May 2016

SUMMARY
March Madness came to the stock market this year as well as to the basketball court.

Oil appears to have found its bottom at $26, and has recovered to the $35 - $40 range.

The dollar has weakened some and that will benefit U.S. corporations; however earnings growth expectations have declined to approximately 10%.

If the S&P 500 companies earn $110 this year as expected, then the P/E ratio is 18.7x estimated earnings. Not wildly expensive, but not cheap either.

Interest rates are likely to remain low again this year. The Fed will probably raise rates once or twice by 0.25% each time.

In This Letter

Market Commentary and Review

by Brad Bickham, CFA, CFP®

Dear Clients and Friends,

Returns as of 3/31/16	1st Qtr	Last 12 Months	Last 5 Yrs. Annualized
60/40 Balanced World Index	1.4	-1.8	4.7
World Equity Index (ACWI)	0.3	-4.4	5.2
U.S. Equities (Wilshire 5000)	1.2	1.8	11.0
Foreign Equities (ACWI-ex U.S.)	-0.4	-9.2	0.3
U.S. Bonds	3.0	2.0	3.8
HFRI Fund of Funds Composite	-1.9	-4.5	1.6

If you were on a boat or an island for the first quarter and just returned, then you might believe it was just a boring, somewhat flat quarter for investors. The reality was far from that. The global equity index was down 11% as of February 11th before staging a remarkable rally of 13% over the following six weeks. For emerging markets it was even more dramatic. They rallied 21% from their lows.

It goes to show that conventional wisdom is often wrong. As written in a recent Barron's article, most strategists were predicting a mild year with modest returns. But instead, oil began the year in a nosedive, falling to $26 per barrel before finding its bottom. At the same time, the Federal Reserve was still predicting up to four interest rate increases this year.

But then the European Central Bank turned full tilt expansionary, the Japanese went further into negative interest rates, and finally Chair Yellen threw in the towel and lowered expectations about the Fed's pace of increases. The employment report was positive and crisis averted – the market came back.

Despite the market recovery in March, it has still been a slightly negative last 12 months for most balanced portfolios. Why? And, perhaps more importantly, what will happen the balance of the year?

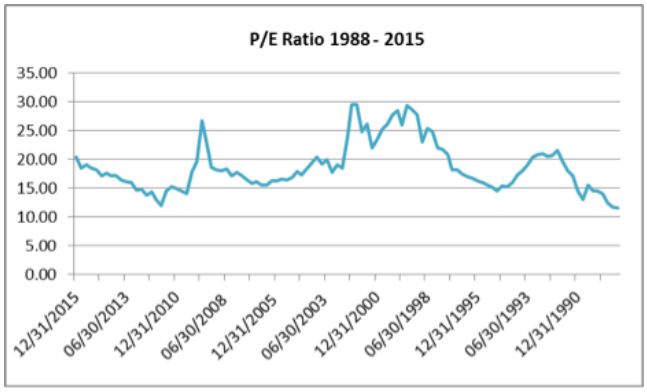
Push me Pull you.

Dr. Dolittle's friend is a good symbol of the current situation. The economy continues to grow, but earnings do not. The economy has low un- employment, low inflation, low interest rates, and a strong housing market. There is some weakness in the industrial sector related to exports, and the energy sector is weak for obvious reasons. But, overall economic growth was at an annual rate of 1.4% in the 4th quarter of last year, 2% in the 3rd quarter, and estimated at +0.3% for the 1st quarter of 2016. The leading economic indicators continue to show positive growth.

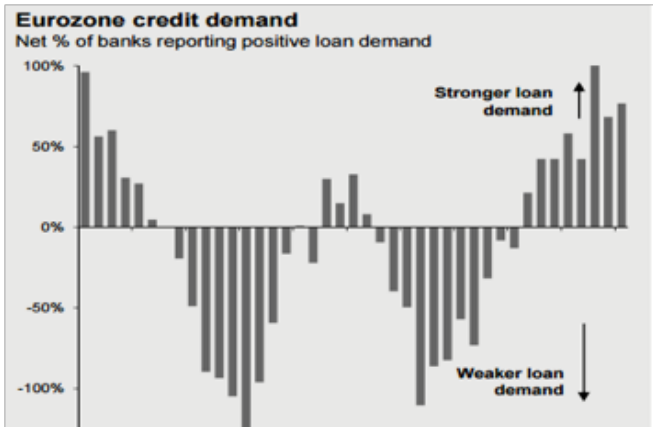
The real reason for the subdued equity returns in our opinion is the slowing growth of earnings, and uncertainty about future earnings growth. Compare the consensus earnings estimates we showed you in January to the new estimates. You can see that estimates for 2016 have been lowered, and that the actual numbers for 2015 have been lowered after final reports. That means 2015 earnings were 11% lower than in 2014.

