TILIA NEWS

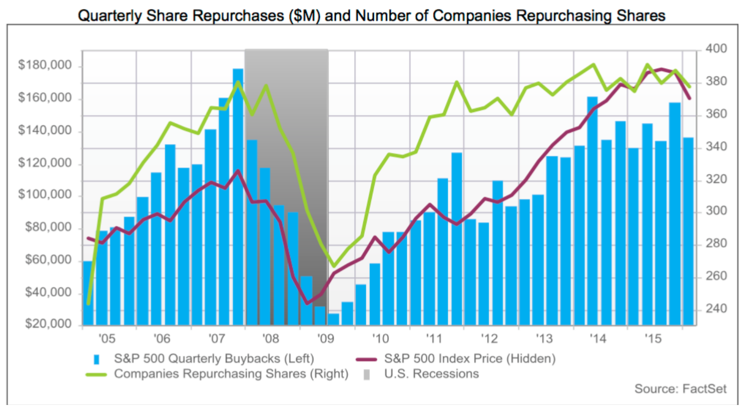
INVESTMENT MANAGEMENT | FIDUCIARY ADVICE | RETIREMENT PLANNING

The Meaning of "Tilia"

Rarely does a week go by where one of us is not asked "Where did the name come from?" or "What is Tilia?" Tilia is a genus of trees that are native to the Northern Hemisphere. Commonly referred to as Lime trees, Tilia trees flower and bear pea-sized fruit. Ranging from 70 - 130 feet tall at maturity, they are known for their sturdiness, dense foliage, broad canopies and extreme longevity.

For us, the Tilia tree represents strength, longevity & protectiveness. When choosing a name for our firm, we wanted something that was approachable, that didn't bear the last names of the founders, and wasn't geographically limiting. It was just as important for the name to describe what we actually do, which is why we included "Fiduciary" in the name. "Partners" was the finishing touch, because we feel it accurately describes our working relationship with clients, and employees of the firm.

June 1st of this year will mark the 5th anniversary of the founding of Tilia Fiduciary Partners. We are extremely grateful for the trust and loyalty of our clients & professional partners!



The American Buyback Machine

One relentless trend over the last few years has been the repurchasing of stock by American corporations. Companies faced with excess cash on their balance sheet have four basic options: 1) Make investments in future growth, via building new plants, embarking on new projects, expanding their workforce or acquiring other companies 2) Return the cash to shareholders via regular and special dividend payouts 3) Strengthen their balance sheet by building cash reserves or paying down debt or 4) Buy back shares of their own stock.

Buying back stock has been far and away the most popular choice lately. The basic premise makes sense. Dividends paid out to shareholders are great, but they are subject to double taxation - companies pay taxes on their earnings, and then shareholders pay taxes on the dividend payout. Making a large increase to the regular dividend also sets an expectation with shareholders that is hard to dial back in the future. Buying back stock alleviates both of these issues. A company that repurchases it's own stock shrinks the total number of shares outstanding. This increases the percentage ownership of all remaining shareholders, without subjecting them to taxable income. While many corporations have standing buy-back programs, where they intend to repurchase an allotment of shares in the coming years, they come and go more freely. Since it's not a cash payment, shareholders don't really miss them if the company decides to halt repurchases. Share repurchases also have the added benefit of providing buying pressure underneath the stock price while they are being executed.

The idea itself is not flawed. The big problem lies in execution. Purchasing company shares is just like any investment - price matters! Naturally,

Keeping Optimism Alive

Investors - people - tend to become less optimistic over time. That makes investing and staying invested hard. Stocks and bonds offer the promise of future returns. So if you are the person who always sees rain and never a rainbow, becoming a successful investor can be next to impossible. So we dug around and found practical tips to boost your optimism & outlook.

Cultivate and live in a positive environment
Who you choose to spend time with and the influences you get from further away via TV, the internet and magazines are huge inputs to your outlook. Identify negative people and negative information sources and minimize your exposure.

Go Slowly
The faster we go, the more goes wrong. Walk, talk and eat more slowly so you mind and body can slow down too.

Don't let vague fears stop you
Your mind can run wild fueled by fear and nightmare scenarios when you contemplate trying something new. A shark attack in Australia shouldn't keep you from enjoying time in the surf this weekend.

Add positivity to someone else
What you send out tends to come back. Not always, but usually. Listen to others, help out when possible, and embrace the ones you love.

Exercise regularly and eat and sleep well
You'll feel better about yourself, think more clearly and be better prepared to face challenges coming your way.

Take criticism in a healthy way
Don't reply right away and take time to listen. It might be that your critic is taking their bad day out on you.

Mindfully move throughout your day
Spending time in the present moment makes it much easier to access positive emotions and to remain practical. Spending time in the past or future can make everything seem bigger and worse.

Americans live to their 80's and 90's. So don't think the last big economic bonanza or stock market boom is the last you will see. Be a Goldilocks investor, go for the middle, take care of your mind and body and enjoy the moment. A well balanced and allocated portfolio will do its job.

corporations tend to buy back shares when the business is performing well and is flush with cash. That underlying business strength more often than not is reflected in the current share price. Just like the average investor, corporations are spending the most money buying back their own stock when they feel best about the business and their shares are the most expensive. The vast majority of corporate buybacks are executed without any concrete parameters for when to buy based on valuation. Warren Buffet's Berkshire Hathaway is the exception. They've long advertised that they will repurchase shares whenever the price of the stock falls below 1.2x book value of the firm. Knowing this, the market rarely allows them to get the chance. Other buyers start to rush in just before the stock hits that level. For some reason, most companies ignore valuation when buying their stock. By doing so, they find themselves plowing profits into an investment that gives them a negative return. Even worse, the trend of late has been to borrow money in the bond market, and use that money to repurchase additional shares. Not only are corporations buying their own stock at elevated levels, they are using leverage to make the purchases, compounding the negative effect. If this isn't bad enough, ponder for a moment the economic growth this country is potentially losing out on by having this money essentially recycled in corporate balance sheets, rather than getting invested in new projects that create middle & high wage jobs. While we have no idea when the next recession will occur, one thing is for certain: Many CEOs will wish they had held on to more of their cash, or deployed it into new projects that generate additional revenue streams.

