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THE SEIA REPORT

Successful wealth management is the result of an ongoing collaboration between investor and advisor, built upon trust and maintained according to the highest standards of integrity and expertise.

WHY THE TRADITIONAL ASSET ALLOCATION PLAYBOOK MAY BE OBSOLETE: THE X'S AND O'S OF ALTERNATIVES

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Asset allocation "strategies" have traditionally been limited to determining what percentage of a portfolio should be invested in stocks vs. bonds. Bond yields around the globe are at historical lows. Rates are eventually heading higher, which will lead to interest rate risk for bond holders' principal. Domestic equities are arguably in the later innings of an all already above average bull market in terms of length and returns. So it is therefore safe to say that "traditional" asset allocation is not what it once was. Consequently, high net worth investors are increasingly turning towards **Alternative Investments** ("alts") as a part of their overall long term game plan. With this in mind, let's break down the game film on alternative investments:

- One-third of high net worth investors are investing in alternatives and nearly two-thirds consider it a way to protect principal. They are mostly accessing alternatives through traditional, liquid and transparent means by investing in managed accounts, structured notes and products, ETF's, MLP's and mutual funds[1].

- While individual investors are relatively new to alternatives as part of their portfolio, large university endowments have utilized these investments for quite some time. In fact over 50% of large university endowments are invested in alternatives[2].

- Alternative investments are typically categorized in five ways: hedge funds, private equity, real estate, commodities and real estate[3]. It is helpful to scrutinize these five categories among numerous others and determine whether they are **Alternative Strategies** or **Alternative Assets.**

Alternative Strategies

Alternative Strategies are typically event driven, relative value, global macro, or hedged funds in nature. An event driven strategy might include a fund that invests into distressed assets. A relative value strategy would be a market neutral or long short fund. Here managers commonly work with a goal in mind of buying call options to capture some upside while buying put options and derivatives to hedge the downside. A global macro strategy includes managed futures funds. These typically mean investing with a professional money manager, or a commodity trading advisor (CTA). These managers generally invest in commodity, currency or equity index futures. Equity alternatives are generally either Venture Capital or Private Placements. These distant cousins to mutual funds are typically illiquid and offer considerable risk and return.

Two of the more popular forms of alternative strategies are hedged and traditional balanced funds. Hedged funds might be hybrid securities that include structured notes or products. They are typically either a basket of

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Globalization vs. the U.S. Business Cycle: The Effects on U.S. Interest Rates

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This summer marks the 100-year anniversary of the onset of World War I (WWI), which may have also marked the birth of globalization. This World War ensnarled over 70 million military personnel and was one of the deadliest conflicts in history costing over 16 million lives from over 25 different countries. From a financial standpoint, there is little doubt that the tragic events ushered in a new era of globalization. That summer, not only did every major European stock exchange close, but even the New York Stock Exchange (NYSE) closed between July 30th and December 12th of that year marking the first time that all the world's major stock markets closed simultaneously. Why mention WWI in a financial newsletter? Simple, it is yet another reminder of how events 6,000 miles away can trump our domestic economy and directly affect investment positioning here in the homeland.

Globalization

Case in point, many investors believed that U.S. interest rates, which started the year at 3.02%, would move north this year and approach 3.50%. But in fact, the opposite has occurred and rates now sit at 2.50% as of August 4th. What happened? This year, Europe joined Japan with another aggressive attempt at further easing of monetary policy, which pushed interest rates lower across the Atlantic. German government bonds (Bunds) are now at an historic low yield of just over 1.15%. Even in troubled Spain, corresponding bond yields have moved below 2.30% to reach their lowest yield dating back 125 years *before* WWI to 1789! Although low, European yields are not the lowest in the developed world. Across the Pacific, Japanese government bonds (JGBs) have an astonishingly low yield of 0.50%. In an era of globalization and rapid money movement, it is hard to argue that current U.S. yields of 2.50% are unattractive compared to corresponding bonds overseas. The 135 basis point (bps) spread between Treasuries and Bunds is rapidly approaching record levels. In fact, the last two times the spread was this wide it soon reversed course leading to one of two results, higher Bund yields or lower Treasury yields. But which outcome is most likely? Let's analyze each case.

