2014 2nd Quarter

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PERFORMANCE WEIGHTED ASSET ALLOCATION REPORT

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ADVISORS' THOUGHTS

At the half way point of 2014 the **allocation of your accounts** in the financial markets have **provided solid investment returns.** Even more encouraging are the returns over the past twelve months as noted on your account statement.

The **strong performance has been driven primarily by the gains in the US stock market.** Over the past year the widely followed Dow Jones Industrial Average (DJIA) gained 12.86% as noted in the Total Return table. Furthermore the S&P 500, a broader measure of US large company stock prices, did even better with a gain of 22.04%.

Stock markets outside the US have also done well in 2014, and over the past twelve months. The MSCI Europe, Australia, Far East (MSCI EAFE) gained 20.33% for the past year. Meanwhile the MSCI Emerging Market index increased 11.75% over the past twelve months with nearly half that gain (5.64%) occurring in the last three months.

Fixed income benchmarks also measured positive returns over the past year, with the Barclays Long Bond index gaining 5.90% and the Barclays Intermediate-Term Bond index achieving a small gain of 0.96%. Fixed income investments in your accounts provided modest positive returns when compared to the strong returns from the stock market.

TOTAL RETURN THROUGH 06/30/14

	3 Mo.	6 Mo.	12 Mo.
DJIA	2.24%	1.51%	12.86%
S&P 500	4.69%	6.05%	22.04%
MSCI EAFE	2.95%	2.95%	20.33%
MSCI Emerging Markets	5.64%	4.80%	11.75%
Barclays Inter-term Bond	0.96%	1.66%	0.96%
Barclays Long-term Bond	4.31%	11.32%	5.90%

Source: Wall Street Journal and Morningstar Principia
Does not include reinvestment of dividends

DJIA: A price weighted average of 30 stocks.

S & P 500: A market value weighted index of 500 stocks.

MSCI EAFE: A stock market index designed to measure the equity market performance of developed markets outside US and Canada.

MSCI Emerging Markets: A stock market which captures large and mid cap representation across 21 Emerging Market countries..

Barclays Capital Treasury Intermediate-Term Bond Index: An index comprised of US Treasury securities with maturities between 2 and 10 years.

Barclays Capital Treasury Long-Term Bond Index: An index comprised of US Treasury securities with maturities of 10 years or longer.

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For those of you invested in Real Estate Investment Trusts (REITs) this asset class also provided a positive contribution to your overall investment returns in the past year. There are more encouraging developments about REITs on Page Two of the newsletter.

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WHAT HAPPENS WHEN A REIT SELLS A PROPERTY?

Commercial real estate conditions across the US have generally improved over the last few years. This has led some **non-traded Real Estate Investment Trusts (REITs) to explore ways to return investors' capital** along with any potential profits. Approaches may include: listing on a stock exchange, merging with a publically traded REIT or selling the REIT's properties. Each one of these methods is unique. Which approach any particular REIT takes will depend on its own set of circumstances.

For those of you who own KBS REIT II we are anticipating a distribution later this year due to the sale of properties according to an SEC filing dated July 10, 2014. In order to understand how a REIT distribution may impact the shareholders, we have created the following **hypothetical example**.

First we will look at the **impact on the share price** in the table below. If an investor made an investment of $10,000 at an offering price of $10 per share they would receive 1,000 shares. During the period of time they held those shares, let's assume the REIT shares increased in value to $10.29 per share and therefore the value of the investment increased to $10,290. If one or more of the properties in the REIT are sold, the net proceeds received from those sales would consist of three items: capital gain/loss, depreciation recapture and return of capital.

SHARE PRICE ADJUSTMENT		Price/ Share
Initial Purchase Price:		**$10.00**
Current Appraised Share Price:		**$10.29**
Distribution:		**$3.75**
Long Term Capital Gain:	$1.00	
Depreciation Recapture:	$0.40	
Return of Capital:	$2.35	
New Share Price:		**$6.54**

In our example we **assume the total distribution is $3.75 per share and therefore the new share price would be $6.54 per share** ($10.29 -$3.75 = $6.54). In reality, the new share price will need to be based on a current appraisal of the remaining properties and would most likely vary from $6.54. In any event, the result in our hypothetical example is that **the investor would receive a distribution of $3,750** (1,000 shares x $3.75/share = $3,750) **leaving $6,540** (1,000 shares x $6.54 = $6,540) still invested in the REIT.

