The Quarterly Advisor

Our Strategic View

In reviewing 2014 market results, the story that stands out is the 13.69% growth in the S&P 500 Index. Based on the calls we've been getting, it's clearly what our clients are focused on.

When assessing such growth, context is everything. Keep in mind that the S&P 500 represents just one segment of the market – large U.S. stocks – and this year, they happened to be the ones that outperformed others by quite a bit.

In 2014, the dispersion among stock indices (chart below) was much greater than in the previous two years. Keep in mind that the S&P 500 won't always be (and hasn't been) the best performing asset class.

Index	Market Segment	Market Return 2014	Annual Return 2013	Annual Return 2012	Annual Return 2011	Annual Return 2010	Annual Return 2009	Annual Return 2008	Annual Return 2007	Annual Return 2006	Annual Return 2005
S&P 500 Composite	**Large Cap**	**13.69**	**32.39**	**16.00**	**2.11**	**15.06**	**26.46**	**-37.00**	**5.49**	**15.79**	**4.91**
Russell Mid Cap	**Mid Cap**	**13.22**	**34.76**	**17.28**	**-1.55**	**25.48**	**40.48**	**-41.46**	**5.60**	**15.26**	**12.65**
Russell 2000	**Small Cap**	**4.89**	**38.82**	**16.35**	**-4.18**	**26.85**	**27.17**	**-33.79**	**-1.57**	**18.37**	**4.55**
MSCI EAFE	**International**	**-4.48**	**23.29**	**17.90**	**-11.73**	**8.21**	**32.46**	**-43.06**	**11.63**	**26.86**	**14.02**
Barclays US Agg Bond	**Bonds**	**5.97**	**-2.02**	**4.21**	**7.84**	**6.54**	**5.93**	**5.24**	**6.97**	**4.33**	**2.43**

Morningstar reported that nearly 80% of U.S. large cap equity fund managers did not beat their benchmark. According to Goldman Sachs, factors that contributed to manager underperformance in 2014 include:

1) Non-Benchmark Securities – Portfolio managers tend to hold securities not in their benchmark including smaller cap names as well as foreign names. These market segments did not perform as well as the S&P 500.

2) Sector Selection – Despite being overweight to Healthcare (the best performing sector) and underweight to Energy (the worst performing sector), managers generally had fewer investments in Utilities and the largest Information Technology companies. Apple was up 41% last year and Microsoft was up 33%. Not holding these names in the right proportions cost managers valuable returns.

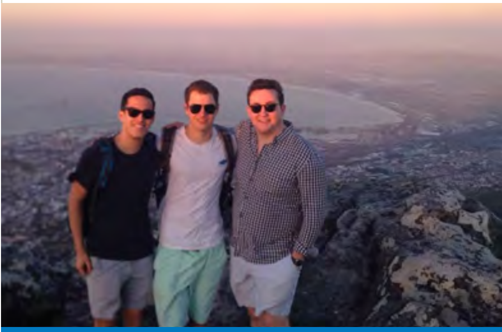
The Death of Diversity & Active Management?

In a year where one segment so dramatically outperforms others, one might question the wisdom of diversification. In 1998, we experienced the same situation when the market was solely focused on large cap growth stocks like Cisco, Dell, and Intel. We all know how that turned out; the tech bubble burst and the market rotated to value stocks.

Some are also questioning the wisdom of active portfolio management.

Given the cyclical nature of investment strategies, when these questions arise, we believe it's a sign that diversified, active management may be the best emerging approach. At times like this, the question should be, "is my portfolio resilient?" rather than "why don't I have more in the S&P 500?" As the market changes and broadens, a diversified portfolio is better positioned to benefit from whatever opportunity is presented.

At Fierston Financial Group



Picture of William (center) with classmates on Table Mountain, Cape Town, South Africa.

The past couple of months have been among the busiest we have ever had at FFG. Seth and Brian have been working non-stop rebalancing client portfolios and preparing for 2015.

Dave and Rochelle are in Florida enjoying their new house. On the home front, cousins Marissa and Mollie are now in their junior years of high school and have both started looking at colleges.

In late January, William left for Cape Town, South Africa, where he will be studying literature at the University of Cape Town. He's in his junior year at Hamilton College and during the winter break he again worked with us in the office, leading the way for a possible third generation at FFG.

We hope you enjoy the winter and, as always, encourage you to contact us with any questions you may have.

Best,

Dave Seth Brian

What We're Doing

As we transitioned from 2014 into 2015, our focus has been on rebalancing portfolios to bring them closer to targets.

This effort involves shifting asset allocations between equity segments as well as from equities into fixed income as a risk control mechanism. We are also adjusting bond portfolios in light of a potential rise in interest rates and bringing foreign stocks up to our target allocation, because as of now, we believe they offer better value than U.S. stocks. Additionally, we are adding more index exposure to client portfolios and feel that combining active and passive managers has merit.

Overall, our philosophy is evolving to include even more diversification, as we respond to the environment and new opportunities in the market.

The view from Brian's meeting at Goldman Sachs

Portfolio Manager

In January, Brian met in New York with Ben Trombley, Vice President, Fixed Income at Goldman Sachs Asset Management, and Sirion Skulpone, Vice President of Product Strategy. As we further diversify our portfolios, we are utilizing the Goldman Sachs Strategic Income Fund (where we now have $39.2 Million invested) and the Goldman Sachs Satellite Strategies Fund ($21.7 Million). We believe these funds can potentially reduce the risk and enhance the returns of our portfolios.

The GS Satellite Strategies Fund invests in satellite asset classes that have low correlation to traditional assets like large U.S. stocks and investment grade bonds. Satellite asset classes also have low correlations to themselves. Examples include: emerging market equity, high yield debt, commodities, and real estate. The GS Strategic Income Fund is a flexible global bond fund that invests in fixed income opportunities across the globe and adapts dynamically to changing market conditions.

We will continue to talk to the folks at Goldman Sachs about their strategies as we work to further improve the risk and return characteristics of our portfolios.