Cypress Financial Planning, LLC

FIRST QUARTER 2015

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## Q4 Market Update

*(all values as of 12/31/2014)*

### U.S. Stock Indices

| | |
|---|---|
| S&P 500 | 2,059 (+4.39%) |
| Dow Jones | 17,823 (+4.58%) |
| Nasdaq | 4,736 (+5.40%) |
| Russell 2000 | 1,205 (+9.35%) |

### Global Stock Indices

| | |
|---|---|
| FTSE (London) | 6,566 (-0.85%) |
| DAX (Germany) | 9,806 (+3.50%) |
| CAC (France) | 4,273 (-3.25%) |
| Nikkei (Japan) | 17,451 (+7.90%) |
| Emerging Mkt. | 149.52 (+0.15%) |

### Bond Indices (Bloomberg)

| | |
|---|---|
| U.S. Gov't. | 121.84 (+2.30%) |
| U.S. Corporate | 136.72 (+1.67%) |
| U.S. High-Yld | 149.84 (-1.88%) |
| Eurozone | 133.73 (+2.65%) |
| Emerging Mkt. | 144.68 (+1.26%) |

### Commodities

| | |
|---|---|
| Gold (per oz) | 1,181 (-2.21%) |
| Silver (per oz) | 15.70 (-7.43%) |
| Oil (WTI, barrel) | 53.46 (-41.36%) |

### Fixed Income Yields

| | |
|---|---|
| U.S. 2-Year Treasury | 0.69% |
| U.S. 10-Year Treasury | 2.20% |
| U.S. 30-Year Treasury | 2.76% |
| U.S. High-Yield Index | 6.16% |

### Currency Exchange Rates

| | |
|---|---|
| Euro/Dollar | 1.21 (-0.05) |
| Pound/Dollar | 1.56 (-0.06) |
| Dollar/Yen | 119.69 (+10.03) |

## Getting To Know Your 401(k)

In mid-December, defense contractor Lockheed Martin elected to settle an eight-year-old class-action lawsuit brought by more than 100,000 of its workers and retirees, alleging excessive fees inside the company's 401(k) plan. While the suit was unusual in its size and scope, it was indicative of a recent trend toward greater employee awareness and vigilance with regard to the management of company retirement plans.

In recent decades, as companies have increasingly moved away from "defined benefit" pension plans toward "defined contribution" plans, the onus of saving for retirement has fallen more directly on the employee. Unfortunately, many individuals are unprepared to deal with the responsibility of managing such accounts, and many do not even know where to begin. If you have questions about your own 401(k), what follows is a basic framework for understanding your employer's plan.

*Know The Benefits*

Like traditional IRAs, 401(k) plans allow employees to contribute pretax money from their salary into an investment account. Taxes on both contributions and any earnings (via capital gains, interest, or dividends) are deferred until the employee's retirement years, when withdrawals will be taxed as ordinary income. Roth 401(k) plans—which accept after-tax contributions and allow for tax-free withdrawals of contributions and earnings in retirement—are increasingly frequent, but still much less common than traditional 401(k) plans.

There are a number of benefits to 401(k) plans that IRAs do not enjoy. For one, 401(k) plans have higher contribution limits. While IRA contributions are capped at $5,500 per year ($6,500 for individuals age 50 or older), employees can direct up to $17,500 ($23,000 for employees age 50 or older) toward their employer-based 401(k) plan. Better yet, those 401(k) limits will increase to $18,000 and $24,000 in 2015, while IRA limits will remain unchanged.

Also, perhaps the greatest benefit to a 401(k) over an IRA is the opportunity for a matching employer contribution. Many companies will match an employee's contribution up to a pre-specified percentage or dollar amount, with the formula varying by company. Any employer-provided funds represent "free money" for the employee, income that cannot be replicated in an IRA.

*Know The Costs*

A recent AARP study found that as many as 80% of 401(k) plan participants are unaware of how much they are paying in fees. Some industry players do a particularly clever job of disguising or outright hiding plan fees (for example, by netting the fees against a fund's investment returns, rather than breaking them out as a separate expense on an account statement), but it is imperative that participants know and understand their plan's fees. Doing so may require looking beyond account statements to the plan's summary documents.

