

Comprehensive Investment Management, LLC
Fee Only Personal Financial Planning
Winter 2018

A Review of the Financial Markets at December 31, 2017

The S&P 500 returned 6.6% for the quarter, putting it up 21.1% for 2017, its best performance since 32.3% in 2013. The gains far exceeded the 3% or 4% many analysts had predicted, with the main surprises being expanded US corporate earnings of 14% and overall extensive global expansion. The US fell into the 2008 financial crisis faster than the foreign markets, and then recovered faster as well. In 2017 the foreign markets finally started to show some life. The European central banks still have accommodating monetary policies in place, whereas the US Federal Reserve Bank took its first steps to remove those kinds of artificial props at the end of 2016. The Reserve Bank has announced plans to raise interest rates at least three times in 2018, and to continue to gradually sell off the 4.5 trillion dollars of bonds it purchased over a six year period starting with the financial crisis in 2008. It remains to be seen how that can be accomplished without negatively impacting our economy and markets, and at some point the European banks will have to do the same.

The following article describes the performance of a select group of mutual funds. You should be mindful that recent market activity can be newsworthy, but for investment purposes, performance over longer periods, while not predictive, is significantly more meaningful.

US Diversified Stock Funds

While the S&P 500 performed very well in 2017, the average performance of the large cap funds managed by Primecap again outperformed by a wide margin, 28.2% to 21.1%. And that's no fluke, as Primecap's outperformance averages 3.7% over the one, three, five, ten and fifteen year periods. Primecap's mid caps outperformed the S&P at those time periods by 5.5%, as did our small caps by 2.9%. The argument that index funds outperform the majority of managed funds, obviously doesn't apply to our managed funds. In a recent webinar, Vanguard's new CEO, Tim Buckley, acknowledged as much, saying Vanguard's managed funds,

US Stocks	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Large Cap	7.1	28.2	13.2	19.0	10.9	13.0
Mid Cap	8.6	30.6	14.4	21.9	12.8	13.9
Small Cap	5.7	24.9	12.9	17.8	12.1	13.1

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Mutual Fund Categories	Quarter Return	Average Annual Percentage Returns				
		1 Year	3 Years	5 Years	10 Years	15 Years
Short Term Bonds	-.2	1.6	1.6	1.3	2.6	3.0
Intermediate Term Bonds	.5	3.6	2.6	1.6	4.5	4.7
US Diversified Stocks	6.9	26.2	12.6	18.5	11.2	12.6
Energy, Health & Real Estate Stocks	3.6	10.9	4.7	10.4	6.9	11.9
Foreign Stocks	5.2	38.2	12.4	9.9	5.7	12.4

The Financial Markets (from page 1)

have historically outperformed its index funds by almost 1%. The stock funds we are in, the majority of which are not Vanguard funds, have exceeded that 1% by a wide margin.

Sector Stock Funds

Energy had its second consecutive good quarter, but poor performance in the first two quarters of 2017 left it at just 3.2% for the year. CIM clients first invested in the Energy fund in 2010 after its big drop following the financial crisis. After a fast start, a worldwide fuel glut caught up with us, and for the most part our overall return has been modestly positive. CIM is in the process of gradually phasing out the Energy fund, but we will still be invested in the energy industry via our diversified funds.

You may have heard some news reports about the healthcare industry. The politicians can talk about it all they want, but its market performance continues to be stellar. Our funds are not concentrated in big pharma. Those companies have been struggling due to a paucity of new medicines, at least ones that are profitable. The average returns at ten and fifteen years for giants Merck, Pfizer and Glaxo Smith are 4.0% and 3.1%. Real estate had a positive quarter of 3.3%, lifting 2017 to 5.7%, and its five year return to a more than respectable 9.5%. Real estate investments are particularly sensitive to rising interest rates, so we may see relatively modest returns over the next couple of years.

Sectors	Qtr	1 yr	3 yr	5 yr	10 yr	15 yr
Energy	6.4	3.2	2.0	2.1	-.2	10.2
Health	1.1	23.8	7.6	19.6	13.4	14.4
R/Estate	3.3	5.7	4.5	9.5	7.5	11.0

Foreign Stock Funds

In 2017 our foreign funds have outperformed the domestics with an average of 38.2%. It's a welcome turnaround from the last few years. Our funds outperformed Vanguard's Total International Stock Index, which even after a 27.4% return in 2017 has a ten year return of just 1.8%. Our funds average return for ten and fifteen years are 5.7% and 12.4%. The index at fifteen years is 8.8%.

Bonds vs. Stocks

The accompanying chart compares two five star Vanguard funds, which have opposing bond/stock allocations. Wellesley is 65/35 bonds vs. stocks, Wellington is 35/65. At ten years there is little difference in the returns. Recent results show what has been the historical out performance by stocks, while bond performance reflects interest rate increases over the last year, and anticipation of more in 2018.

Return	1 yr	3 yrs	5 yrs	10 yrs	15 yrs
Wellesley	10.2	6.3	7.4	7.1	7.3
Wellington	14.7	8.1	11.0	7.5	9.1

Looking Ahead

While still positive, only a very few market pundits are predicting 2018 stock returns to be anything like 2017. Vanguard predicts stock returns in the mid single digits, and I haven't heard anybody who expects bonds to get more than half that. Those who expect better returns in 2018 sight the growing US and global economies, very low unemployment, recently passed federal tax reductions, and still relatively low interest rates, even after the increases planned by the Federal Reserve. The counter argument is that all that good news is already built into prices, and there is no obvious path for continued growth through higher employment and increased productivity. As someone once said, I think it was Elvis, if stocks are priced for perfection, get ready for a correction.

