Cypress Financial Planning, LLC

THIRD QUARTER 2015

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## Q2 Market Update

*(values as of 6/30/2015; % changes for Q2, not YTD)*

### U.S. Stock Indices

| | |
|---|---|
| S&P 500 | 2,063 (-0.23%) |
| Dow Jones | 17,620 (-0.88%) |
| Nasdaq | 4,987 (+1.75%) |
| Russell 2000 | 1,256 (+0.29%) |

### Global Stock Indices

| | |
|---|---|
| FTSE (London) | 6,521 (-3.72%) |
| DAX (Germany) | 10,945 (-8.53%) |
| CAC (France) | 4,790 (-4.84%) |
| Nikkei (Japan) | 20,236 (+5.36%) |
| Emerging Mkts | 157.71 (-5.48%) |

### Bond Indices (Bloomberg)

| | |
|---|---|
| U.S. Gov't. | 121.56 (-1.96%) |
| U.S. Corporate | 135.52 (-3.05%) |
| U.S. High-Yld | 154.78 (+0.65%) |
| Eurozone | 131.77 (-5.54%) |
| Emerging Mkts | 145.62 (-1.30%) |

### Commodities

| | |
|---|---|
| Gold (per oz) | 1,172 (-0.93%) |
| Silver (per oz) | 15.69 (-5.81%) |
| Oil (WTI, barrel) | 58.34 (+19.89%) |

### Fixed Income Yields

| | |
|---|---|
| U.S. 2-Year Treasury | 0.64% |
| U.S. 10-Year Treasury | 2.35% |
| U.S. 30-Year Treasury | 3.11% |
| U.S. High-Yield Index | 6.73% |

### Currency Exchange Rates

| | |
|---|---|
| Euro/Dollar | 1.11 |
| Pound/Dollar | 1.57 |
| Dollar/Yen | 122.50 |

## Slaying the Student Loan Monster

As college tuition costs have marched ever higher over the last decade, student loan balances have risen along with them, to the point that they now represent a meaningful portion of many household balance sheets. The numbers are staggering: one in five households carry some student debt, a rate that has more than doubled since 1990. Total outstanding student debt is now in excess of $1.2 trillion, which far exceeds the aggregate level of consumer credit card debt (currently around $800 billion). The average student loan balance is roughly $28,000 per borrower, and a full 13% of indebted households hold a balance above $50,000. For the most recent graduates, the Wall Street Journal reports that average loan balances at graduation exceed $33,000, up from $20,000 a decade ago.

These loans are clearly concentrated among the younger generation, but they do impact older generations as well (either stemming from their own advanced degrees or from borrowings on behalf of their offspring). And while salaries for recent college graduates are typically high enough to service those debt balances without too much of a problem, it's clear that the loans are having a wide impact on the financial decisions of the younger cohort. Studies have shown that millennials are delaying marriage, shunning homeownership, and having children at increasingly advanced ages. Stresses from student loan debt are contributing to–if not entirely responsible for–all of those dynamics.

The inability to build wealth in the early working years could have long-lasting impacts on millennials' ability to meet their lifetime financial goals. Given that fact, it's surprising that comparably little has been said or written about strategies for getting out of (or avoiding) that debt. Whether you're trying to figure out how to put your kids through college or already struggling with debt of your own, this discussion should put some context around a burgeoning financial struggle.

### *Look to your home*

One of the biggest mistakes that many households make is a failure to think about their various debt balances in their totality. As a result, they'll often unwittingly make outsized debt payments to their lowest-rate loans while allowing a high-rate loan to continue piling up punishing interest charges. There are often opportunities to concentrate (or consolidate) debt into the most favorable vehicles, and mortgages on primary residences are the most beneficial of all debt instruments.

If you own a home and also carry a student loan debt balance, it may be advisable to increase the amount of your mortgage (tapping your home equity) in order to pay down the higher-rate loan debt. Such a move could have two benefits–a decrease in the rate (because mortgages are secured by the house, while student loans are unsecured), and an increase in the tax-deductibility of interest payments (since there are fewer limitations on deductions for mortgage interest than for student loan interest).

