Quarterly Newsletter July 2015

Market Update

As of the writing of this newsletter, international markets are once again making headlines. Puerto Rico is saying they can't pay their debts.[1] China's stock market has fallen 20% off its recent highs into bear market territory.[2] And the ongoing economic problems in Greece seem to be coming to a head. Right at the moment it appears to be Greece that is rattling the markets.[3]

Greece owes foreign creditors about 280 billion euros and doesn't have the cash to make the interest payments. The big concern is whether or not Greece will default on their debt and what impact that default would have on the global financial economies and markets.[4] How financial markets will react in the short-term can be difficult to approximate. For example, it's hard to know how much of the potential impact of Greece's financial problems have already been factored into the investment markets prices. We should have a better idea in the coming weeks as to the investment markets' response to the Greek economic drama.

This ongoing volatility and uncertainty in overseas investment markets affirms for us our aversion to overseas markets. While we see strong trends in the stock markets, our emphasis continues to be on the U.S. stock markets. We still don't feel the risks are worth it when it comes to investing overseas, especially international stocks.

This is different, by the way, from "Modern Portfolio Theory" which insists investors have their investments spread over certain asset classes at all times. That is called a "passive" approach.[5] Passive investing is based on the assumption that market trends are unpredictable and that investors are better off spreading their investment dollars across multiple asset classes at all times and during all economic and market environments in the hopes that, over time, some of the of those investments will eventually go up. In passive investing there is little or no attempt made to choose a time when to invest in a certain investment or group of investments. In our opinion, the passive approach to investing can put investors at greater risk than necessary when it has investors putting their money in places of volatility, uncertainty and downside risk. There are times, we believe, that you don't want to be invested in certain asset classes, sectors or areas of the world at all, and we will structure our investment decisions and recommendations accordingly. With the pounding international markets have been taking recently, we are glad we have been shying away from international investments. If you run across anyone who might be concerned their advisor has them investing overseas, please pass our name along and we'd be glad to talk with that person.

If the volatility of the international markets spills over into the U.S. stock and bond markets, we will take steps to decrease our investment exposure to domestic investments as well.

Is there really a recovery happening in the jobs market?

Summer is upon us and there is usually a lot to celebrate with summer: vacations, Fourth of July, time with family and friends. Economists and politicians are celebrating too, but right at the moment they are celebrating for a different reason. Economists and politicians are celebrating a 5.5% unemployment rate.[6] But after digging a little deeper into the numbers, we wonder if there is really all that much to celebrate.

While the job market may indeed be well on its way to recovery, we're not so sure the numbers published in the news tell the complete story. As mentioned above, the unemployment rate published by the government in May reported that unemployment has fallen to 5.5%. Part of all the hoopla appears to be around the fact that we've been adding something like 200,000 jobs a month to the labor force.

The first point we will make is this—of course we are adding all these jobs each month, we are coming out of a recession. That's what happens when you come out of a recession where a bunch of people lost jobs to begin with. The job growth over the last 6-7 years looks great because we are making up for what we lost in the financial crisis. In 2008-2009 we lost close to 8.7 million jobs. So in some sense, we aren't really gaining all that much, we are just making up for lost time--we've been catching up on laid off workers.

Our second point about the recent unemployment report is that it doesn't include the "participation rate." The participation rate is the portion of the population that is either employed or looking for employment. From January 2007 to March 2015 the participation rate fell from 66.4% to a low of 62.7%. What this means is that less people are participating in the job market or are even looking for work. Apparently some people get fed up with looking for a job and quit trying.

So if you include the people who have been left out of the unemployment numbers because they were instead factored into the "participation rate," you get an unemployment number that is much higher. Instead of unemployment at 5.5%, it's more like 9.2% when you factor in the participation rate.

But it gets worse.

Our third point about the current unemployment numbers is that if you add the people who are working part-time but want full-time work, unemployment gets closer to 11%.