There are two primary sources of 401(k) fees. The first source is *direct investment expenses*, charged by the companies who manage the funds that comprise a plan's investment options. Depending on the fund and how it is managed, this fee can be a few hundredths of a percent, up to

2% per year or higher. It is not uncommon for funds with nearly identical investment returns to have significantly different expense ratios—it is incumbent upon the individual to know the difference, and to determine whether the higher expenses are justified.

Beyond the fund-specific fees, there will also be general *administrative fees*. These fees, which are usually smaller than the direct investment expenses, are typically charged by the 401(k) vendor in order to cover the costs of administering the plan. While some employers will cover these costs on behalf of their employees, the fees will often be passed on to plan participants, and not always in a way that is evident to the employee. Additional transaction fees or sales commissions are typically smaller in magnitude than the two main categories, but they can also sometimes be significant enough to impact investment returns.

If, after learning about your plan expenses, you find that your plan isn't competitive with other company plans (or if your all-in costs are higher than 1.5%, with average investment expenses higher than 1%), consider asking your company's benefits manager about ways to improve the plan.

*Know The "Menu"*

The employer—typically along with a plan vendor or an investment advisor—will select investment options for its employees. The plan sponsor has a fiduciary responsibility to ensure that the selected funds are appropriate for the plan participants, in consideration of income and wealth levels, ages, and state of residence. Beyond that, though, it is the responsibility of the employee to choose how to allocate investments among the available funds.

According to research from the Plan Sponsor Council of America, 401(k) plans offer an average of 19 funds to choose from, a number that can often be overwhelming for an unsophisticated investor. Unsure of how to proceed, many employees will simply default to investing in target-date funds (which nearly 70% of plans offer), which are set up to gradually shift from a riskier (stock-heavy) portfolio to a more conservative (bond-heavy) portfolio over time. While these funds are simple and low-maintenance, not all target-date funds are created equal, and some do a better job for investors than others. Take time to understand what your target-date fund is doing—check the fund's Morningstar rating to get a feel for its relative performance, study its asset allocation schedule to see if it may be too aggressive (or too conservative) for you in a given year, and finally, check to be sure that its fees are competitive. If the target-date fund falls short, then you may be better off building your own asset allocation strategy.

*Know Your Exit*

Upon leaving the company, there are usually four options available to the employee: a lump-sum distribution of plan assets (which creates tax consequences), a rollover into an IRA, a rollover into another employer's 401(k), or simply leaving the money in the existing 401(k). Depending on your plan's setup and your investment approach, these options will carry varying costs and benefits. While it's typically best to roll into an IRA—where investment flexibility is generally greatest—there are many circumstances in which an IRA may not be best.

Either way, you can't leave the money in the plan forever. Like IRAs, 401(k) plans have required minimum distributions (RMDs) starting at age 70 ½ (unless you are still employed by the 401(k) provider, in which case RMDs are suspended until your retirement). These RMDs will be treated as ordinary income, so if you have other income streams—like Social Security, real estate rental income, deferred compensation, or annuities—the tax impact of these RMDs may start to affect decisions about whether (or how much) you'll want to contribute to a 401(k).

There are always a number of moving parts as retirement nears, but thoughtful planning in the early years can minimize tax impacts and maximize the income you'll have to enjoy your golden years.

*Other Considerations*

While the above issues are typically the most important ones, secondary matters can also merit consideration. For investors with liquidity concerns, early withdrawal penalties and the availability of 401(k) plan loans can be significant considerations. And since pre-tax 401(k) and IRA withdrawals are taxable as ordinary income, investors may lose the ability to avail themselves of lower rates on long-term capital gains. Because of this wrinkle, certain assets are less appropriate than others for 401(k) plans, and might be better held in taxable brokerage accounts.

