

# Fagan Financial Report

Registered Investment Advisor

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INVESTMENTS \* FINANCIAL PLANNING \* RETIREMENT PLANNING

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## 2015 IS OFF TO A CHOPPY START

Oil is in free fall and the market gyrates like a rodeo bronco. Last week the market moved in triple digits (as measured by the Dow) EVERY single day. Interest rates simply will not move in the direction that the "smart money" has promised us it will.

The stock market has had strong results over the past five years. The S&P 500 has returned 13.5% in 2011, 32.2% in 2013, 15.8% in 2012, 2.0% in 2012 and 14.9% in 2010. The past five years have been great but the 10 year trail on the index is only 7.5%, slightly about average, and 5.1% for 15 years slightly below average. In short, we believe the market is fairly valued and thus will deliver average returns for 2015- somewhere in the high single digits.

Oil scares investors and despite its consumer assistance the possibility that it precedes and foretells a global economic slowdown concerns investors. Oil is a wild card but the idea that lower oil prices is ONLY a negative is ludicrous. Consumers, especially those of moderate economics, will love the relief at the pump and in their heating bills.

Interest rates will eventually go up and the smart, and evidently not so smart money, will be right. We prefer to spend our time speculating elsewhere than on the direction of interest rates. The smart money has proven it's just too easy to be wrong on rates year after year after year. Stick with a mix of intermediate and strategic funds such as LSBDX, MWTRX, BCOSX and DLTNX. These funds should be purchased as they fit into your overall strategy as an investor.

It is important to remain flexible and invested in this market. Daily, investment advisors rain down a deluge of negativity. We hear about declining energy costs as a negative. In reality, gas prices will lead to more purchases of goods and more disposable income for some of the folks most likely to spend it immediately rather than invest it. This will take some time to work its way into the economy. Stagnantly low interest rates are viewed as a cautionary sign of a weak economy but there are signs that these low rates are finally showing up in housing numbers. Europe, long a continent bent on curbing inflation as a priority, is just this week showing a further openness to economic growth programs.

2008 was a disasterous year for risk oriented (stock and bond alike) investors. Bullishness, or even market neutrality, was nowhere to be found. We don't see that level of bearishness but with the recent ( and currently short lived) upheaval in stock prices, negativity is everywhere. We morphed from solid returns for 6 years to panic in no time. This instant worry indicates to us that we are nowhere near complacency in the stock market. We don't think investors should become negative based on public opinion.

We remain constructive on stock prices over the coming 3-5 years and anticipate solid returns over that timeframe with some scares along the way (isn't that always the case?). Despite the recent retreat of rates on the 10 year to under 1.8%, we think that interest rates will rise over the coming months and years with an improving US economy and continued expansion of US energy despite its recent tumult.

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## MAKE CERTAIN THE LIGHT ISN'T A TRAIN

You've begun to walk through a tunnel when you see a light at the end. Do you continue to plod forward or immediately turn tail and get out the way that you came in? The answer and reasoning are quite simple. You get the hell out as soon as possible because the potential reward is far outweighed by the risk you are taking.

Investing is similar. When things don't add up, when there are too many outstanding unanswered questions as there are currently with the energy market, we have learned a long time ago to get out of the way. It is as plain as day that the risk of being wrong far outweighs the potential and reward of being right.

First and foremost, it remains unknown whether the more than fifty percent slide in the price of crude oil from approximately \$98/bbl to \$46/bbl in six months has been caused by too much supply coming to market or a slide in demand. With domestic production having more than doubled over the past five years while OPEC producers held firm on their production, it stands to reason that the equilibrium between supply and demand seemed to shift. However, that only explains part of it. The rapidity and violent nature of the decline could point to some demand erosion from weakening Chinese, Indian, Japanese and European economies. Will these weakening economies spill over into the United States or will lower oil prices act as a catalyst to get them moving again?

