

Uncommon INSIGHT

SYM FINANCIAL ADVISORS NEWSLETTER

SPRING
2016

SPRING 2016

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SYM

Financial Advisors

Uncommon relationships. Uncommon results.



Smart Beta, Allocation, and Patience

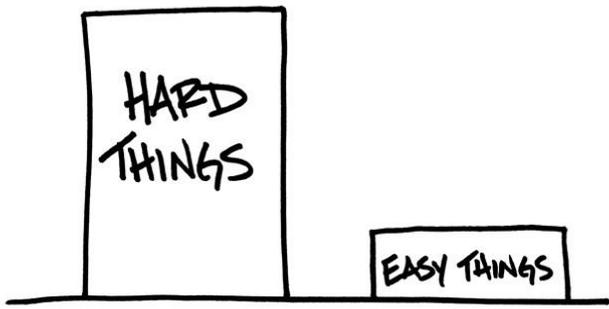
For decades, stock investors have found themselves falling into one of two broad and very different schools of thought. First, low-cost capitalization-weighted index funds attracted those who believed markets fully, correctly, and immediately incorporate all information into prices (thus eliminating outperformance opportunities for even the savviest investment team), and also attracted those who doubted their ability to select skillful managers who may well exist. Those who believed they could identify managers capable of doing better than average over 50 percent of the time were more inclined to opt for active management. Professors and investing legends have published countless journal articles, books, and industry white papers on the debate, almost always concluding that only fools wander to the other side of the tracks from their body of work. For every white paper showing the devastation of paying an extra “x%” of expense ratio for a long investment career under active management, a rebuttal is published describing the staggering consequences of missing out of “y%” of an active strategy’s reasonably-expected outperformance.

Both approaches have their critics. Capitalization-weighted equity index funds automatically increase their exposure to stocks whose prices appreciate and reduce their exposure to stocks whose prices fall. As a result, they overweight the largest companies and underweight smaller ones. For instance, in the S&P 500, a capitalization weighted index of 500 U.S. companies, one company, Apple, is 3.3% of the index. The smallest company at .0007% is Californian Resources. In case you’re wondering, this company is an oil and gas exploration company focused on projects in California. Technology grew to a heavy weight in the S&P 500 approaching the dot-com slide, and Financials were a heavy cap-weighted allocation heading into the mortgage crisis.

Active management is less transparent, typically comes with higher fees, and its differences from the benchmark will inevitably cause even the best managers to lag the index in certain shorter time horizons (and investor psychology makes an unplanned switch likely at the worst time of any active strategy). Yet some managers do consistently outperform the popular benchmarks over long horizons, they tend to have some identifiable traits in common to aid those searching for them,

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RELATIVE VALUE



and some investors consistently stay the course during the rocky periods.

A third choice builds a passive portfolio (in the sense that it diversifies across many stocks, charges lower expenses than active management, and doesn't rely on single-stock outlooks or "picks") by forming constituent stock weights based on non-capitalization factors such as earnings or company size. While these strategies have existed for several decades, spawned in large part by a body of scholarly work published in the early 1980's and 1990's, their popularity has recently soared: "smart beta" was Investopedia's most-searched term of 2015. While each practitioner has a different flavor, the strategies seek the best of both worlds: lower expenses, but with the opportunity to outperform the index by "overweighting" stocks that scholarly research suggests possess higher expected returns. Typically, the smart beta method tips the portfolio to investments in less expensive stocks from a fundamental perspective and smaller companies that can experience higher appreciation, and many rely on other factors as well. While smart beta pursues the best of both active and passive management, it also shares some of each philosophy's difficult points; for example, consider a case where small inexpensive stocks come from a few sectors that investors particularly shun (which are overweighted in the portfolio due to their inexpensive valuations). Without human portfolio manager intervention, this resembles an index's struggle. If the strategy lags the benchmark for an intermediate horizon and investor psychology pressures a sale prior to the eventual rally, it reminds us of an active management struggle.

The SYM equity portfolio relies on two factor-based passive "smart beta" managers: DFA and AQR. DFA is an industry icon, with several affiliated Nobel Prize winners, including Eugene Fama, involved with ongoing design and implementation efforts. AQR is run by Professor Fama's former Ph.D. student Cliff Asness (who employs his own army of Ph.D's and CFA's), whose methods differ from DFA's in the treatment of stocks with lower expected returns and higher confidence in the "momentum effect." While the managers have their differences (good for us from a diversification standpoint), they both prioritize research from the top journals which has been validated out-of-sample geographically and after each study's original publication. Many other managers set a lower bar as to the factors they are willing to incorporate, which increases the chance the portfolio falls victim of the original dataset's nuance as the future unfolds.