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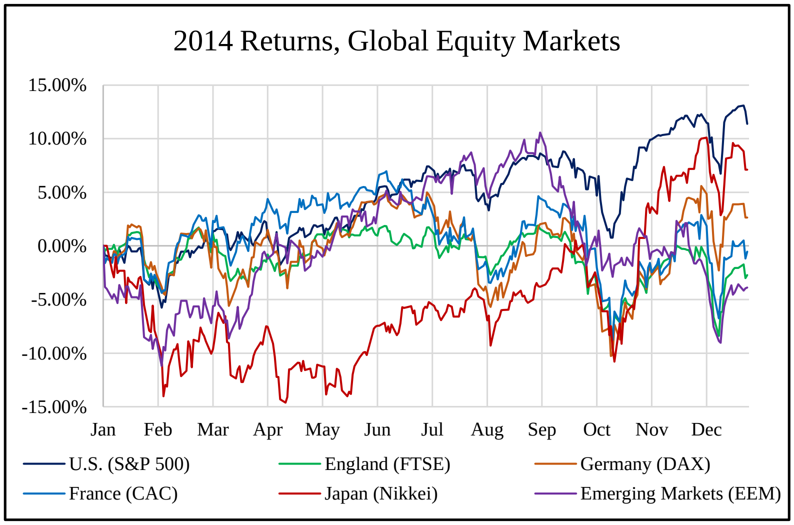
The S&P 500 Index Did Not Experience a Single Four-Day Losing Streak in 2014

## Equity Overview – Domestic Equity Markets

U.S. equity markets declined sharply in October amid concerns of Ebola and global economic weakness, but stocks rebounded swiftly and strongly to again mark new all-time highs. By year-end, the S&P 500 had registered a gain of more than 11%, notching an all-time closing high for the second straight year. The index registered double-digit percent gains for the third straight year, a feat last accomplished in 1999.



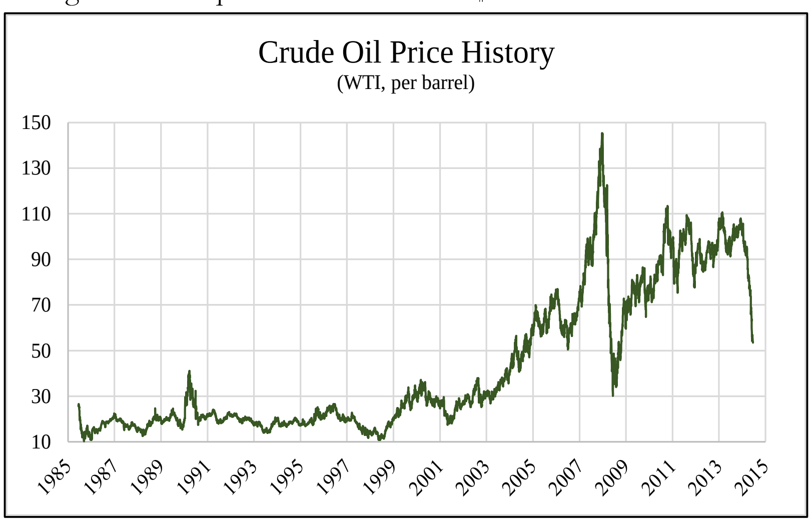

But what was perhaps most notable about 2014's rise was the continued lack of volatility. Even with October's plunge, the S&P went the entire year without ever experiencing a four-day losing streak, the first time that has happened in the index's history. The persistent strength in U.S. markets was particularly impressive when placed in a global context, as its returns were far and away the best of any global market. Only Japan's Nikkei, with its 7% gain, came close, while England's FTSE and the emerging market nations finished 2014 with losses.

With central banks seeming to head in opposite directions as 2015 dawns—the Federal Reserve has ended its quantitative easing program for now, while the European Central Bank, People's Bank of China, and Bank of Japan are still firmly in easing territory—the relative fortunes of those nations' equity markets could follow suit. But for now, the trend of American outperformance has shown no sign of dissipating.