On the fringe, what happens to all of the industries supporting the energy sector, those that provide oilfield services, drilling, engineering, geological, exploration and production and refining? What happens to the offshore drilling companies where costs are higher? What happens to the truckers, barge and rail companies that transport the oil? Certainly, some of this is on the periphery and many will survive. But will they thrive?

What happens to the debt that many of the smaller exploration and production companies have taken on? Debt that can only be repaid with oil at or above \$75/bbl?

Much of this debt has been bought by the high yield market. Some of this debt will obviously need to be restructured if the price of crude does not rebound.

Is there a squeeze being put on by Saudi Arabia, the world's low cost producer in an effort to halt some U.S. production or push some of the high cost producers such as Russia, Iran or Venezuela into economic turmoil? With its' huge sovereign wealth fund, Saudi Arabia can play a waiting game by using this wealth to continue its social programs while other countries suffer economically. The lower and longer the spiral of oil goes, the more we question the economic viability of Russia, Iran or Venezuela. Do they just disintegrate into turmoil? Who knows?

What happens to renewable energy such as wind, solar, hydro and electric? There's not a lot of incentive to buy an electric car when the price of gasoline is falling like a rock? New solar panels? Why should I when the cost of heating my house just dropped by approximately \$800 this winter?

What happens to demand for new airplanes? After all the new planes screamed fuel efficiency. With the price of jet fuel tumbling the length of time it would take to recover the cost of a new plane has lengthened substantially.

Suffice it to say that we have only raised some of the questions regarding the impact resulting from the decline in oil. How low it goes and how long it stays low will ultimately provide the answers. Let us also say that the United States is still a net importer of oil and that the U.S. economy is still 70% driven by consumption. Therefore, lower energy prices are a net positive for our economy. However, this benefit may come only after the turmoil from the collapse in energy prices has subsided. It is with these factors in mind that other than the strongest integrateds (COP, XOM, CVX, HES), it is prudent to at best only nibble at oil and natural gas investments keeping your overall exposure moderate.



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## ASSET ALLOCATION CONSIDERATIONS

At Fagan Associates, we manage portfolios on an individual basis. That said, all portfolios initially fall within one of the three types outlined below. After an initial allocation and if need be, the Investment Advisor (IA) can further tailor how your money is invested by placing tighter restrictions on the percentages allocated to each asset class or perhaps by requiring a specific level of income either on a dollar basis or as a percentage of your portfolio.

As a result of past client meetings, Fagan Associates, along with the client have agreed to a range of allowable percentages into which their investable assets must be allocated. The description of which is noted below.

**THE GROWTH PORTFOLIO** is designed for investors seeking capital appreciation with an investment time horizon of ten or more years. An investor into this portfolio is willing to accept the volatility inherent in equities and must overlook this volatility for the potential of greater gains that would have been made through an investment in either bonds or cash. After an initial period of up to twelve months to allow for dollar cost averaging, the portfolio will generally have a minimum of 75% of the total in equities with the balance in cash or a cash equivalent such as a money market. However, regardless of the parameters outlined within each model described below, Fagan Associates reserves the right, predicated upon advisor perceived market conditions; advisor perceived outlook for available investment opportunities; and/or tax ramifications of portfolio changes, to have an allocation to the asset classes described below that is less than the model dictates. The model that has been applied to your investment with Fagan Associates is noted either at the top or bottom of your year-ending portfolio statement. Please read the enclosed Portfolio Model allocation sheet and call immediately should you have any questions, concerns or need clarification regarding the allocation of your investment with Fagan Associates, Inc.

**THE GROWTH & INCOME PORTFOLIO** is designed for investors whose primary objective is capital appreciation with a secondary consideration for income. This secondary consideration is accomplished by an allocation of 25% to 50% of invested assets into fixed income instruments (bonds, cash & cash equivalents). The portfolio is designed for investors

with an investment time horizon between five to ten years and/or investors that have a longer investment time horizon, but whose tolerance to risk is not aligned with this investment time horizon. After an initial period of up to twelve months to allow for dollar cost averaging, the portfolio will generally have a minimum of fifty percent of the account balance in the stock market and a maximum of seventy-percent. However, regardless of the parameters outlined within each model described below, Fagan Associates reserves the right, predicated upon advisor perceived market conditions; advisor perceived outlook for available investment opportunities; and/or tax ramifications of portfolio changes, to have an allocation to the asset classes described below that is less than the model dictates. The model that has been applied to your investment with Fagan Associates is noted either at the top or bottom of your year-ending portfolio statement. Please read the enclosed Portfolio Model allocation sheet and call immediately should you have any questions, concerns or need clarification regarding the allocation of your investment with Fagan Associates, Inc.