What drives stock prices is economic growth. It leads to corporate profits, and the anticipation of more of the same. The tax reform at the end of the year should help with that. But nobody really knows what will happen in the short term. Who would have predicted the 2017 markets would shrug off North Korea testing missiles that can reach the U.S; the Department of Justice appointing a special counsel to look into possible ties between the White House and Russia; the president appointing a committee to investigate an election he won, because he says it was rigged; the most expensive year ever for US natural disasters; and the U.K.'s special election that weakened its own bargaining position in its Brexit negotiations?

Vanguard and Security Issues

I have a lot of confidence in the security of Vanguard's internet system. That's because, as long as you haven't set up its Bill Pay feature, there is no way to transfer money from your accounts other than to your linked bank account. Money can be moved between the similarly titled various funds you are invested in, but what would a perpetrator get from that? And if that did happen, Vanguard could easily put the accounts back the way there were, retroactively.

A perpetrator could have Vanguard issue a check from your account, but it would be payable to the owner, and mailed to the account address. So, in that case your mailman would have to be in on it, and he or she would have to find a party willing to cash a double endorsed check. Your address can be changed on line, but that freezes mailing checks for seven days, and a notification letter is sent to the current address.

Several years ago, Vanguard initiated security questions. A question pops up whenever you log in from a device on which you have not previously used to log in. Taking it another level, Vanguard now offers to send a security code to your phone, either every time you log in, or only when an unrecognized device is used. Vanguard recommends the latter. These days, especially after hearing stories about the hacking of Equifax, it's hard to argue against taking extra precautions. So CIM is currently assisting clients in setting up the security code feature, unless they see it, probably correctly, as a potential hassle with little upside. If you decide later you don't like it, it can be turned off.

Concerning Vanguard's Bill Pay system, I don't recommend it, because it exposes you to an outlet for money to be drawn from your account. If you use your bank account to pay bills on line, the exposure to your assets is limited to just the balance in your bank account, which, I think it's safe to assume is much smaller than the balance in your Vanguard accounts.

To round out this discussion, you should be aware of the availability of Vanguard's Voice Verification feature. Your voice is unique, and Vanguard uses sophisticated biometric technology to identify it, and allows you to direct funds to be sent from your account to another party. The only other way to do that is to send in paper work with your signature guaranteed. For those subject to required minimum distributions, Voice Verification can be used to make charitable donations from an IRA. The Qualified Charitable Distribution provision not only was not eliminated in the recent tax reform, but because the standard deduction has been doubled, the number of taxpayers who can benefit from it have been significantly increased. I also recommend Voice Verification, because it could come in handy in an emergency. However, other than emergencies and donations, I don't think it's great idea to get in the habit of executing financial transactions verbally.

You will Soon Interact With Vanguard Differently

(That is, unless you don't like the idea.)

Vanguard wants to make you aware of a change that's coming in how you'll interact with its staff. You will no longer have a designated contact person, but instead will have access to a team of representatives. Vanguard says you will still receive the same level of service you've come to expect from its reps: "...who are trained to handle the unique needs of investors like you. *But, if at any time you'd like to have an assigned representative again, just let us know.*"

When I call Vanguard, my rep is never available anyway, and the other members of the team are usually competent and able to help. However, due in part to its extraordinary growth, Vanguard's customer support, whether specifically assigned or not, has slipped. A hiring binge is underway, but improvement will take time. I'm sure the so called "upgrade" hasn't helped matters.

**Comprehensive Investment
Management, LLC**

Investment Management &
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It's morning in the personal financial services industry

The CIM investment strategy:
Control risk yet outperform the market
by using well managed, no
commission, low cost mutual funds.
Maintain appropriate asset allocation and
diversification. Minimize taxes.

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Tax Changes Q & A with Bill

Q: Bill, is it true that starting in 2018 not only is home equity loan interest no longer deductible, but also investment expenses and other miscellaneous deductions?

A: First, a clarification. Interest on home equity loan debt used to acquire or substantially improve a primary home is still deductible. What has been ended is the deduction of home equity loan proceeds used for other purposes, for example, to buy a car. The change treats an equity loan the same as a mortgage. If you refinanced your mortgage and used the proceeds for something other than home acquisition or improvement, the interest would not be deductible either. This change will put a big dent in the practice of using home equity lines of credit as a ready source of tax deductible interest. Because credit lines have variable interest rates, they are not the best source for funding longer term assets.

Most miscellaneous deductions are netted against 2% of your taxable income. They have been eliminated. The standard deduction has been doubled, so depending on the numbers and how you choose to look at it, you may not have lost a deduction, but instead have been relieved of the need to report the expense on your tax return. The financial services industry, which in recent years has moved to charging management fees instead of hidden commissions, isn't happy. For many of their clients investment expenses are the biggest miscellaneous deduction they have. It will be interesting to see if they make adjustments in how they bill and collect for their services.

The good news about the doubling of the standard deduction is significantly offset by the bad news about the elimination of personal exemptions. For an individual the standard deduction increase is \$6,350 and the lost exemption is \$4,050. For joint filers the numbers are \$12,700 gained, and \$8,100 lost. Filers with dependents, lose \$4,050 for each one, although child credits (under 17 years of age) have been expanded.

There have been many other changes, as well, and tax rates have been reduced and new brackets created. So, for most taxpayers, it's very hard to generalize about who gained or lost. We just have to run the numbers.