BCS Wealth Management

the BENCHMARK
Newsletter

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BCS Wealth Celebrates 20th Anniversary with a Look at Our History

Nathan Goodwin and Philip Bachman detail the history of BCS Wealth Management. Founded in 1998 by the partners of Blackburn, Childers & Steagall, CPAs with the guidance of Jim Wilson, the then-named BCS Financial began with managing partner Mike Alread.

From humble beginnings, BCS Wealth is now one of the largest wealth management firms associated with a CPA firm in the nation. We are proud to grow and thrive in East Tennessee, and we know we couldn't do it without the trust our clients place in us.

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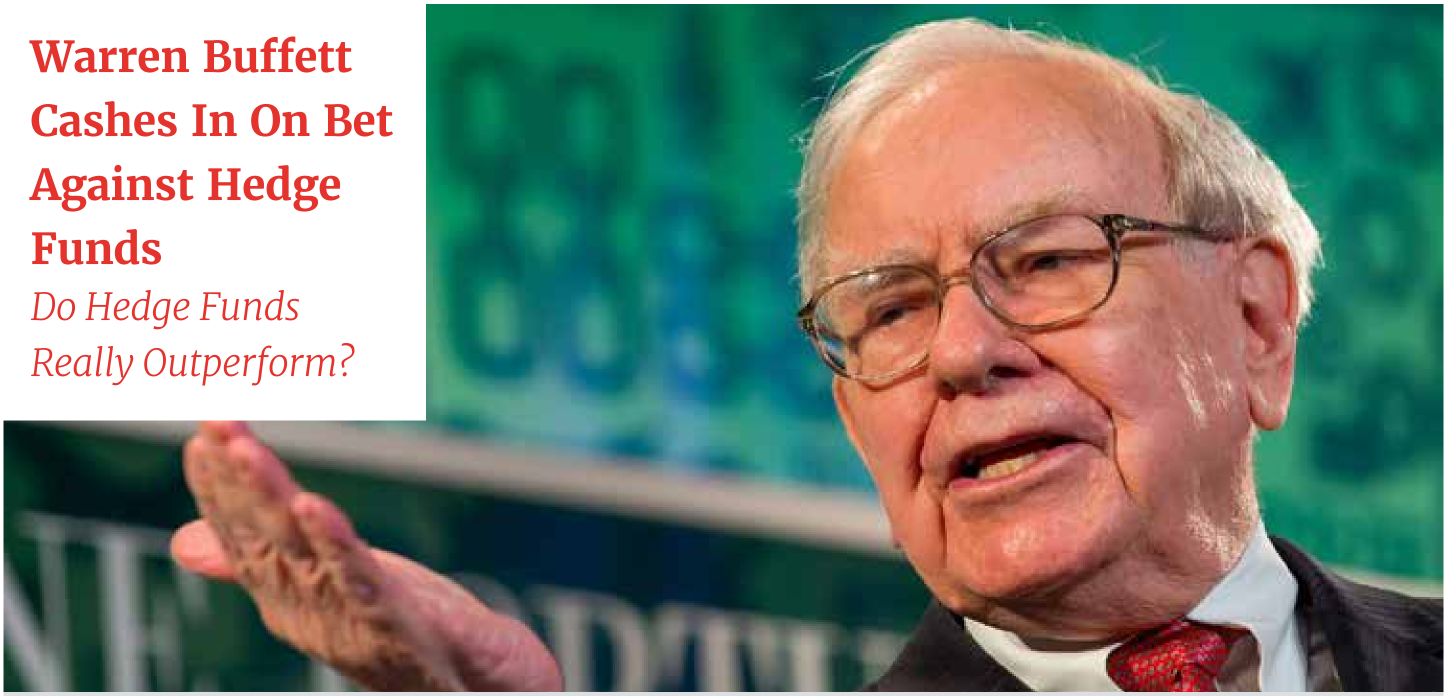
Warren Buffett Cashes In On Bet Against Hedge Funds

Do Hedge Funds Really Outperform?



By Nick Clay

I always look forward to reading Warren Buffett's annual letter to shareholders of Berkshire Hathaway stock. The reasons I enjoy reading the letters are because they are very clear, easy to understand and full of investment wisdom from an investing icon. (The webpage address with each letter appears at the end of this article. There is even a book that compiles the annual letters.)