Year	Oper. EPS Est a/o Jan.	Last 12 Months
2013	$107	$107
2014	$113	$113
2015	$106	$100
2016	$125	$118

At least one firm, Goldman Sachs, has lowered their earnings estimates for 2016 to $110, which would mean growth this year would be 10% rather than 18%, and below the earnings from two years ago.

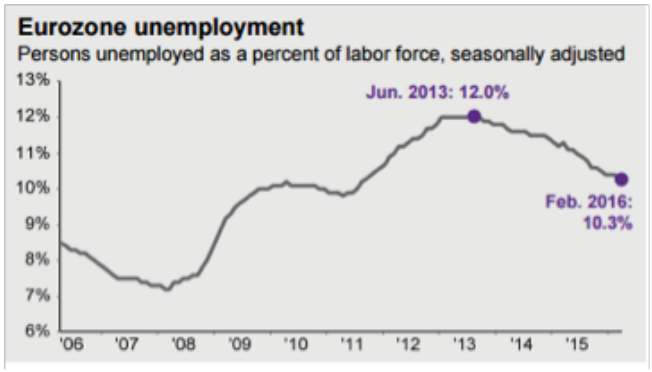


What this means for valuation is that the market is either reasonable or expensive depending on where earnings actually end up. We lean toward conservative estimates. Using $110 as a baseline view, the S&P 500 multiple is 18.9x estimated earnings and 20.8x trailing earnings. As shown, these aren't extreme readings, but they aren't cheap either. This, we think, is why the market is stuck in a sideways consolidation pattern and it will probably remain that way until there is more confidence about growth in earnings.



What about other asset classes and strategies? International equities are continuing to lag U.S. equities. These cycles go in waves that can last 5 – 10 years, and we have thought for a few years it was due to turn in favor of international markets. This has been wrong so far. Valuation favors

foreign equities, but economic growth has been very hard for them to stimulate. Their entire political and financial systems are not as dynamic as in the Unites States. This is true whether we look at Europe, Japan, or China. Europe and Japan both have negative interest rates in an attempt to get people to take their money out of savings, and to get businesses to borrow and invest. It is having some effect as shown in loan demand and gradually improving employment.



Emerging markets have suffered disproportionately due to the slowdown in both Europe and China, and due to the strength of the U.S. dollar. Some of these factors appear poised to change. The dollar's rise was really concentrated in the second half of 2014 as shown in this chart. It appears that it has established a new trading range, and is no longer in a rising trend. If so, the pressure on emerging markets, commodities, and even multi-national corporations will abate. As mentioned earlier, and shown in the following chart, these trends last several years and this one has lasted about six years already.

Bonds and Alternative Strategies

We have argued for several years that investment grade (higher quality) bonds have held little relative value. While we still maintain this is true, we admit we have been wrong in the sense they have provided decent returns with very little risk or volatility. But can this continue? It seems unlikely with interest rates below 3% everywhere in the world, and central banks doing everything they can to stimulate inflation, that bonds can deliver anything more than modestly positive returns over the next 5 – 10 years. So what can we do to get higher returns without taking the risk of stocks?

As shown in the table on the next page, over the last 10 years High Yield bonds and Emerging Market (EMD) bonds have provided returns higher than investment grade bonds (Corp, MBS, AGG, TIPS, & Treas). What has been less effective, especially the last five years, has been Hedge Funds. Hedge Funds are not a homogenous group. There are many different strategies, but in aggregate we would argue that if they cannot outperform bonds, they certainly have not justified their typical management fee of 2%. Over the last 5 years the HFRI Fund of Funds Composite has returned a measly 1.6% per year vs. 3.8% for bonds and 4.7% for a global balanced portfolio.