A **second impact** that would occur as a result of a distribution is a **change in the monthly income distribution**. Currently in our **hypothetical example** below the investor is **receiving $650 per year** (approximately $54.12 per month). That is 6.5% of the original investment of $10,000 or approximately 6.32% of the current value of $10,290. Because a substantial portion of the investment in the REIT (about 36.44% of the current value) is being returned, the income distribution would be reduced by a similar percentage. The new distribution rate will be determined by the cash flow of the remaining investments. In this example, **the new annual distribution would be $413.12** per year. It would **still be 6.32% of the amount invested because the remaining investment in the REIT would now be $6,540**.

DISTRIBUTIION ADJUSTMENT	
Current Distribution:	**Annual**
Dollar Amount:	**$650.00**
Percentage of Initial Investment:	**6.50%**
Percentage of Current Appraised Value:	**6.32%**
New Distribution:	
Dollar Amount:	**$413.12**
Percentage of Initial Investment:	**4.13%**
Percentage of Current Appraised Value:	**4.01%**
Percent of Remaining Value based on New Share Price:	**6.32%**

As you can see in the tables above, the sale of properties in a REIT and the resulting distribution received would impact both the remaining amount invested and the annual distribution amount. For this type of an investment the objective is to receive an income distribution during a long term holding period and a return of capital along with the potential for profit. **We view a distribution that includes capital gains as a positive development for an investor in a non-traded REIT.**

Will your living trust do what you think it should do? Recently we met a couple whom we will call John and Joanie Smith. Mr. and Mrs. Smith asked us to review their estate plan. They had an attorney prepare a living trust for them about 15 years ago, but they wanted to make sure it still fit within their overall financial plans.

The Smiths were well organized. They had prepared a list of asset and liabilities for our first meeting and brought in their estate planning documents (living trust, will etc.). At the initial meeting we discussed their goals and objectives, and at first glance it appeared that their existing living trust would accomplish most of what they wanted with a few minor changes.

They wanted to see how their estate would be distributed, so we agreed to meet again and prepare an estate distribution diagram showing how much each heir would be receiving. Although it may seem unnecessary since they had already provided a list of assets and liabilities, we had them provide us statements from each financial institution where they held their assets before preparing their plan. These statements provide us not only the value of each account, but how each account is titled.

A common mistake we have seen with an estate plan is not titling assets in the name of the trust. As a refresher, what does it mean to title an asset in the name of the trust? This means that each account (bank, credit union, investment company, etc.) must be re-registered under the trust name. Note that there are certain exceptions, such as retirement accounts, that will not be titled in the trust. Going forward, newly acquired assets should also be opened in the name of the trust. Without opening new accounts in the name of the trust the assets will be considered assets held outside of the trust and their distribution will be governed by their will.

In reviewing Mr. and Mrs. Smith's banking and investment statements we discovered that many of their assets were not titled in the name of their trust. They were not too concerned with this because they had diligently kept their Schedule A up to date. Trust documents will have a Schedule A for a list of trust assets. That list will change over time, however it does not replace the necessity to re-title assets in the name of the trust. Unless assets are titled in the trust they are subject to probate.

There is also another reason assets are not always titled correctly. Many assume that their will can transfer assets into their trust without cost, because along with their living trust they have a type of will that is commonly referred to as a Pour-Over-Will. This tandem document works alongside their living trust.

A Pour-Over-Will simply says that at the deceased's estate whatever they forget to title in the name of the trust should be put in the trust and distributed per the trust instructions. This may give one the appearance that having assets titled in the name of the trust is an unnecessary burden. However, there is a very important distinction between assets titled in the name of the trust during one's life and assets in the estate that flow through a Pour-Over-Will into the living trust. Probate!