This year's letter was especially informative. You may remember 10 years ago Mr. Buffett made a well-publicized bet with Protégé Partners, a fund-of-funds that handpicks and invests in hedge funds. He initially offered his bet to anyone, especially anyone on Wall Street, but Protégé Partners was the only company willing to accept the bet.

The bet was simple. Protégé Partners could select a minimum of five hedge funds, including their own fund. Mr. Buffett bet them $1,000,000 (to go to charity of choice) that none of the hedge funds could outperform a simple S&P 500 index fund for the 10 year period.

Mr. Buffet's argument was that popular, high-fee investment vehicles (hedge funds) could not deliver on their promise of superior returns. The typical fee arrangement when investing in hedge funds is a "2 and 20" model, which simply means they charge a 2% management fee and they also keep 20% of the profits they generate. Buffett has long taken issue with hedge funds' promise of outperforming the market and their high fees that diminish their clients' returns.

December 2017 marked the end of the bet, and the results speak for themselves (see the chart on page 3)!

Over the 10 year period, the S&P 500 index fund returned 125.8%. The five hedge funds returned 87.7%, 42.3%, 27%, 21.7% and 2.8% respectively.

Welcome Jessica Hampton

Jessica Hampton has joined BCS Wealth Management as a financial paraplanner. Jessica grew up in East Tennessee and attended Science Hill High School. She then travelled to Liberty University where she obtained a degree in Accounting. After college, she worked as an Auditor for PricewaterhouseCoopers in Greensboro, NC. During her three years with PWC, she travelled throughout the East coast and Midwest working with a variety of clients. Outside of work she enjoys painting, fishing, and bonfires with friends and family. Jessica is off to a fast start and already bringing value to our clients.

Year	Fund-of-Funds A	Fund-of-Funds B	Fund-of-Funds C	Fund-of-Funds D	Fund-of-Funds E	S&P Index Fund
2008	-16.5%	-22.3%	-21.3%	-29.3%	-30.1%	-37.0%
2009	11.3%	14.5%	21.4%	16.5%	16.8%	26.6%
2010	5.9%	6.8%	13.3%	4.9%	11.9%	15.1%
2011	-6.3%	-1.3%	5.9%	-6.3%	-2.8%	2.1%
2012	3.4%	9.6%	5.7%	6.2%	9.1%	16.0%
2013	10.5%	15.2%	8.8%	14.2%	14.4%	32.3%
2014	4.7%	4.0%	18.9%	0.7%	-2.1%	13.6%
2015	1.6%	2.5%	5.4%	1.4%	-5.0%	1.4%
2016	-3.2%	1.9%	-1.7%	2.5%	4.4%	11.9%
2017	12.2%	10.6%	15.6%	N/A	18.0%	21.8%
Final Gain	21.7%	42.3%	87.7%	2.8%	27.0%	125.8%
Average Annual Gain	2.0%	3.6%	6.5%	0.3%	2.4%	8.5%

The letter's Footnote: Under my agreement with Protégé Partners, the names of these funds-of-funds have never been publicly disclosed. I, however, have received their annual audits from Protégé. The 2016 figures for funds A, B and C were revised slightly from those originally reported last year. Fund D was liquidated in 2017; its average annual gain is calculated for the nine years of its operation.

The five funds-of-funds got off to a fast start, each beating the index fund in 2008. Then the roof fell in. In every one of the nine years that followed, the funds-of-funds as a whole trailed the index fund.

Let me emphasize that there was nothing aberrational about stock-market behavior over the ten-year stretch. If a poll of investment "experts" had been asked late in 2007 for a forecast of long-term common-stock returns, their guesses would have likely averaged close to the 8.5% actually delivered by the S&P 500. Making money in that environment should have been easy. Indeed, Wall Street "helpers" earned staggering sums. While this group prospered, however, many of their investors experienced a lost decade.

Performance comes, performance goes. Fees never falter.

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I would imagine Protégé Partners tried to pick some of the best run hedge funds in order to win the bet, but none of their picks came close to matching Mr. Buffett and the simple S&P 500 index fund.

In order to ante up for the bet, both Mr. Buffett and Protégé Partners each purchased in face value $500,000 worth of zero-coupon bonds that were to mature at the end of the 10 years with a payout of $1,000,000. Ironically, for various valuation reasons, in 2012 both Mr. Buffett and Protégé Partners agreed to sell the bonds and place the money in Mr. Buffett's Berkshire Hathaway stock for the remainder of the bet. The final tally was far more than $1,000,000. It turned out to be $2,222,279 that went to charity due to appreciation in Berkshire stock.