2006	2007	2008	2009	2010	2011	2012	2013	2014	2015	YTD	2006 - 2015 Cum.	2006 - 2015 Ann.
EMD LCL. 15.2%	EMD LCL. 18.1%	Treas. 13.7%	High Yield 58.2%	EMD LCL. 15.7%	TIPS 13.6%	EMD USD 17.4%	High Yield 7.4%	Muni 8.7%	Muni 3.8%	EMD LCL. 11.0%	EMD USD 114.0%	EMD USD 7.9%
High Yield 11.8%	TIPS 11.6%	MBS 8.3%	EMD USD 29.8%	High Yield 15.1%	Muni 12.3%	EMD LCL. 16.8%	MBS -1.4%	Corp. 7.5%	MBS 1.5%	EMD USD 5.0%	High Yield 95.9%	High Yield 7.0%
EMD USD 9.9%	Treas. 9.0%	Barclays Agg 5.2%	EMD LCL. 22.0%	EMD USD 12.2%	Treas. 9.8%	High Yield 15.8%	Corp. -1.5%	EMD USD 7.4%	EMD USD 1.2%	TIPS 4.5%	Corp. 67.4%	Corp. 5.3%
Asset Alloc. 5.7%	Barclays Agg 7.0%	Muni 1.5%	Corp. 18.7%	Corp. 9.0%	Corp. 8.1%	Corp. 9.8%	Asset Alloc. -1.9%	MBS 6.1%	Treas. 0.8%	Corp. 4.0%	Muni 66.0%	Muni 5.2%
MBS 5.2%	MBS 6.9%	Asset Alloc. 0.1%	Asset Alloc. 14.7%	Asset Alloc. 7.9%	Asset Alloc. 8.1%	Asset Alloc. 7.4%	Barclays Agg -2.0%	Barclays Agg 6.0%	Barclays Agg 0.5%	Asset Alloc. 3.5%	Asset Alloc. 65.7%	Asset Alloc. 5.2%
Muni 4.7%	Asset Alloc. 6.7%	TIPS -2.4%	TIPS 11.4%	Barclays Agg 6.5%	Barclays Agg 7.8%	TIPS 7.0%	Muni -2.2%	Asset Alloc. 5.5%	Asset Alloc. -0.3%	High Yield 3.4%	EMD LCL. 62.0%	EMD LCL. 4.9%
Barclays Agg 4.3%	EMD USD 6.2%	Corp. -4.9%	Muni 9.9%	TIPS 6.3%	EMD USD 7.3%	Muni 5.7%	Treas. -2.7%	Treas. 5.1%	Corp. -0.7%	Treas. 3.2%	MBS 57.3%	MBS 4.6%
Corp. 4.3%	Corp. 4.6%	EMD LCL. -5.2%	Barclays Agg 5.9%	Treas. 5.9%	MBS 6.2%	Barclays Agg 4.2%	EMD USD -5.3%	TIPS 3.6%	TIPS -1.4%	Barclays Agg 3.0%	Barclays Agg 55.5%	Barclays Agg 4.5%
Treas. 3.1%	Muni 4.3%	EMD USD -12.0%	MBS 5.9%	MBS 5.4%	High Yield 5.0%	MBS 2.6%	TIPS -8.6%	High Yield 2.5%	High Yield -4.5%	MBS 2.0%	Treas. 50.6%	Treas. 4.2%
TIPS 0.4%	High Yield 1.9%	High Yield -26.2%	Treas. -3.6%	Muni 4.0%	EMD LCL. -1.8%	Treas. 2.0%	EMD LCL. -9.0%	EMD LCL. -5.7%	EMD LCL. -14.9%	Muni 1.9%	TIPS 47.0%	TIPS 3.9%

Source: Barclays, FactSet, J.P. Morgan Global Economic Research, J.P. Morgan Asset Management.

Another way of looking at this is that it is harder to find and exploit inefficiencies in the market. Hedge funds are forced to take greater risk in order to create returns, which leads to more volatility in their results.

It has been harder for us too. We have tried a number of different mutual funds over the last two years that have underperformed. These are managed by the biggest firms and brightest managers, such as Goldman Sachs, Blackrock, PIMCO, John Hancock, Eaton Vance, etc. None of the "hedge fund like" strategies have had consistent outperformance; so our Alternatives Strategy has been reduced to five or six mutual funds that are more "bond like" and less complicated than in the past. We continue to research new ideas and look forward to adding new ideas to this strategy when we feel comfortable they will add to risk adjusted portfolio returns.

In sum, it is unlikely to be smooth sailing for the rest of the year. The economy is inching ahead slowly, but not robustly. The election will create abundant uncertainty, and profit growth is too slow to lead to robust capital spending. That doesn't mean abandon your long term plan, but be prepared for further volatility.

Estate Planning: A Summary of the Role of a Personal Representative

By Gary Powell

This article is an abbreviated explanation of the roles and responsibilities of a PR and may guide you through the decision on your PR or the decision whether to serve in that role for someone else. If you wish to go into further detail, our planning team has developed an extensive list of duties and obligations of a PR. Please contact us if you would like to obtain a copy.

