CLIFFORD SWAN
THE Investment Counselor
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WISDOM *for* GENERATIONS

A ONE HUNDRED-YEAR LEGACY

By Maye Albanez
CFA, CIC

I was seven years old the day I walked into the downtown Los Angeles office of A.M. Clifford Associates. Eighteen years later and fresh out of college, I began my first real job at Clifford Associates in Pasadena. A.M. "Tony" Clifford II took me under his wing and introduced me to the investment counseling profession—first pioneered in the United States in 1915 by his grandfather—which I would become passionate about in the coming years. Having been raised in a home where integrity ruled, Clifford's message of integrity resonated with me. Tony never tired of reminding me and my colleagues that we were there to serve our clients whose interests always came first. We had no products to sell; we simply provided investment advice to our clients. As someone who has spent my entire career with this unique firm, it is my privilege to share a bit about our history, some of which I learned from Tony over the years.

A.M. Clifford graduated from Yale in 1904 and subsequently returned home to St. Louis and joined a brokerage firm. In 1911, he moved permanently to Pasadena and set up his own shop in Los Angeles, primarily as a stock and bond dealer. He was approached in 1915 by a woman who had inherited a $30 million estate and engaged his services to analyze her security holdings and provide investment recommendations. A.M. Clifford recognized that major undertaking as the origination of his investment counseling days and henceforth served investors on a purely professional and advisory basis. In 1921, after much soul searching, he formalized the path he had undertaken in 1915 by announcing he would cease to act as broker-dealer permanently and would instead serve exclusively as an investment counselor.

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As for many other professionals in the business, the 1920s proved challenging for A.M. Clifford. In December 1928, believing financial equilibrium had been lost in the market, he wrote his clients and recommended they divest themselves from the stock market—a bold move many people considered foolish at the time. In October 1929, the stock market plunged and the Great Depression ensued, taking stock prices down nearly 90% from their 1929 highs. In 1931, A.M. Clifford reversed his earlier recommendation to clients and advised they begin to accumulate common stocks, even though prices continued to drop—another bold move considered foolish at the time. By 1932, all losses in his portfolios had disappeared.

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During the 1920s and into the 1930s, he feared others might tarnish the growing reputation of his new profession. In 1933, in response to the excesses of the 1920s, the U.S. Congress created the Securities Exchange Commission ("SEC"). In 1936, the SEC began a survey of the investment advisory field. Wary of what could follow and recognizing the need

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for the industry to establish standards, A.M. Clifford in Los Angeles and another investment counselor in New York set out to create professional associations for investment counselors. The New York gentleman's idea centered upon creating an association of investment counseling firms, while A.M. Clifford's idea was that individual counselors should attain membership, but only after successful completion of a rigorous exam. In 1937, A.M. Clifford and his contemporaries formed the Investment Counsel Association of Southern California. The Investment Counsel Association of America followed and survives to this day as the Investment Adviser Association ("IAA"). Were A.M. Clifford here today, I believe he would enjoy reading the first bullet of the mission statement of the IAA which reads as follows: "… to be the leading industry organization: Promoting high standards of fiduciary duty, integrity, public responsibility, and competence in the investment advisory profession …"

During the 1940s and the 1950s, many talented professionals joined the firm A.M. Clifford had founded. Among them were A.M.'s son, Henry, and another young man by the name of Philip V. Swan. Some of these professionals remained with the firm and others moved on to form their own businesses. In the 1970s, Henry, his son Tony, and a childhood friend of Tony's, formed the partnership which later became known as Clifford Associates. In the early 1980s, the firm left downtown Los Angeles permanently and relocated its office to Pasadena.

In 1982, Phil Swan founded his own investment counseling firm, Philip V. Swan Associates. Clifford Associates and Philip V. Swan Associates remained friendly competitors for the better part of thirty years. Both firms were located in Pasadena, both served high net worth individuals and non-profit organizations, and both consulted with many of the same professionals who advised their clients. More importantly, both firms shared the same heritage and could trace their roots back to the founder of our profession, A.M. Clifford.

Over the years—and more than once—Clifford and Swan considered joining forces. However, for one reason or another, all efforts to combine never came to fruition. In 2007, the two firms decided to merge and become who we are today: Clifford Swan Investment Counselors.