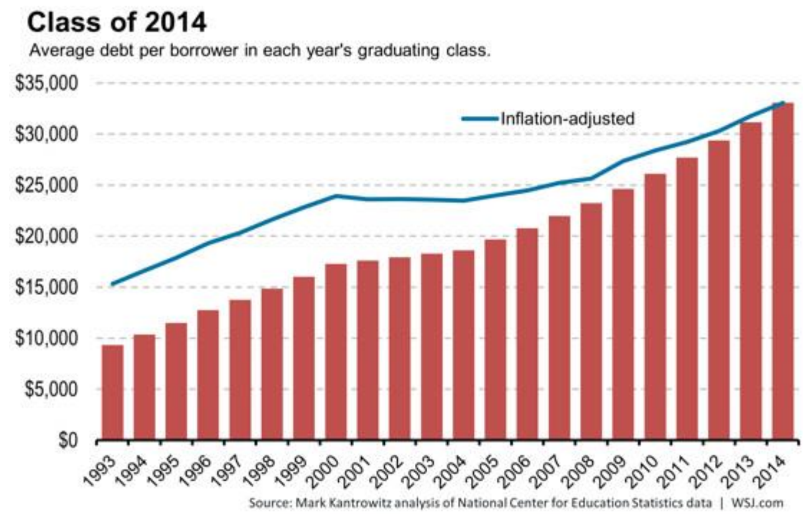
While you generally won't be able to increase your mortgage above 80% of the house's value via a home equity loan, it's worth checking to see what your options may be, as your budget and life circumstances allow. Home equity can often be a very valuable debt-management tool.

*Look to your family*
According to Rohit Chopra, the student loan ombudsman for the Consumer Financial Protection Bureau, the seeds of the increase in student loan debt lie in the financial crisis of 2008-09, though not in the way we might first think. At a conference earlier this year, Chopra related that "what we found is that because American families lost so much in home equity [and] wealth, what they would typically have contributed to their child's education really shrunk. And so it shifted a lot of costs from one generation to another, leading to a huge jump in debt."

In essence, parents who wanted to pay for their children's education were unable to do so because cash flow and investment balances were tight. Now, with the stock market having recovered to record highs (and unemployment at several-year lows), it's likely that the stresses on the older generation have eased somewhat, and they may be in a better position to help now than they were during the actual years of education. For parents who still have the desire to help their children, there are options available.

First, the parents can elect to help via an outright gift to their heirs (gifts that stay within annual exclusion limits are best, so as to avoid giving taxable gifts), in order to help pay down the loan balance. Alternatively, an intrafamily loan can be arranged, with the parent essentially taking the place of the original student loan lender. Intrafamily loans can often serve a dual purpose for families–the student/borrower is able to lower his rate to a more manageable amount, and the parent/lender is able to earn a reasonable rate of interest from a known and (presumably) creditworthy counterparty.

Rates on current student loan balances can be as low as 4% or as high as 8% or above. For parents who are currently invested in fixed income instruments that pay only 2% or 3% (which is common in the current environment), they could be doing as well or better for themselves by lending to their children instead, saving the kids interest in the process. If the parents are so inclined, they could even forgive a portion of the loan each year by taking advantage of the annual gift tax exclusion (currently $14,000). Given the various benefits, it's perhaps unsurprising that intrafamily loans have increased in popularity in recent years, even becoming a standard part of some families' estate planning efforts.




*Take preemptive strikes*
Of course, the best way to manage student loan debt is to minimize or eliminate it on the front end. For parents (and students) who have not yet begun paying tuition or accumulating loan balances, it's never a bad time to start having conversations about optimal education financing strategies.

Intelligent usage of Roth IRAs and Section 529 plans can help invest saved funds in a tax-optimal manner, which can help reduce the overall financial burden. Also, direct tuition payments made by family members are exempt from gift tax consequences when paid to cover a current student–that is, if a grandparent or other family member wants to pay for a child's education, he or she can do so without giving rise to a taxable gift, as long as payments are made directly to the institution (and not to the student). For individuals or families who are looking for ways to minimize the size of their taxable estate, this unlimited exemption can help to meet multiple goals simultaneously. Proper education planning is an integral part of both retirement planning and estate planning–doing the right things in one area can dramatically help your progress in the others.

