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Investment Analysis
for
Joan & Joan Smith

The objective behind our investment analysis is not only to seek out the best way to maximize your risk adjusted returns, but also to give you “peace of mind” while doing so. Our investment review will take into consideration your emotional risk tolerance, financial plan risk capacity, financial goals, current financial situation and, lastly, your time horizon for your goals.

We have entered your current portfolio holdings into MorningStar Office®, our investment research software. After reviewing your current portfolio holdings, we want to bring some key areas of information to your attention and identify your areas of greatest opportunity.

When analyzing your current portfolio, we compare various risk and return measures against a benchmark. In your case, we are using the 60% Equity Dow Jones Relative Risk Index as the benchmark. Keep in mind that this is a rear-looking snapshot of today’s holdings. Unless you have not made any purchases, sales, or trades in the last 10 years, this is not reflective of your actual experience, just a snapshot of current holdings. Here is how your accounts aggregated (all accounts combined) measures:

- ***Beta-*** The measure of sensitivity of an investment’s return to the movement of its benchmark index. A Beta greater than 1 is more volatile than its benchmark.
    - 10yr 1.05
- ***Standard Deviation-*** The statistical measure of the expected volatility of returns above and below the mean return.
    - 10yr 10.97% vs. 10.26% of the benchmark
- ***Alpha***- The measure of an investment’s performance after adjusting for its inherent risk in the market as a measure of Beta.
    - 10yr .11
- ***Expense Ratio***- The underlying expenses charged by the investments inside your portfolio.
    - Underlying Expense Ratio .99%
- ***Appropriateness for Client Goals-*** Based on the financial plan we have prepared, you have a targeted risk profile (Risk Capacity) which maximizes your probability of successfully funding your goals.
    - Your plan targets 45% equity exposure, you currently have 63% equity exposure.
- ***Maximum emotional risk tolerance -*** We measure your emotional risk tolerance through our risk tolerance questionnaire, which helps us determine the maximum risk you can emotionally handle.
    - Your emotional risk tolerance indicates you can handle up to 72% equity exposure.

- ***Returns on 3-, 5-, and 10- year vs. their benchmark-*** These measure the consistency of returns in the 3-, 5-, and 10-year marks based on an appropriate index.
    - Portfolio 3yr – 8.68%, 5yr – 9.18%, 10yr – 7.08%
    - Benchmark 3yr – 8.52%, 5yr – 8.61%, 10yr – 6.73%

Underperforming Investment

The numbers above are aggregate weighted numbers for all accounts. When each account was evaluated separately, one stuck out as vastly inferior to the others. The non-qualified variable annuity posted the following key metrics.

- 10yr Alpha -1.89
- 10yr Return 4.89%
- Expense Ratio 2.3%

This account has a very high fee load and has posted low returns for the risk taken.

<u>Recommendation: We would encourage you to look at a 1035 exchange into a lower cost annuity with better investments. The 1035 exchange avoids realizing the ordinary income gains that have built up in this policy over the years and allows you to fully transfer the account to another annuity contract.</u>

John & Joan Smith (Proposed Investment Strategy)

<u>Asset Allocation</u>

Our preliminary emotional risk tolerance questionnaire helps guide our recommendations when advising clients on how to allocate their portfolio. In a dual household, we take both spouses' emotional risk tolerance into consideration and compromise between the two tolerance scores to come up with a household emotional risk tolerance. Asset allocation is important to a financial plan's success in that it manages the risk of a portfolio over time. As a general rule, we do not recommend taking on a riskier allocation than a household can emotionally tolerate, as it may cause risk-adverse behavior in times of high market volatility. By following a pre-determined asset allocation and by rebalancing your portfolio periodically, you inherently will buy securities low and sell them at a higher price.

<u>Recommendations: Based on the financial plan projections, we are recommending re-adjusting your risk profile to a 45% equity, 55% fixed income allocation. This should provide moderate growth potential with significant downside protection during times of market volatility.</u>

<u>Asset Location</u>

By locating asset classes by their tax characteristics, you can increase the tax efficiency of your overall portfolio. In a portfolio that has both taxable and/or tax-deferred/tax-free accounts like (IRA, Roth & annuities), we utilize asset location to separate tax inefficient securities into tax-deferred accounts while keeping tax efficient securities in taxable accounts. This doesn't change the risk profile of the portfolio, just the expected tax burden of the investment returns by utilizing the unique tax characteristics of various account types. Examples of tax inefficient securities include high-yield bonds, corporate bonds, REITS, and value stocks. Tax efficient securities that generally have lower tax cost in taxable accounts are growth stocks, tax exempt bonds, and ETNs. The capital growth aspect of these types of investments help an investor take advantage of the lower capital gains rate as opposed to bring taxed at ordinary income tax rates.

Your current portfolio is split 29% taxable, 71% tax deferred/free and would benefit from asset location. You should highly consider this strategy.

Name	Weight	12 Mo Yield	Total ($) Position	Brokerage	IRA/Annuity
CASH	4%	0.1%	60,000	$35,000	$25,000
Vanguard Short-Term Bond	9%	1.2%	135,000	$50,000	$85,000
Vanguard Inter-Term Bond	16%	2.7%	240,000		$240,000
iShares TIPS Bond	20%	1.6%	300,000		$300,000
Vanguard High-Yield Bond	6%	5.6%	90,000		$90,000
Vanguard Growth	7%	1.2%	105,000	$105,000	
Vanguard Value	7%	2.3%	105,000		$105,000
Vanguard Mid-Cap Growth	3%	0.8%	37,500	$37,500	
Vanguard Mid-Cap Value	3%	1.6%	37,500	$37,500	
Vanguard Small-Cap Growth	3%	1.0%	37,500	$37,500	
Vanguard Small-Cap Value	3%	1.8%	37,500	$37,500	
Vanguard FTSE Europe	6%	3.4%	90,000		$90,000
Vanguard FTSE Pacific	6%	2.5%	90,000		$90,000
Vanguard FTSE Emerging Mkts	3%	2.7%	45,000	$45,000	
Vanguard REIT	3%	3.5%	45,000		$45,000
ELEMENTS Rogers Intl Cmdty	3%	0.0%	45,000	$45,000	
Trailing 12 Month Yield as of: 3/31/2015	**$1,500,000**	**Total Balances**		**$430,000**	**$1,070,000**

Overall		Brokerage	IRA/Annuity
4%	Cash	8%	2%
51%	Bonds	12%	67%
24%	US Equities	59%	10%
15%	International	10%	17%
6%	Specialty	10%	4%

2.1%	**Total Yield (%)**	**1.2%**	**2.5%**
$31,950	**Total Yield ($)**	**$5,047**	**$26,867**

Most of the income generated in the brokerage account would be qualified dividends taxed at the lower long-term capital gains rates.