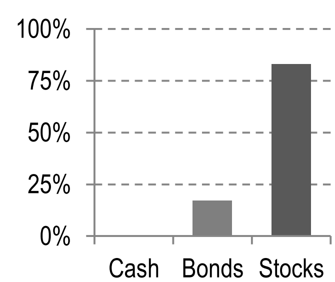
1-Year Periods



5-Year Periods



10-Year Periods



[1] *Wilshire Compass - 1/1/78 through 12/31/13. Cash is represented by U.S. 91-day Treasury Bills; Bonds are represented by Barclays Capital U.S. Aggregate Bond Index; Stocks are represented by the S&P 500. Past performance is no guarantee of future results. Bonds are subject to market and interest rate risk if sold prior to maturity. Bond values will decline as interest rates rise and bonds are subject to availability and change in price.*