At SYM we have long defined our allocation process as tactical, with a top down approach to best allocate among these approaches (in concert with the geographic and

other considerations we write of more often). We believe there is merit in using multiple strategies to limit the tracking error to the benchmark, and this practice has particularly paid off over the past two years' rare experience, wherein large-cap expensive U.S. "growth" stocks outperformed essentially every category (including those with the highest long-term expected returns). By seeking a little bit of outperformance from a variety of sources, we avoid the blow-ups that an "all-in" strategy inevitably encounters every few years.

With that said, it's not lost on us that the corners of the portfolio having the roughest quarter will always jump out. That's normal, and that is when keeping the long view pays the most. For context, consider inexpensive value stocks, with value being a key factor employed by AQR and DFA. In the United States, value has outperformed growth by an average of 4.81% per year since 1928: a huge difference for a long horizon. Questioning whether some of the data baked into this average are too old to be persuasive and whether they should influence our current expectations, we observe value beating growth in 88 percent of the 937 rolling 10-year periods ending in 2015, and in 97 percent of the 15-year periods. It's rare when value doesn't win over a full equity investing horizon, and value investing tilts the probabilities strongly in your favor. While this adds to our confidence that "getting more company for the money" via value investing creates a dependable source of expected return on a forward looking basis, we know full well that value stocks won't outperform growth stocks every minute, hour, day, week, month, quarter, or even year. In fact, despite its incredible long-term statistics, value has only outperformed growth in 61% of one-year periods! Like equity investing itself, smart beta investing must be a long-term effort to realistically expect to reap what the markets provide. The same is true for DFA and AQR's other factors, both in the United States and abroad.

Turning to our geographic allocation work, today we have a global market that has mostly stalled the last two years. Based on past performance we know the S&P 500 has held up, while small stocks, value stocks, developed market international stocks, and emerging market stocks have lagged. Essentially, this is a period when both smart beta and geographic diversification have detracted from returns instead of enhancing them. However, as discussed above, that will sometimes be the case in a healthy market.

By extending the horizon thinking to the geographic questions we ask, we can learn a few other things from the past. We all remember the lost decade of 2000-2009 where the S&P 500 was basically flat after ten years of drama. In that same period emerging markets were up 200 plus percent. Today, the S&P 500 shines and emerging markets are in trouble and being avoided. In the late 1980's, the shoe was also on the opposite foot, with the Japanese stock market leading the EAFE to eclipse the S&P 500, however shirking diversification to dive in to Japanese stocks as a result would have been heartbreaking. While we don't know whether it will be negative factors like a market-unfriendly United States election outcome or a Chinese "soft landing" that will eventually spur a new global returns leader, we do know that being undiversified is not a risk that boosts expected returns.

Your SYM advisor can discuss these hard and easy choices in more detail as it applies to your individual situation.

2016 Bond Market

Do Not Be So Negative

Presently, more than seven trillion dollars of government bonds outside of the United States have yields below zero percent. Because this concept - investing in a promise to receive a smaller amount at a later date - is so unusual, we wanted to be sure to address the underlying rationale and how this part of the market influences our investment view. Rather than discussing whether or not negative-yielding bonds are attractive (which would be a quick conversation), we focus on negative rates' less-obvious implications to the overall economic and financial landscape.

For many years now, the interest rate discussion has focused on historic low rates and when we could expect a change. At the time of our last newsletter, the Central Bank of the United States had just raised rates by one-quarter of one percent and we were watching a trend of divergence in global central bank policies.

Just three months later, these foreign stimulus efforts have moved to the forefront. Within the European Union, several countries have cut key interest rates to an extent that the return is negative. The European Central Bank cut rates on March 10th, moving to a negative 0.4 annualized percent to hold cash overnight. Japan also caught economists by surprise by adopting negative interest rates in January of this year.

Outside of the United States, many regions' economic realities are quite different with respect to interest rates and economic growth. When faced with negative bond interest rates, the natural question is "why wouldn't low-risk investors just hold the funds in literal cash?" Believe it or not, some countries actually do pay negative interest rates on bank deposits as an added pressure to pull money out and inject it into the economy. Literally, depositors are charged to keep their money in a bank account. While "cash under the mattress" might appear to be a rational response on the surface, physical security can make the storage fee relevant in the face of a fire, flood, burglar, or other unsavory self-storage threat wiping out a saver's nest egg.

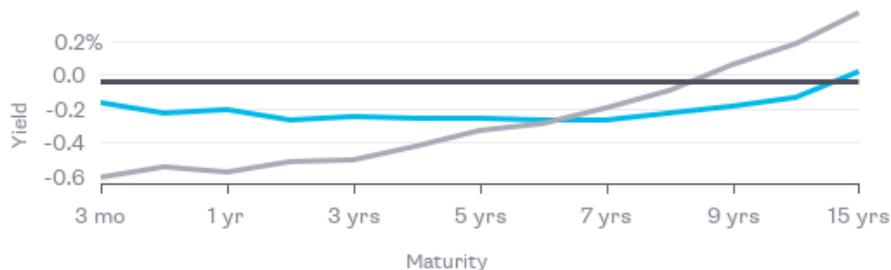
To some extent, the adoption or consideration of a negative interest rate policy is an act of desperation, a reflection that traditional central bank policies have not worked well enough and that potential spenders won't act without the central bank lighting a fire beneath them. But as unorthodox as the strategy is, it's also important to understand its value.