**THE INCOME PORTFOLIO** is designed for investors whose primary objectives include income as well as a preservation of capital. The portfolio is designed for investors with an investment time horizon of less than five years or whose tolerance to risk reduces their appetite for equities. After an initial period of up to twelve months to allow for dollar cost averaging, this portfolio will have at least fifty percent of the total invested by Fagan Associates, Inc. in fixed income instruments, to include, bonds, cash and/or cash equivalents such as a money market. However, regardless of the parameters outlined within each model described below, Fagan Associates reserves the right, predicated upon advisor perceived market conditions; advisor perceived outlook for available investment opportunities; and/or tax ramifications of portfolio changes, to have an allocation to the asset classes described below that is less than the model dictates.

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## IS THERE A FIRE IN THE LOBBY?

Which of the following would prompt you to respond quicker – “there’s popcorn in the lobby” or “there’s a fire in the lobby?” Suffice it to say that if you are like the vast majority of us, the potential for a fire would get you out of that seat a lot faster than the potential for some popcorn. The logic is simple – fear is a greater motivator than greed. Investing works in a similar fashion. This is why investors tend to buy near the top and sell near the bottom. Although not foolproof, by developing, implementing and adhering to a mid- to long-term strategy, a long-term perspective and a disciplined approach to managing your portfolio, your chances of success in the investment arena will improve.

We begin this column with the above question because the short-term noise and news currently raising volatility in both the equity as well as fixed income markets has most likely caused some to question their commitment to their investment strategy. With this in mind, we thought it appropriate to reiterate where we stand on the economy, fed policy and the financial markets.

With a high degree of conviction, we believe that the Federal Reserve will maintain an accommodative stance regarding monetary policy longer than the consensus anticipates. We believe this because allowing, some say even encouraging a little inflation is a far better outcome than raising interest rates sooner rather than later and risking a deflationary environment. In fact, a noted inflation hawk, St. Louis Federal Reserve Bank President James Bullard, reversed his stance with regard to monetary policy stating that “Inflation expectations are declining in the U.S. That’s an important consideration for a central bank. And for that reason we think that a logical policy response at this juncture may be to delay the end of the QE.”

We do not believe the recent pullback in the market is cause for longer-term concern. Despite the fact that over the short-term stocks may get weaker before rallying, we do not believe that this is a repeat of 2008. Every correction is not the start of a bear market. Stop fighting the last war. American consumers and corporations, including financial institutions, are in much better condition than they were in 2007. Corporate balance sheets have been fully repaired while personal balance sheets continue to improve.

We continue to favor investing predominantly domestically. The United States was the first to go into the financial crisis several years ago, tackle most of the issues that caused it head on and emerge from it better off. Although also along the curve, most countries, especially Western Europe, are still dealing with the repercussions of the financial crisis.

Finally, the long-term is more predictable than the short-term. Maintain a three-, five-, even a ten-year perspective. If history is any guide you will be happy you did. That said, we do realize that the market has been volatile recently and with this in mind, please feel free to contact us with any questions, concerns or should you wish to get together to discuss your portfolio.

### **SEND US YOUR EMAIL ADDRESS**

Here’s an idea – send your e-mail address to us at [www.investment@faganassociates.com](mailto:www.investment@faganassociates.com). By doing so, you will solve a couple of potential issues. The first, we will have an additional way to contact you and keep you informed as to what is going on at Fagan Associates and two, upon your approval, Charles Schwab & Company can set you up with electronic access to your account(s). As always, feel free to telephone Chris, Dennis, Mary or Aaron at (518) 279-1044 or at (800) 273-6026.