COST OF PROBATE—An Example

Probate estate value of $948,269

4% on first $100,000	$100,000	$4,000
3% on next $100,000	$100,000	$3,000
2% on next $800,000	$748,269	$14,965
1% on next $9 million	-0-	-0-
	$948,269	$21,965

Probate is a process where assets not titled in the trust of the deceased are transferred to the heirs with the supervision of the Probate Court. As a court overseen process there are certain fees and expenses that must be paid. In Mr. and Mrs. Smith's case the probate cost at the second estate was estimated to be $21,965, as noted in the table above. Once these assets went through probate they would then be distributed per the living trust. By simply re-titling their assets into the name of the trust, their estate would avoid a future cost of $21,965, along with the time delay before their estate could be distributed.

Having a well drafted living trust does not ensure that your estate will be transferred as you assume. Titling of your assets in the name of your living trust is required for your estate wishes to be carried out properly. For our clients, we make sure that the assets are titled properly to coordinate with their estate planning documents. If you have questions about the title of assets, especially those not held with us, or if you have questions about your estate plan in general, please give us a call. We are here to help!

A concern that one may have after the last twelve months is that **since everything has done so well, is it now about to all change**? We believe the **health of the US economy**, and where we are in the business cycle, **will help answer that question**.

One key measure of the strength of the US economy can be seen in retail sales, in particular new car and light truck sales. **Car and light truck sales totaled 17 million last month** at a seasonally adjusted annualized rate. This was the **highest reading since January 2006**. During the last three months, vehicle sales averaged 16.6 million units, the best performance since the three month period ending February 2007.

In order for retail sales to grow, consumers in the aggregate need to increase spending. There is probably no better measure of a consumer's confidence in the future than the purchase of a new vehicle. These big ticket items cost tens of thousands of dollars and one must feel confident about their employment situation or retirement income in order to commit to the purchase. There simply are not too many people who are unemployed or fear losing their job that will go out and buy a new $30,000 car. In our view the **strength of new vehicle sales bodes well for a continued economic expansion** in the coming months.

The backbone for the continuance of any economic expansion lies in the job market. Having a job that pays well, and that you are not afraid of losing, is the source of confidence increase spending. This increase in spending by the individual translates to more sales for business. Rising sales will eventually translate into an increase in hiring and wages that in turn will lead to more sales. This positive feedback loop appears to be where the US economy is positioned today.

Non-farm employment advanced at a seasonally adjusted 288,000 last month as reported by the Bureau of Labor Statistics. More importantly, for **the first six months of 2014** the economy has **added 1,385,000 jobs**. **If this trend was to repeat itself** for the last half of 2014 **the total jobs created this year would be 2,770,000**, that **would be the largest annual total since 1999** when 3,177,000 jobs were created. Clearly the job market has been improving. Continued gains in employment have resulted in a steadily declining unemployment rate that now stands at 6.1%.

Despite solid recent gains in employment the **job picture still remains mixed**. **A large number of those being hired are still part time workers** who desire full-time employment and job gains have been primarily concentrated in lower paying sectors. The retail industry added over 40,000 new jobs while leisure and hospitality added 39,000. This compares to more modest gains in higher wage areas such as manufacturing that added 16,000 jobs and construction that only added 6,000 jobs during June.

Although there has been a significant improvement in the unemployment rate over the past few years this figure has also been clouded by some underlying weakness. Part of the decline in the unemployment rate has been due to people dropping out of the labor force. For the month of June the labor force participation rate held steady despite declining earlier this year. An increasing labor force participation rate is needed for a truly healthy job picture.

One measure of the job market that we find particularly useful for anticipating future changes with employment and the unemployment rate is the **new applications for unemployment insurance weekly claims**. When businesses are laying off people it is very unlikely that they will simultaneously be doing a lot of hiring. A relatively low number for weekly jobless claims is a good indication of future hiring.

The weekly claims for unemployment insurance have been posting a solid reading all year towards continued future hiring. **Throughout 2014 it has been at or below 350,000**. This is a **level that has been consistent with job growth in past economic expansions.** Recently the four week moving average seasonally adjusted fell to 311,500, that being near its low point for this business cycle. We view this as a positive indication of future employment gains.

While the job recovery has been slow in this economic expansion it appears to be gaining momentum. **Strength in the job market should lead to** continued growth in spending and the **continued expansion of the US economy** in the coming months.