What is a personal representative?

A PR is the person named in the legal documents to oversee the settling of the decedent's personal, financial, and estate affairs. It can be flattering to be asked to serve as a personal representative; but, it also can be intimidating, since a PR is entrusted with the large and potentially complex responsibility of making sure a person's wishes are carried out and their property is accounted for and distributed according to their legal documents.

Some practical examples of duties of a PR are:

- Locating the legal documents, since those can contain instructions for burial/cremation, funeral

preferences, and personal property designated for specific beneficiaries.

- Pulling together a team of professionals (attorney, CPA, and investment advisor), should be a top priority to assist in the process. If you do not have a strong estate attorney with estate administration experience or a CPA with experience filing estate tax returns, we can refer you to one.

- Locating, protecting and maintaining all of the decedent's real and personal property and gathering all the related financial documents (e.g. bank and investment statements and business agreements).

- Compiling a statement of Assets and Liabilities (a balance sheet) as of the date of death is necessary in most situations.

- Checking all life insurance policies, IRAs, and/or 401(k) accounts to determine if these items have adult living beneficiaries named.

- Locating the beneficiaries of the estate and communicating regularly with them will assist in ongoing decisions; be open and transparent with everything that you do.

- Settling the debts of the deceased, paying bills that preserve the estate's assets, and distributing the remaining assets according to the decedent's wishes.

- Organizing and maintaining good records, files, and all paperwork is required to document the activities of the PR.

Setting Your PR Up for Success

We are proponents of a key estate planning technique that is often overlooked: an estate that is organized before death by you, not the PR, will be of great benefit in a stressful time for your family.

Company News

By Patty Meneley, COO

The last quarter's theme here at Colorado Financial Management has been change. We changed our name as the result of our merger and that theme has continued with many other aspects of our business.

As I'm sure you've noticed, our email addresses have changed from the old SBL mail server to our new CFM mail server. Mail will forward for a while but you should update your address books to our new addresses @colofinancial.com.

Also changed is the address of our Denver office. We recently moved our Denver folks to the American National Bank Building at the corner of Milwaukee and 1st in Cherry Creek. The new address is 3033 East First Avenue, Suite 408, Denver. We're excited to have a dedicated space for our Denver office in this great location. Look for information on an open house event there later in the summer.

Recently we changed our network configuration which, while not visible from your point of view, is allowing us to complete security upgrades that will increase our ability to safeguard the sensitive data that we store on our servers. We want you to know that we take cybersecurity very seriously and are continually looking for ways to improve in this area.

Lastly, you should all have received your quarterly report by now and will have noticed that the format of the reports is new. We hope you will appreciate the more streamlined nature of the reporting, combining many types of information on fewer reports. Let your service team walk you through the new reports if you have questions. As is always the case with software changes, there might have been capabilities in the old system that didn't translate quite the way you expected in the new. If you'd like for us to configure anything differently for you, please let us know.

The Last Word

By Rick Lawrence, CEO

You may already have heard about dramatic new rules brought forward by the Department of Labor to protect consumers when they make choices about their retirement savings. The Labor Department has said it aims to protect retirement savers from expensive or inappropriate investments when they "roll over," or transfer, assets from a 401(k) or other employer-sponsored retirement plan into an IRA, according to the Wall Street Journal (April 4, 2016).

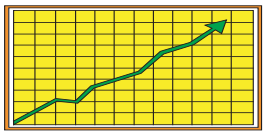
The final rule takes the form of requiring anyone providing professional investment guidance to "work in the best interest of the investor", a standard that you may be surprised to learn stockbrokers have not had to meet in the past. We have. Colorado Financial Management (and Sargent Bickham Lagudis prior) has always been bound to conduct its business with the client's interest considered above all – meeting what is known as a fiduciary standard of care.

When these new rules do become effective, there are likely going to be new forms and other disclosures which we will produce and sign together, and add to our records. But the way that we do business will not change. A key distinction of most RIAs (that is Registered Investment Advisors – we are one) compared to stock and bond brokers is that rather than earn fees from commissions that relate to trading activity and vary by the type of investment a client is making, we earn money based solely off of the value of your account, an arrangement referred to as "Fee Only" pricing. So, our interests are aligned with yours – we benefit when your account grows.

Ask any of our partners and employees: they will tell you that the Fee Only structure and a business model based on putting the interest of the client first are the main reason we are working here.

There will be more news about the implementation of the new retirement account protection strategies of the Labor Department coming, and we will likely be sending out materials. But in the meantime, thank you for your business – it means everything to us.

Many happy returns,



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