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## Common Stock & Equity ETF Portfolio Holdings\*\* Ranked by Market Value as of December 31<sup>st</sup>, 2014.

Percent of Common Stock	Company Name	Symbol	As of Dec 31, 2014	As of Nov 30, 2014	As of Oct 31, 2014
5.96%	Apple Computer	AAPL	1	1	2
5.94%	SPDR Dividend ETF	SDY	2	2	3
4.75%	Nike, Inc.	NKE	3	4	4
4.56%	Gilead Sciences, Inc.	GILD	4	3	1
3.55%	Celgene Corp.	CELG	5	5	7
3.47%	Conoco Phillips	COP	6	8	5
3.21%	MasterCard, Inc.	MA	7	9	9
3.20%	General Electric	GE	8	7	8
3.06%	Visa, Inc.	V	9	10	10
2.88%	JP Morgan Chase	JPM	10	11	11
2.77%	Bank Of America	BAC	11	12	12
2.28%	Lowe's Companies	LOW	12	16	17
2.23%	Express Scripts, Inc.	ESRX	13	13	13
2.22%	Starbucks Corp.	SBUX	14	14	16
2.11%	Hartford Financial Services	HIG	15	17	14
2.06%	Harley Davidson	HOG	16	15	15
1.91%	Google, Inc.	GOOG(L)	17	6	6
1.60%	KeyCorp	KEY	18	24	23
1.54%	Hertz Global Holdings	HTZ	19	20	20
1.48%	Hain Celestial Group	HAIN	20	22	21
1.40%	DR Horton Company	DHI	21	21	27
1.45%	Exxon Mobil	XOM	22	19	18
1.47%	Verizon Communications	VZ	23	18	19
1.30%	Hewlett Packard Co.	HPQ	24	N/A	N/A
1.26%	Skyworks Solutions	SWKS	25	43	35
1.24%	Ambarella, Inc.	AMBA	26	25	33
1.20%	Hospitality Property Trust	HPT	27	26	24
1.05%	Johnson & Johnson	JNJ	30	27	25
0.00%	Boeing Company	BA	N/A	23	22

**Portfolio Concentration: Top 25 holdings represent 67.60% of the Common Stock portfolio, as of December 31<sup>st</sup>, 2014.**

## Largest Mutual Fund Holdings as of December 31<sup>st</sup>, 2014

Domestic Equity Funds	International Equity Funds	Balance/Fixed Income/ Muni Fund/ETF
Parnassus Equity Income Fund	Oakmark Global Select	Double Line Total Return Fund
DJ US Broad Market ETF	Oakmark International Fund	MetWest Total Return Fund
Schwab 1000 Fund	Harbor International Fund	Loomis Sayles Bond Fund
Oakmark Fund	Tweedy Browne Global Value	Baird Core Plus Bond Fund
Sout MidCap Fund	Templeton Foreign	Income Fund of America



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## DISCLOSURES AND MARKETING INFORMATION

The enclosed report is provided to you as a service. You also receive reports from the broker dealer, bank or other qualified custodian that holds and maintains your investment assets. You are urged to carefully review and compare official custodial records to the account statements or other reports that Fagan Associates provides. Fagan Associate's reports may vary from custodial statements based on accounting procedures, cost basis, reporting dates, or valuation methodologies of certain securities.

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Additional information including management fees and expenses is provided on our Form ADV Part 2. The actual return and value of an account fluctuate and, at any time, the account may be worth more or less than the amount invested. Bond Investments are affected by interest rate changes and the credit-worthiness of the issues held in the portfolio. A rise in interest rates will cause a decrease in the value of fixed income positions. **Past performance results are not indicative of future results.**

Presentation is prepared by: **Fagan Associates, Inc.**

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- A spotlight on one or some of our **mutual fund holdings** or **EFT holdings**.
- A look at the upcoming week, including economic data and earnings reports.
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