The Problem with Mutual Funds

Despite many predictions of their demise, mutual funds continue to hold a major place in the investment world. What has allowed the industry to keep trudging along you might ask? Fees & ease. Many financial advisors spend the majority of their efforts working to gather new assets. Once gathered, said assets need to be invested in the market. By utilizing mutual funds, advisors can get paid (sometimes by the client and the fund, other times just through a commission from the fund) without having to work too much. It's a piece of cake to string together 7 to 10 funds that have done well over the past 5 years, and show clients a pretty picture of what their portfolio would have been worth - if they had a time machine to take them back 5 years and make the investment! Investing is about looking forward. During the next 5 years, the types of investments that do the best won't mirror the last 5. Investors that focus on trailing returns of mutual funds are always fighting the last war. We've seen it countless times following the financial crisis. Financial advisors put clients in the 5 or 6 funds that did the best job of protecting money in the downturn. The problem was that those managers either had a pessimistic bias, or were extremely cautious investors, which is why they performed so well in 2007 & 2008. Those same traits translated into horrible under-performance during the new bull market that started in 2009. One example of this is the Hussman Strategic Growth fund. This balanced growth fund rose to prominence in 2008 after losing a mere 8% while the S&P 500 was down 39.5%. For the next few years, advisors all over the country included the Hussman fund in their portfolios. By including it in a client or prospect presentation, the advisor could demonstrate that their strategy held up well during the financial crisis. Fast forward to the end of March 2016. The Hussman Strategic Growth fund has averaged -6.46% per year for the last 5 years, and the 10 year average is now -3.81% per year, which is a near impossible feat, given the strength of US stocks over that timeframe. What made for a compelling presentation in 2010 has done nothing but destroy wealth since.

While that is one example of how mutual funds can be utilized in a detrimental way, the major flaws are in the structure of the product itself. A standard open-ended mutual funds works like this: Investor money is pooled together in the fund, managed by one or more professionals, and usually marketed by a team of reps that roam between brokerage offices. These reps offer lunch, dinner, drinks, etc. to financial advisors, with the hope of persuading them to invest client money in one of the rep's funds. Once in the fund, client money is deployed into whatever investments the manager chooses, within the mandate of the fund. If more client money is flowing in than out, the fund issues new shares and adds to it's stock and/or bond holdings. If more money is flowing out, the manager retires some shares and funds the distributions either out of cash holdings or by selling something. This pooled structure paired with the active sales force generates a "herd effect". Let's say you invest your hard-earned dollars in a mutual fund. We'll make up a name and call it the "America Fund." Your dollars are invested, and the fund does really well for the first year or two that you are invested. Market participants notice the America Fund's performance. The fund's reps go out and tout said performance to as many advisors are possible. This leads to the fund becoming more and more flooded with new money, the longer the strong performance persists. Since most funds mandate what % of the fund can be left in cash, the manager has no choice but to continue to increase holdings and buy at more elevated levels. Forced buying of stocks at high prices has a way of severely hampering performance. The opposite is true on the downside. When the market is tanking, or the America Fund's strategy doesn't jive with what's working in the market, many investors start to panic and want to redeem their shares. Even though you, as an investor in the fund, may be perfectly calm and willing to ride out the storm, the manager is not so lucky. As redemptions come in, the manager is forced to sell while the market is down, or the strategy is out of favor. At the exact moment when buying is most compelling, the manager has no choice but to sell and lock in the depressed price. This compounds the negative result. As if that isn't enough, maybe the America Fund sold a bunch of Apple shares, bought in 2006 to meet the redemptions. Who gets the tax bill for that capital gain? America Fund's remaining shareholders are stuck with it.

Another major downside to mutual funds is cost. The average mutual fund has internal management costs (you don't see these come out of your account) in the 1.3% - 1.5% annual range. "C" share mutual funds cost nothing up-front, but have yearly fees that are typically north of 1.5%. "A" share mutual funds have upfront fees up to 5.75%, and in exchange for that, the annual fee is closer to 1 % on average. Most advisors these days utilize mutual funds in what's known as a "wrap account" or managed account. In that situation, client's usually pay the advisor 1-2% per year, and the advisor selects funds from share classes that are lower cost, usually in the 0.60% - 1% range. Client's invested in these managed accounts usually wind up paying 2% - 2.5% in investment costs each year. Keeping up with the average stock benchmark, such as the S&P 500, is a tall task with that cost structure.

We don't believe that mutual funds are an efficient way to invest in financial markets. In today's world of low transaction costs and abundant options, there are far better methods. As our clients know, we build & manage portfolios of individual stocks and bonds. For some accounts, we utilize ultra low-cost index funds. Individuals stocks and bonds are direct investments, and don't come with the added carrying costs of a fund. At Tilia, we build you your own fund. This fund isn't subject to forced buying or selling, and you aren't stuck with capital gains bills when you aren't the one selling. On top of that, you get to look the people in the eye that are making the actual investment purchases and sales on your behalf. If your account's performance is lacking, we aren't able to cast the blame on some third-party manager in a far-away office. You know what you own, versus looking a statement full of funds that require research to discern their holdings. As fiduciaries, we believe this is what gives our clients the best shot at long-term investment success.