Negative interest rates aim to accomplish a few things for the economy's benefit. The first is to lower the cost of borrowing for both consumers and corporations, because banks effectively borrow money from the central banks at no cost to them. Thus, a business expansion with a barely-positive expected return becomes newly-worth financing when the capital cost drops to a lower percent. Widespread profitable business expansions tend to "float all boats." Perhaps the clearest example of this effort is the European Central Bank's offering a premium to banks that borrow in order to encourage them to extend more loans. Additionally, negative rates encourage citizens and foreigners alike to move their money elsewhere, with a side effect of devaluing a country's currency. Devaluing a country's currency should make exports cheaper and imports more expensive to the benefit of your own nation's manufacturers. Also, a devalued currency should

Paying to Save

Investors in shorter-term Japanese and German government bonds receive a negative yield

■ Japan ■ Germany ■ Zero Boundary



As of March 18, 2016

Source: Bloomberg

Announcing

New Chief
Compliance Officer



SYM is proud to announce the promotion of Crystal Creekmore to the role of Chief Compliance Officer. She will continue to maintain her current role as Vice President of Operations.

Crystal joined SYM in 2000 and works out of our corporate office in Winona Lake, Indiana.

Congratulations Crystal!

encourage domestic consumer spending and boost lending by financial institutions. Ideally, converting cash hoarders into market bidders helps stave off the threat of deflation by stimulating investment and consumption.

Some of our concerns about negative interest rate policies have to do with a perceived punishment to banks for keeping cash and not making loans. One possible harmful outcome for a negative rate policy would be the possibility of banks entering into unusually-risky revenue-making strategies. SYM believes in economic policies that reward a desired behavior. An effective fiscal strategy should not defeat the desire of banks to make profits, potentially leading them to take inadvisable risks in search of those profits. However, if the policy of negative interest rates ultimately does work, then central banks will gain additional tools to support global economies. As is so often the case in economics, moderate efficacy is likely what's best for the global economy.

Another key consideration is the economic term referred to as the liquidity trap. The liquidity trap exists when interest rates are low or in some cases negative, and high savings rates make monetary policy ineffective. In a liquidity trap, an ongoing belief that interest rates will soon rise drives consumers to avoid bonds and other short-term investments and instead keep their funds in savings. Because bonds have an inverse relationship to interest rates, many consumers do not want to hold an asset with a price that is expected to decline in the near term. This brings to the forefront the question of whether citizens will simply put up with the costly bank savings discussed above to avoid their governments' bonds' unsavory risk/reward profile. Whoever first said, "Man plans, and God laughs" could have used this example as a solid illustration of his or her point. While we only have a few months to assess real-world outcomes, markets and economies have not reacted in extreme ways to the policy announcements - answering investors' first obvious question.

The other important question on the mind of analysts and investors asks whether the United States will eventually join the club and consider a negative interest rate policy. Last November Janet Yellen, the U.S. Federal Reserve chair, confirmed negative rates were "on the table" if the United States economy would benefit from such measures. Because our domestic economy appears to still be growing, the discussion around Fed policy is about additional rate *hikes* this year and not negative rates. It is with this understanding that SYM continues to hold a bond portfolio that mitigates much of this inverse relationship risk by keeping duration reasonably low and income beyond our benchmark.

As always, SYM's investment committee continues to monitor the global changes most important to your investment mix, and we are available at any time for discussion or consultation on your portfolio.

SEC Filing Offer

Annually we offer to you the opportunity to receive a copy of our Registered Investment Advisor filing with the Securities and Exchange Commission. If you're interested in a copy of this public document please e-mail Terri Savill at tsavill@sym.com and request a copy to be sent to you.



Community Involvement

The annual Tracey Yeager Memorial 5K is approaching on Memorial Day, May 30th! We look forward to seeing participants and sponsors again this year, new and old! This year we welcome the partnership of Warsaw's Fellowship Missions, who will be hosting a shoe and sock drive, "Soles for Souls," during the event. Please consider donating new socks and new or gently used shoes (athletic or other, size infant to adult) for the homeless. Items may be dropped off in Winona Lake Park on Memorial Day, or at any time to any SYM office in Michigan or Indiana.

Learn more about Fellowship Mission's service to the homeless at www.fellowshipmissions.net.

Ready to register for the race? Visit TYM5K's registration site at www.TYM5K.com.

THE SYM DIFFERENCE

If you have any questions about your portfolio, please don't hesitate to contact your advisor or team.

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