Seven years after the onset of the crisis, Europe is still struggling for growth. A weak economy and negligible inflation will force the European Central Bank (ECB) to maintain their accommodative stance at the very least. Recent deflationary fears could even cause the ECB to provide additional stimulus. The outlook for easy (and easier) monetary policy doesn't usually equate to higher interest rates. Therefore, higher Bund yields don't appear likely. It can be argued that two of the world's economic juggernauts (U.S. and Germany) should have similar yields, thus the relative trade and the current 135 bps spread should narrow with U.S. Treasury yields falling.

Also it is logical that in terms of safety, the yield on Spanish debt (troubled economy, high unemployment) should not be on par with that of the U.S. (improving economy, declining unemployment, reserve currency of the world, etc.). Thus, according to Guggenheim Partners, these two relative value trades argue for increased demand for U.S. Treasuries from international buyers. Meanwhile, the U.S. Treasuries supply is down as the deficit has shrunk considerably from -10% to -3% of GDP in just the last four years. A lower deficit equates to less borrowing need, thus less Treasury bond supply outstanding. The end result is increased foreign demand in the face of shrinking domestic supply. Econ 101 taught us that Demand > Supply equates to higher Prices ($D > S = \uparrow P$). In bonds, higher prices equates to lower yields, thus European investors 6,000 miles away could cause Treasury yields to move even lower.

U.S. Business Cycle: Job Market

The Fed does not want to make the same mistake they did in the Great Depression which is to tighten monetary policy (i.e. raise rates) prematurely and impede any economic recovery. One of the Fed's mandates is the goal of full employment, so the job market is central to any policy. The good news is that the July employment report marks the sixth consecutive month of nonfarm payroll growth over 200,000—a feat last accomplished in 1997. Over the last six months, 1.47 million jobs were added which is more than any other six-month period since 2006. Traditionally, six consecutive months of strong growth would be enough to signal an all-clear on the health of the economy, as traditionally such job creation would suggest underlying growth in wages. However, this time the Fed believes that there is hidden slack in the labor market and must rely on nontraditional indicators to glean a better sense of the true health of the U.S. labor market—and it's not all good news.

Recently, the Fed focused on other more

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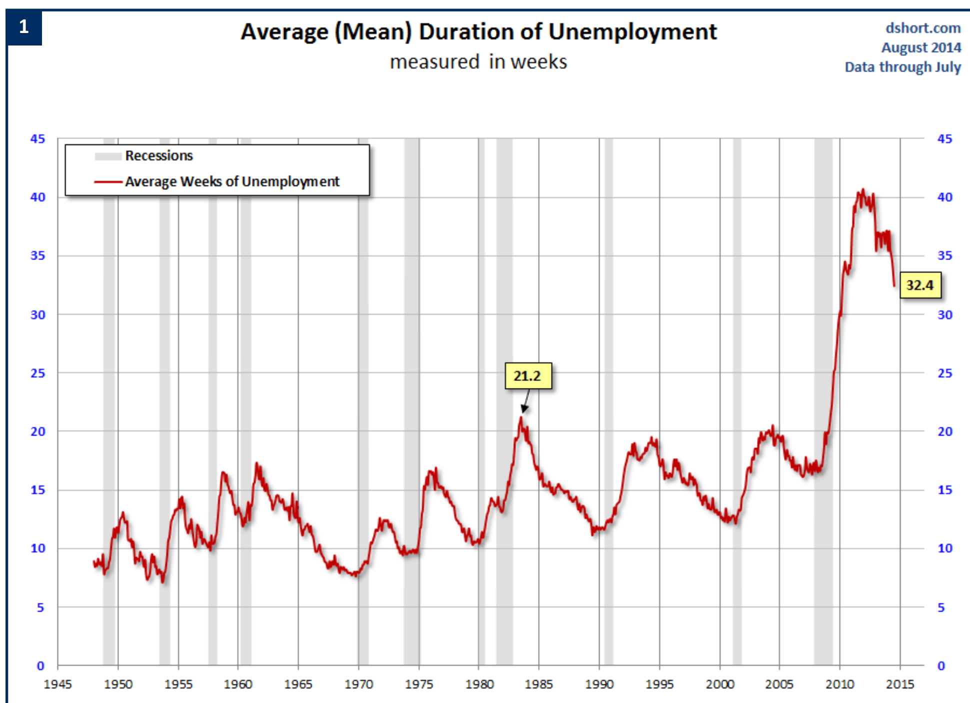
qualitative factors that they feel can better measure any slack in the labor market. Rather than the headline unemployment number (6.2% as of July), a mélange of other factors are used including not only analyzing those out of work (the duration of unemployment) but also those that do have work (the quality of jobs and whether any job gains are translating into wage pressures).