At the end of the day, Mr. Buffett's wager highlighted investing discipline. Investors like you and me are inundated with the new "latest and greatest" investment ideas. We see commercials on TV, hear commercials on the radio, read advertisements and sometimes get sales calls. The old saying, "If it sounds too good to be true…" nearly always applies. The secret to successful investing is not based on successfully timing and navigating the thousands of investment ideas out there – or having a hot stock tip or two. Successful investing involves good stewardship, discipline, diversification and a plan.

Nick is the managing partner of BCS Wealth Management and one of a select few Dave Ramsey endorsed SmartVestor Pro advisors in our area.

BCS Wealth Management: 20 Years of Client-Focused Success

By Nathan Goodwin and Philip Bachman

In a few short weeks, BCS Wealth Management will celebrate 20 years of helping clients achieve their financial goals. Thanks to a strong foundation that its visionaries laid in 1998 and the team's hard work since, BCS Wealth Management has been blessed with a thriving business. The firm celebrates its first 20 years and looks forward to the next 20.

BCS Wealth Management was born from an idea to build a financial planning firm to complement the Blackburn, Childers & Steagall (BCS) CPA practice. BCS partner Jeff Blackburn reflects, "BCS Wealth Management was the brain child of Jim Wilson, a pioneer in CPA personal financial planning and an associate with and mentor to BCS. He felt there was a real need for a fee-only wealth management firm operated with the same principals of integrity, client service, and Biblical world view that are ingrained in our BCS culture."

Wilson worked with Mike Alread and the partners of BCS to establish the firm in May 1998. The founders stayed true to the core values of BCS as the financial planning division grew. Jeff Blackburn comments, "The growth of the firm and the quality of the team assembled to carry the firm into the future are a testimony to Jim Wilson's wisdom and vision."

Mike Alread served as managing partner until his retirement in December 2017. Alread led a team who focused on clients' needs instead of merely numbers. As a result, the firm grew to become one of the leading wealth management firms in the region. The main office is in Johnson City, and the firm added a full-time financial advisor at the BCS office in Kingsport in 2014.

BCS Wealth Management expanded its offerings in 2010 when Nick Clay joined the team. Clay established the firm's transactional-based service offerings to supplement the investment advisory platform. He also brought expertise in annuities and group benefits including 401(k) plans and other retirement plans. Clay is now the firm's managing partner.

To approach personal financial planning even more comprehensively, BCS Wealth Management began providing insurance services in 2010. The firm provides insurance reviews, life insurance, disability insurance, and long-term care insurance. The firm also provides group health policies for businesses. Paul Hoilman has been BCS Wealth Management's in-house insurance specialist since 2016.

Managing just under $400 million in assets, Accounting Today magazine recognized BCS Wealth Management in 2017 as the third-ranked firm in Tennessee and 74th in the nation for wealth management firms affiliated with CPA firms, based on assets under management.* Although that is an achievement, the team is not resting yet. Instead, they are focused on making the next 20 years even better. "We have a great team available to serve our clients. They are the best at what they do and are well positioned for the future," BCS partner emeritus Charles Steagall says.

BCS managing partner Tommy Greer remarks, "The growth we have had has far exceeded any expectations we ever could have imagined. It's amazing how fast 20 years went by. What a blessing BCS Wealth Management has been to our CPA firm, related clients, and region. With the talented, professional team we currently have, we couldn't be more excited to see what the next 20 years holds."

Nick Clay concludes, "Many firms do what we do – but not how we do it. It's all about relationships, and we're blessed with great clients."

BCS Wealth Management would like to thank all our clients, friends, and business associates for making the past twenty years such a success.

Should You Pay Off Your Mortgage Early?

By Philip Bachman

Homeownership has been central to the American dream for generations. Many revere the sense of independence and the peace of mind of owning their family's own home. But homeownership is a milestone that usually comes with a mortgage.

Although much more could be written on this subject, let's briefly address the question of paying off a mortgage early. The same logic could be applied to other types of debt too. For those who are able, is it a good idea to pay down or to pay off a mortgage or other loan ahead of schedule?

Many folks understandably have a goal of starting retirement debt-free. If achieving that goal means paying down a mortgage early, the answer may be complex and different for everyone. Here are four questions (adapted from Fidelity Retirement Viewpoints) to help guide the decision.

1. Is prepaying your mortgage a priority?

Before you pay down your mortgage early, make sure you are not overlooking other debts that might deserve priority.