***Sources: S&P, Wall Street Journal***

## The Oil Price Selloff Picks Up Steam – Commodities

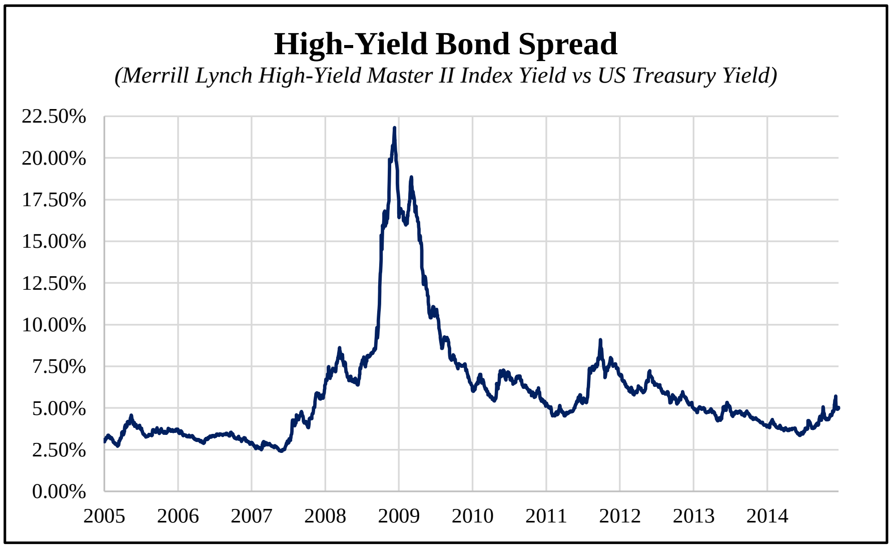
The price of crude oil was under pressure throughout the second half of the year, with prices peaking at $108 per barrel in June and declining some 15% during the third quarter to settle near $91. But the fourth quarter added a new dimension to the oil price selloff, as prices plunged suddenly and severely, losing more than 40% during the quarter to settle below $55 per barrel. The decline left the commodity trading at levels not seen since the peak of the financial crisis, trading at less than half of its summer highs. The implications for the broader economy, meanwhile, remain uncertain.




In general, a lower oil price represents a boon for consumers and businesses, as oil tends to be both a significant consumer expense and a major business cost input. But when major dislocations like this occur, the effects are often more widely felt, while the causes behind the plunge are arguably of greater importance. Recall that the last time the price of oil plunged in a similar fashion, equity markets were not far behind. While the broader impact of this price dislocation is still to be determined, the oil market certainly bears watching as we enter 2015.

Interest Rates on High-Yield Bonds Increased More Than 2% During Q4

## Trend Shift in the High-Yield Bond Market? – Fixed Income




One market sector that very clearly felt the effects of the declining oil price was the U.S. high-yield bond market. Rates on high-yield bonds (as measured by the Merrill Lynch High-Yield Master II Index) increased by more than 2% in the fourth quarter, even as yields on U.S. Treasury bonds were falling by nearly half a percent. The combined effect led to a significant widening of the high-yield bond spread, commonly known as the credit risk premium. After reaching a low of 3.35% in June—the lowest level since the summer of 2007—the credit risk premium rose sharply in the fourth quarter, nearly doubling to a level of almost 6%.

With the Federal Reserve pursuing its historically aggressive zero-interest rate policy in recent years, yield-hungry investors have been forced to turn to these high-yield bonds in order to increase the nominal return on their assets. That dynamic had led to a continuing narrowing of the high-yield bond spread, as the long-term chart of the spread attests. While it is always tempting (and typically prudent) to have at least some exposure to high-yield bonds in an investment portfolio, it is important to remember that high-yield bonds are, by their nature, impacted not only by macroeconomic factors but also by a variety of business-specific risks.

In this case, bond yields in the high-yield sector spiked in large part because some of the most aggressive issuers of this higher-yielding debt in recent years have been energy and oil exploration companies, many of which are engaged in fracking activities that have sparked the so-called "shale oil boom". As oil prices swiftly declined, the business prospects for many of these companies were materially impacted, since many shale-oil projects require a high crude oil price in order to be profitable. As these firms' profitability came into question, their perceived ability to repay their debt followed suit, contributing to the spike in yields that we have witnessed.

While the recent widening in the spread may turn out to be a unique buying opportunity in the high-yield space, it also presents a stark reminder of the business-specific risks that often come along with such investments. As with any investment, diligently researching the background and business prospects of the issuing company is imperative.

## A Summary of Key Tax Changes for 2015 – Personal Finance

As we begin preparing our 2014 tax returns, it's worth looking ahead to 2015 to consider the impact of changes in the tax code. The first major tax-related change stems from the ongoing rollout of the Affordable Care Act (ACA). Under ACA, all Americans are required to have health insurance, or else be subject to a tax penalty. In 2014, the penalty amounted to the greater of 1% of household income or $95 per person, but those numbers will increase to 2% of income or $325 per person in 2015. If you don't yet have insurance, the sooner the better. Most other tax code changes are incremental in nature: a slight increase in tax bracket thresholds, an increase in 401(k)—but not IRA—contribution limits, and incremental raises in the Standard Deduction and AMT exemptions.