The duration of unemployment in essence measures how quick and/or easy it is to land a new job. As the chart illustrates *(Reference Chart 1)*, the duration of unemployment remains relatively high at 32.4 weeks. Although the number is less than the 2011 all-time string of highs above 40 weeks, it is still far higher than any previous recession peak—suggesting that the labor market is worse now than the depth of any previous recession since the Great Depression. This is not a sign of a healthy economy, thus rates could stay low or move lower.



According to Barron's, the June employment report detailed a 288,000 increase in jobs, but further analysis shows that 500,000 full time jobs were lost while 800,000 part-time jobs were gained.. Thus the entire monthly increase was driven by part-time labor—again not another sign of a rip roaring economy. In addition, wages grew at a meager 2% annual rate enough to barely cover inflation.

In short, according to these figures; 1) it is hard for some to find work, 2) those that do find work may be forced to work part-time, and 3) employee real wages are stagnant. As such, the economy is nowhere close to overheating and the Fed will be comfortably on the sidelines until job creation reflects full-time employment gains which translate into wage pressures.

But there are two sides to every coin. We just postulated how the job market is weak and will cause rates to stay low but that very argument, the amount of slack in the US economy, is a source of some very significant debate right now. While long-term (duration) unemployment is still elevated, the short-term unemployment rate is now below its long-term average. In other words, those who recently had a job are finding work quickly while those unemployed for a longer period of time are struggling. If those long-term unemployed are now so detached from the economy that they might never find work, then the available pool of talent just became a whole lot smaller. If demand outstrips a new smaller supply pool (D > S), then employers may be forced to pay up (↑P) to attract talent, thus creating wage gains (and possible inflation) forcing the Fed to raise rates. Investors are just now witnessing the first hints of increased compensation as Q2's Employment Cost Index gain was the largest increase since the onset of the crisis.

U.S. Business Cycle: U.S. Inflation

Unlike other global central banks, the Fed has a dual mandate to seek full employment with stable prices (inflation). Thus, investors must acknowledge that the interest rates are subject to both. Inflation has been a non-factor in this recovery with the Consumer Price Index (CPI) recently reaching a low 1.57% in February. But in the last six months, the CPI has moved up over 1.90%. At this point it is too early to conclude that the trend of higher inflation is here to stay as other measures show a still benign environment, but it bears mentioning as we are just now reaching the Fed's 2% inflation target.

U.S. Business Cycle: The Fed

To put our current environment in a historical context, consider recent thoughts from Liz Ann Sonders of Charles Schwab, "The Fed's suggested natural rate of unemployment is 5.4% (vs. 6.2% currently). The Fed's target inflation rate is 2% (we are at 1.8% presently, based on the Fed's preferred measure, the PCE). We are getting close to both. When we were at similar [position] in 1994, the Fed had been tightening for six months already; and in 2004 they had been tightening for a year already." According to recent cycles, the symmetry of 1994 and 2004 should have extended to 2014 but in reality, this year has brought about only the reduction/removal of Quantitative Easing (QE) and 2015 should mark the first rate increase according to recent Fed projections.