For example, consider paying off high interest rate credit cards or other loans that have a higher interest rate than the mortgage. Mortgages generally have a lower interest rate than many other types of debt. If you have not taken full advantage of saving in an IRA or an employer's retirement plan like a 401(k), consider stashing extra savings there first. There may be tax benefits or employer matches to be had. Those might make additional retirement contributions more appealing than paying extra on the mortgage.

2. What will produce the greatest wealth?

The question of whether to pay off fixed debts like mortgages or to invest the equivalent money is a good question with no single correct answer. If your goal is to build the most wealth, paying off your mortgage early may or may not make the most sense. It depends on the interest rate the mortgage has and the expected rate of return on the investment strategy in question.

> **"In the long run, it's not just how much money you make that will determine your future prosperity. It's how much of that money you put to work by saving it and investing it." ~ Peter Lynch**

Market Returns

Major Stock Indexes	1st Quarter 2018	Year End 2017
DJIA	-2.5%	25.1%
Nasdaq Composite	2.3%	28.2%
S&P 500	-1.2%	19.4%
Russell 2000	-0.4%	13.1%
Global Dow	-2.0%	21.9%
Japan: Nikkei 225	-5.8%	19.1%
Stoxx Europe 600	-4.7%	7.7%
UK: FTSE 100	-8.2%	7.6%

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"Financially speaking, paying off your mortgage is equivalent to a guaranteed return at your mortgage interest rate," a Fidelity article explains. "So, hypothetically, if you had $1,000 and used it to prepay a mortgage with a 3.5% interest rate, or invested it in a bond at 3.5%, the impact on your net worth would be the same either way." That is a simple way to evaluate the decision. In reality, taxes might come into play and might affect the outcome. Also, personal preference and attitude about debt are factors to think about.

3. When will you need your money?

Reduced liquidity could be a drawback of prepaying a mortgage. Prepaying a mortgage may make it more difficult to use that money in the future, should you need to. Using home equity to come up with cash would require selling the house or setting up a home equity line of credit.

It is generally easier to sell investments in a brokerage account if you need cash. Yet selling investments to raise cash means you would have to accept market volatility and prevailing market prices at the time.

A conversation about timeframe and anticipated cash needs is beneficial to making investing decisions.

4. How important is paying off debt to you emotionally?

Research has shown that taking on debt can weigh on a person's sense of wellbeing. And paying off debt can have a very positive emotional impact. In our view, these things are worth considering alongside "the numbers" in decisions about paying off debt.

Fidelity concludes, "If you are very conservative, the appeal of a guaranteed return on your money, and the security knowing your house is paid up, may have value beyond the dollars and cents involved." In cases such as that, math is not the only variable that should steer the decision. On the other hand, "It may be worth considering investing if you are more comfortable with risk, short on retirement savings, value flexibility, or if your main goal is growing your wealth."

Decisions about debt and investing are personal and unique to everyone. Please let us know if we can help you think through your situation.

This article is adapted from an article published by Fidelity: "4 Questions to Ask Before You Pay Off Your Mortgage."

Philip's Manx cat Max also enjoys reading about financial planning.

Tax Cuts and Jobs Act

BCS Wealth hosted two tax update seminars in February. Travis McMurray, CPA, discussed the highlights of the new tax bill and its implications for 2018 and beyond.

For individuals, the new legislation is a series of cuts and tweaks, which may or may not make tax planning less complex for many. Seven tax brackets remain, but most of them are lowered a bit and the top rate is 37%. The standard deduction has been increased, which means fewer people will likely claim itemized deductions in the future. As a part of the standard deduction increasing, personal exemptions have been eliminated. Also, the Pease limitation, which reduces the amount of itemized deductions that certain taxpayers are allowed to claim, has been repealed. Capital gains and qualified dividend rules have not been changed although they no longer line up with the ordinary income brackets. These changes are scheduled to sunset after 2025.

These are only a few of the many changes resulting from the Tax Cuts and Jobs Act. It will likely take some time for new tax planning strategies to develop, but we're here to help you navigate these changes and how they affect your financial plan.

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**Accounting Today*'s "The Top 150 Firms by AUM (2017)" ranking was assembled using data from Audit Analytics. Submissions were received from over 200 firms. Rankings are not indicative of a firm's future performance nor do they evaluate the quality of services provided to clients. BCS Wealth Management did not pay a fee to participate in this ranking.