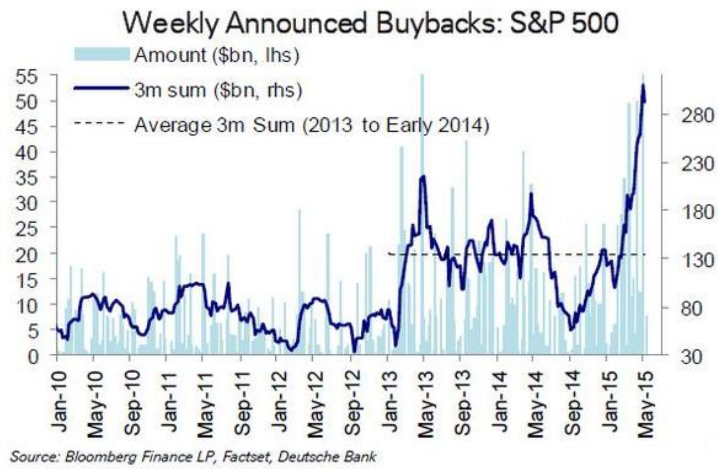
## Equity Overview – U.S. Equity Markets

Domestic stock markets continued to churn with no discernible direction during the second quarter, as most major stock indices ended the quarter in much the same place as they began it. The S&P 500 did manage to eke out a new all-time high just above 2,130 in mid-May, only to fall back below 2,100 to close out June as concerns about Greece and European sovereign debt once again re-entered the daily news flow.

One dynamic that has become clear over the last several months is the ongoing divergence between the quality of economic data (and corporate earnings) and the subsequent performance of equity markets. Some of that divergence can be blamed on geopolitical issues (with Europe at the forefront), and even more of it can be credited to continued policy action from an activist Federal Reserve.

But a factor that must also be considered is the continued trend of record stock buybacks by American corporations. According to the Financial Times' Edward Luce, total stock buybacks in 2014 totaled $550 billion, whereas "new money" coming into the market from investors comprised just $85 billion, mostly into mutual funds and ETFs. That trend continued in early 2015, as total buyback authorizations in the first quarter totaled $257 billion, led by a record $104 billion in the month of February.

These buybacks have at least two major impacts on markets—for one, they create an inherent "bid" below the markets, as firms stand ready to buy their stock even when other investors have retreated.




But corporate buybacks also reduce the supply of shares of stock available for purchase, meaning that absent new issuances (IPOs or secondary offerings), it takes an increasingly small amount of investor activity to generate a relatively large market move.

Eventually, the pace of buybacks will slow, but until then, corporate actions—and not underlying economic fundamentals—are likely to have an outsized effect on the pricing of domestic equities.

***Sources: Financial Times, Ticker Sense***

## Interest Rates Already Increasing? – Fixed Income

As the economy continues to recover, investors have anxiously watched the Federal Reserve for any signals as to the pace and timing of increases in interest rates. While it doesn't seem like the Fed will be raising rates any time soon, one measure indicates that short-term rates may already effectively be on the rise.

When the Fed sets its target for short-term interest rates, it typically refers to "nominal" rates, or the stated interest rate that will actually be used to calculate interest payments. However, economists are generally more concerned with "real" interest rates, which take the impact of inflation (and its effect on purchasing power) into account. While nominal rates have been pegged near zero for more than six years now, real interest rates (calculated as the federal funds rate minus CPI) have fluctuated between -3% and -1%, depending on the level of inflation.

However, when a plunge in oil prices led to negative inflation numbers during Q1, the resultant increase in purchasing power drove real interest rates into positive territory for the first time since the financial crisis, if only barely. In that sense, then, interest rates are already effectively on the rise, even if that rise proves to be purely temporary. Longer-term, it will take action by the Fed—and not just movement in oil prices—to keep rates in positive territory. Investors will be watching.