But to be blunt, the Fed is a horrible predictor. According to Goldman Sachs, the Fed historically has tended to not only underestimate the pace of rate hikes but also the extent of each rate hike. Using the last three cycles as a guide, if either growth or inflation starts to pick up the market will start to price in the possibility that the Fed behaves in the way that they have historically—raising rates farther and faster than current guidance suggests *(Reference Chart 2)*.

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	Fed Rate Hike Projection	Actual Rate Hikes
1994	150 bps over nearly two years	300 bps in less than a year
1999	150 bps over 2.5-year period	175 bps in less than a year
2004	325 bps over 3-year period	425 bps over 2-year period
2015*	350 bps over 4-year period	?

Source: Goldman Sachs Global Economics, Commodities and Strategy (ECS) Research, as of April 2014. 2015 is an estimate based on the path implied by the Fed's Summary of Economic Projections and mid-2019 as the likely timeframe for rates to return to the Fed's projection for rates over the longer term, consistent with Fed communications that the funds rate is likely to rise gradually over 2-3 years after 2016.

Conclusion

So what are bond investors to do? As always, in building investment portfolios it is critical to own a basket of diversifying assets then evaluate the probabilities of outcomes against all known risks and finally

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THE X'S AND O'S OF ALTERNATIVES

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securities, a stock or a bond, plus a derivative. Features of some structured notes are bonds with principal protection (if held to maturity), with upside potential tied to different derivatives or options of market indexes.

Alternative Assets

Alternative assets on the other hand are typically easier to understand. They fall under categories such as infrastructure, real estate, equity or commodities. The most popular infrastructure investments of the past couple of years, demonstrating strong historical returns*, are MLP's or master limited partnerships. MLP's combine the benefits of limited partnerships and the liquidity of publicly traded securities. They provide high tax advantaged yields, mostly pertaining to the use of natural resources, including petroleum and natural gas, transportation and extraction. Think of them as "toll roads" for the transportation of energy. This would include oil and natural gas pipelines.

REIT'S or (Real Estate Investment Trusts) are among the most popular alternative real estate investments. These can be either public or privately traded and allow investors to participate in commercial real estate income without the burden of property management. REIT's must pay out about 90% of their income and are treated as ordinary income. Commodity alternatives generally consist of energy, agriculture, base and precious metals. The most popular and transparent way to invest in commodities are through the numerous ETF's (Exchange Traded Funds) in the marketplace. These investments are liquid, simple, transferable, transparent and cost efficient.

In Conclusion

Alternative investments offer many different types of risk and return, correlation, and liquidity profiles. There are tremendous differences among alternatives. Therefore, seeking an investment advisor experienced with the various complexities inherent within them is essential in order to determine the right mix to meet the unique needs of each investor. These investments are not only here to stay, but deserve their rightful place as an ever increasing percentage of high net worth investors' portfolios. Their complimentary nature to traditional stocks and bonds, together with their individual merits and structure, are helping high net worth investors potentially boost their risk adjusted performance, dampen volatility and better meet their unique goals and needs. So as you prepare your long term investment game plan with your financial advisor review your financial playbook carefully. If your asset allocation approach does not include alts, it might be time to review the game film, lest your portfolio lose its competitive edge.

1 - Mainstay Investments HNW Study 11/11/2013
2 - Common fund.org Alternatives reality 1/2014
3 - Blackrock Investment Insights 9/2012
**http://www.nepc.com/writable/research_articles/file/2012_09_nepc_investing_in_mlps_-_risks_and_opportunities.pdf*

A Perfect Storm

Could water and infrastructure be the next wave of investing?