Here is the reality: we have had a grim jobs recovery. With close to 11% of people either out of a job or not working full time. That's not a recovery in our opinion and can't be good for the economy.

In addition, we tend to agree with the Gallup organization that it makes a big difference about how one defines those who are employed. The Bureau of Labor and Statistics says people with jobs are employed and people without jobs are unemployed.[7] That's the definition of employed vs. unemployed they are using when they publish the unemployment numbers. Gallup uses a slightly more descriptive definition of employment as adults 18 years or over who are working 30 hours a week or more and are earning a good paycheck. According to Gallup, only 44% of adults 18 plus in America are defined as 30 hours or plus with a good paycheck.[8] Again, not a good job situation in America, from our perspective.

We don't mean to be overly pessimistic in this newsletter. We just want to try and be realistic because we think it's important to try and structure an investment plan around a realistic picture of our best estimate of what's really going on. Because we take a proactive approach to investing we think it makes sense to sometimes look at numbers like the current unemployment report with a dose of skepticism. One of the mistakes we think investors can make is to get lulled into thinking everything is fine when things might not be fine.

While the U.S. economy still remains the best house in a bad neighborhood as far as economies go, we also think it's important to balance out one's investment perspective that while the U.S. may be the best place to invest currently in light of international concerns, that could always change at some point and it will be important for investors to remain flexible.

A financial suggestion for the summer

Summer is usually a time for family. One financial thing you could do this summer in regards to your family is review the beneficiaries on your accounts. While your summer may be full with travel and vacation plans, reviewing your beneficiaries is something that usually doesn't take a lot of time. So take some time and check and see who the beneficiaries are on your retirement accounts, life insurance policies or annuities. Your personal situation might have changed and it's possible there are changes you would make if you reviewed your beneficiaries. For example, maybe you have your old college girlfriend or boyfriend listed as a beneficiary on your retirement account because you couldn't think of anyone else to name when you first went to work all those years ago. If something tragic were to happen to you while your old college boyfriend or girlfriend is named as a beneficiary to your accounts, that's probably not the way you'd like to be remembered by your family.

For the accounts held with us, we'd be glad to go over beneficiaries with you anytime. Please don't hesitate to call and set up a time to review your beneficiaries either by phone or in person. Having the proper beneficiary designation on your accounts could make quite a difference for your loved ones someday. We also suggest you run your beneficiary choices by your tax and legal professional as there could be important tax, legal or estate planning issues to consider.

Updates around the office

We are all settled in our new location (upstairs, same building). If you haven't had a chance to come by and see our new offices in suite 205, please do.

Jon Teran just completed his term as the Covina Rotary president and is now looking for something to do with his free time (just kidding, he's still very involved in Rotary and the community).

Casey Morris is currently the chapter president for the Team Referral Network in West Covina. Team is a business networking group of professionals from various businesses and lines of work. Don't hesitate to get in touch with Casey if you are looking for a referral to a local business professional.

Have a great summer and we look forward to our next meeting or conversation with you.

Sincerely,

The Team at Capstone Pacific

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1 "Puerto Rico facing historic default on its $72 billion debt," Alan Gomez, *USA Today*, June 29, 2015.
2 "China stocks freefall into a bear market," *CNN Money*, June 29, 2015.
3 "Dow Tumbles 350 Points as Greek Crisis Worsens," Corrie Driebusch, *The Wall Street Journal*, June 29, 2015.
4 "7 things investors need to know about the Greek crisis," *CNBC* , Tim Mullaney, June 29, 2015.
5 "Passive Investing", *Investopedia*.
6 "Keep Up the Pace?" Harry Dent, *Economy and Markets*, June 16, 2015. The unemployment numbers from this section of the newsletter are taken from Dent's article.
7 "How the Government Measures Unemployment," Bureau of Labor Statistics, www.bls.gov.
8 "The Big Lie: 5.6% Unemployment", Jim Clifton, Gallup Inc. February 3, 2015.