***Sources: Federal Reserve, BLS***

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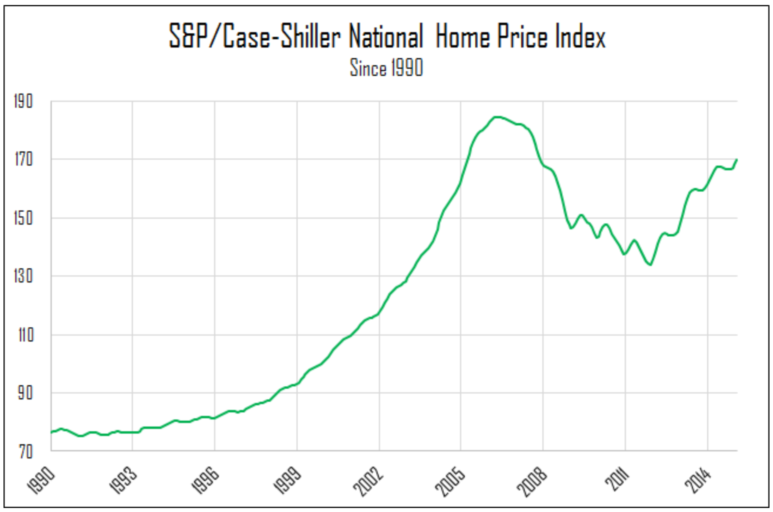
THE SHANGHAI COMPOSITE INDEX MORE THAN DOUBLED IN THE LAST YEAR

## The Housing Recovery Continues – Real Estate

The continued low interest rate environment has certainly been beneficial for the housing market, which has steadily recovered since plummeting during the financial crisis. That recovery has largely come on the back of cheap financing, as 30-year mortgage rates broke below 5% for the first time in history in 2009 and have remained there ever since, bottoming out at a historical low of 3.35% in 2012.




Home prices have remained strong even as rates have begun to creep higher, with the most recent reading of the S&P/Case-Shiller National Home Price Index clocking in at 170.01, an increase of 4.2% over a year prior, though still significantly below the all-time high reading of 184.56.

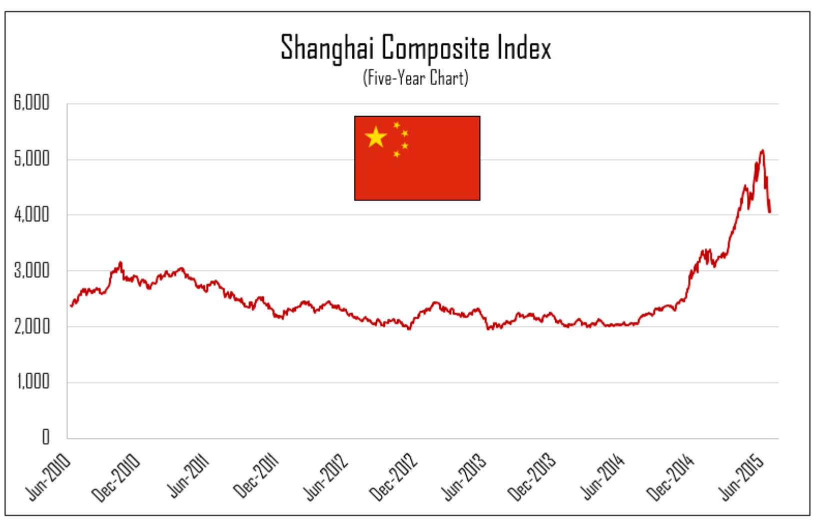
With mortgage rates now standing at 4% (up from 3.5% late last year), time will tell if the housing market strength can continue without an accommodative Federal Reserve. However, it seems that foreign demand—particularly from China—has been a large driver of the increase in some markets, especially in the western part of the country.

While the pricing surge has been good news for shares in homebuilders (up between 6% and 8% this year), shares in REITs have suffered in 2015, as the recent increase in interest rates has made the fixed-income aspect of those investments less attractive.

***Source: Federal Reserve Bank of St. Louis***

## An Eye Toward China – International Markets

When U.S. stock indices dropped during the last week of the quarter, much of the financial media blamed the decline on Greece and the renewal of that nation's debt-based hysteria. However, more attention should arguably be directed toward China, where irregular recent movements in the markets cannot be ignored.




The Shanghai Composite Index surged from a level of 2,030 last June to as high as 5,166 in June of 2015, a 12-month rally of more than 150%. More than half of that rally came in just three months' time, as the index stood at just 3,300 at the beginning of March. But after reaching its peak on June 12th, the Chinese market plunged more than 20% in two weeks, giving up the majority of its year-to-date gains. While the gyrations in Europe may garner most of the headlines, the Asian fireworks may prove to be more impactful to global markets.

***Source: Yahoo Finance***