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Senior Partner, CFO

As I sat down to write this article, I clicked on the evening news in the background. The lead story was an investigation into the recent massive water-main break on Sunset Boulevard near the UCLA campus that spilled more than 20 million gallons. This was quickly followed by an update on the ongoing statewide drought, a report on new wildfire outbreaks, and a feature on climate change. In essence, the broadcast encapsulated and coalesced all the ideas swirling in my head.

It's the essence of human existence – our most precious commodity. Yet from an investment perspective, rarely do we ever think about water. Ask the average investor, or even most investment professionals, to name traded commodities and they'll list oil and gas, gold and other precious metals. They might even mention pork bellies. But I'd hazard a guess that you'll never hear the word **water.**

The H_2Opportunity

Those of us in developed nations have been conditioned to think of water as a limitless resource. Our state's ongoing drought concerns, however, should serve as an ever-present, close-to-home reminder of just how vital a commodity water is. And although we're cognizant that a large part of the third-world doesn't have efficient access to clean water, we tend to overlook the fact that accomplishing that goal will represent a massive economic undertaking.

By 2030, at current rates of growth, demand for water will likely exceed supplies by 40% and it's estimated that around 47% of the world's population will be living in areas deemed to be under "high water stress." The United Nations estimates that total annual spending on water infrastructure by developing countries will need to more than double, from a current $75 billion to $180 billion by 2030.[1] We've even seen the advent of an international *Global Water Investment Summit.*

Clearly, there is significant growth potential in this often overlooked sector, and ways to invest to become part of the solution. A number of mutual funds and ETFs seek to focus their investments on the water industry, tracking indexes such as the S&P Global Water Index. But it's not just the third-world where water investment opportunities exist.

Our aging infrastructure

The pipe that burst on Sunset was 90 years old. It was an accident waiting to happen. The aging of much of our nation's infrastructure including pipelines, roads and bridges has been and continues to be a serious concern. Just in water infrastructure alone, the American Water Works Association estimates that the U.S. will need to invest nearly $1 trillion over the next 25 years to replace aging or faulty pipes.[2] On a global perspective, water infrastructure spending needs may approach $11.7 trillion between 2013 and 2030, according to Janney Montgomery Scott.[3] As is the case with water, there are ways to invest in water infrastructure – both domestically and internationally. In addition to stocks, mutual funds and ETFs, municipal bonds have the potential to deliver reasonable returns and tax advantages, while affording you the opportunity to invest back into our community.

While no one knows precisely what the future holds for any economies, markets or investments, it's hard to imagine the significance of water diminishing. It truly is THE most essential commodity on the planet. Take a few minutes to talk to your financial advisor about water investment opportunities. It may be a unique chance to *do well while doing good.*

1 - Source: World Bank sponsored 2030 Water Resources Group report.
2 - American Water Works Association, "Buried No Longer: Confronting America's Water Infrastructure Challenge," February 2012
3 - The Economist, "Infrastructure Financing: A Long & Winding Road," March 22, 2014

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SEIA in the News:
Signature Estate and Investment Advisors Continues Rapid Growth; Now At $4 Billion In Managed Assets

- **Named to the inaugural 2014 Financial Times 300 Top Registered Investment Advisers List**
- **Named to the 2014 Forbes Top 50 Wealth Managers in the U.S.**
- **Included on 2014 Los Angeles Business Journal list of top money management firms**
- **Firm credits strength of advisor-client partnership model for its success**

Signature Estate and Investment Advisors, LLC (SEIA), a full service wealth management firm headquartered in Southern California, has surpassed $4 Billion AUM* and is growing at a rapid pace, with a completely organic approach that exemplifies the power of independent financial advice. The firm has created an advisor-client-community service ecosystem second to none, that fuels growth by optimizing the way clients receive financial advice.

"Our clients are not just the cornerstone of our success, they are quite literally the measure of it" says Brian Holmes, CEO. "By tying our growth as a firm directly to the growth and development of their financial futures, our interests are aligned – that is powerful."

SEIA's approach has recently won acknowledgment from some of the world's, nation's and region's top publications. The Financial Times published its first ever list of top independent advisors, including SEIA. Forbes magazine ranks SEIA as a Top 50 Wealth Manager 2014. And the Los Angeles Business Journal has consistently put SEIA among its top ranked money management firms.

SEIA believes that its growth validates its approach, and is investing heavily in internal infrastructure for advisors, so that they can continue to work with clients in the most meaningful and powerful ways possible. The firm invests in advisor training, having created an associate advisor structure to groom the advisors of the future. Amongst the 18 independent advisors and 47 support staff, the commitment to ongoing education is best illustrated by the number of CFP® and CFA® designated professionals at the firm. The bi-coastal company is also heavily involved in the Southern California and Mid-Atlantic communities, sponsoring events and donating to charitable causes.

Holmes concludes, "We believe that the concept of investing has many facets – we invest for clients, we invest in our community and we invest in our advisors. All are linked and all contribute equally to our success."

**$4.2B AUM is total AUM of SEIA and its affiliates as of 6/30/2014.*

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adjust weightings accordingly.

In the short-term, it may not be wise to reposition an entire portfolio to guard against an immediate rise in rates. The effects of globalization (not to mention the potential for greater conflict in Eastern Europe) and worldwide capital flows could trump improving domestic economic data, thus keeping rates low for the time being. Besides, being too defensive in short-term bonds (< 3 years) provides little reward in a Zero-Interest Rate Policy (ZIRP) environment.

Ultimately, we believe that an improving economy and the U.S. business cycle will prevail and interest rates should move higher over the next 1-3 years. Therefore, we would avoid a fixed income portfolio entirely consisting of longer-dated (> 15 years) high quality bonds subject to interest rate risk which would result in lower prices in the face of rising rates.

As a result, we believe bond ladders should neither be too short nor too long. Instead, extend maturities out 5-7 years in order to offer attractive real yields, locked in higher yields and price appreciation if rates should fall near term, all while offering defense in a rising rate environment 1-3 years out as the bond ladder would then consist of 3-5 year bonds as the maturities would naturally become shorter as time progresses. Then potentially, the bonds would mature at the top of the rising rate cycle allowing investors to lock in higher yields for the next leg of the cycle.

SIGNATURE FUND *for* GIVING

By Marshall Smith
Operations & Project Manager

The SEIA Signature Fund for Giving was created in 2011 to support local youth in Southern California. Through partnerships with A Place Called Home, Toberman Neighborhood Center, and Children's Hospital of Orange County, we have raised over $150,000 for both local and national nonprofits since the fund's inception. Every quarter in "The SEIA Report," we feature one of the nonprofit organizations that the Signature Fund for Giving supports. We are proud to highlight the tremendous impact these organizations have on the lives of those they serve.

A Place Called Home

A Place Called Home (APCH) is a safe haven in South Central Los Angeles where underserved youth are empowered to take ownership of the quality and direction of their lives through programs in education, arts and well-being. These programs inspire the youth to go on and make a meaningful difference in their communities and the world. Core programs work in conjunction with one another to support APCH members in avoiding destructive behaviors by developing life skills and providing motivation to overcome adversity, make healthy, productive choices and take advantage of the opportunities which lie before them.

"I can't say enough how much we appreciate the partnership and the investment SEIA has been making since 2011. There is a direct, positive impact in the lives of the hundreds of youth and families APCH serves every day, and the message to peers in the business community is clear: you can make a difference," said Jonathan Zeichner, executive director of A Place Called Home.

For more information on how you can get involved with A Place Called Home, please visit www.apch.org. For questions regarding our Signature Fund for Giving please contact Marshall Smith at 310-712-2323 or msmith@seia.com. Thank you all for your continued support—we could not achieve such growth and make this impact without you.