> "As I reflect on my thirty-two years with this firm, I realize the values which once drew me to it as a young college graduate have withstood the test of time …"

As I reflect on my thirty-two years with this firm, I realize the values which once drew me to it as a young college graduate have withstood the test of time, and more importantly, those values are instilled in the people of this firm. My colleagues and I clearly understand our primary duty is to serve our clients and to honor the trust our clients place in us.

A.M. Clifford would take pride in knowing that, even if the tools of our trade have evolved significantly over the past century, his investment philosophy—one he believed in so passionately—remains in place. To this day, we believe in purchasing high-quality investments on behalf of our clients and owning them for the long term. Rather than limit our service to managing money on behalf of our clients, we instead counsel them across all other areas which affect their finances—same as we always have since 1915.

Fortunately, we have the distinct privilege of having served multiple generations of the same families for decades. Doing so has enabled us to not only get to know our clients and their families well, but to understand the underlying dynamics of those families, and as a result, serve their long-term family goals.

Finally, when it comes to the collection of people who make up this firm, we take pride in knowing we collected each and every one of them one person at a time. For the great majority of us, this firm is our final destination—the capstone to our respective careers. We hold each other accountable. In serving our clients, integrity remains first and foremost. And in doing so, we honor the remarkable legacy A.M. Clifford entrusted us with one-hundred years ago. ◆

MARK YOUR CALENDAR!

Clifford Swan Investment Counselors is pleased to announce a conference call for clients and friends of the firm on Thursday, March 3rd at 10 o'clock in the morning, Pacific Standard Time.

Investment counselors Peter Boyle and Randy Zaharia will lead a discussion on how we at Clifford Swan research and implement fixed income (bonds) investment strategies within the context of a client's investment objectives. Call participants are invited to pre-submit questions for a Question and Answer session at the end of the call.

While further details will be provided closer to the date, please email Jennifer Loesch at jloesch@cliffordswan.com or call at 626.792.2228 if you would like to be added to the attendee list now. ◆

2016 MARKET OUTLOOK

By Allen T. Mercer

U.S. equity market returns for 2015 were challenging, with the price of the S&P 500 Index down 0.73% over the year. With a peak to trough difference of approximately 14%, a long distance was traveled to end relatively flat. Including dividends, however, the S&P 500 Index was up 1.37%, demonstrating the importance of dividends to shareholders. The road traveled was unlike what investors have seen in recent years. Highlighted by choppy domestic equity markets and narrowing opportunities to invest in high-quality undervalued companies, investors clamored for growth and yield in their portfolios. The year was driven by interest rate speculation, currency volatility, weakening commodities, and a strengthening U.S. dollar. The underlying reasons are, however, somewhat more complex as the U.S. economy experiences slower growth, lower inflation, and the prospects of modest returns carried into the New Year.

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A durable U.S. domestic economy has been the strong leg on a shaky global stool. With the U.S. focused on tightening monetary policy and major, global developed economies, such as China, Europe, and Japan, focused on more accommodative policies, this global economic divergence became greater throughout the year and should continue into 2016. Given that many investors look for large, stable, high-quality businesses in times of uncertainty, the strength of the U.S. dollar could provide an additional hurdle as these companies typically receive a large portion of their total revenue internationally and are consequentially more exposed to foreign currency exchange impacts. As a result, the typical "flight to safety" could be different than previously experienced given the macroeconomic landscape. With more questions than answers in the global financial markets, the focus on diversification and active management should become more important themes moving forward.

With that said, the U.S. has a relatively strong domestic economy; attractive valuations in the EU and Asia could materialize into long-term opportunities as those regions have additional tools to propel growth. Deciphering the noise from the news will continue to be a theme for investment professionals moving forward. With the Federal Open Market Committee (FOMC) raising the target range for the federal funds rate by 25 basis points, the domestic equity market appears to be in somewhat unfamiliar territory.

With this backdrop, Clifford Swan will continue to execute on its long-standing equity strategy of analyzing company-specific fundamentals. While a rising tide lifts all boats, the converse has also proven to be true, and our analysis of current market fundamentals leads us to believe there will be opportunities for active managers to add value through individual security selection and portfolio construction moving into 2016. The chart below depicts the monthly price movement of the S&P 500 Index (red line) against the trailing 12-month earnings (beige line) and operating margins (black line) of its constituents, since 1990. This displays a "topping" and slowing of corporate earnings growth in the broader market, as measured by the S&P 500 Index. As earnings growth has slowed, so has the broader market. This is creating an equity market inflection point.

It is important to monitor whether the market is "getting ahead of itself"

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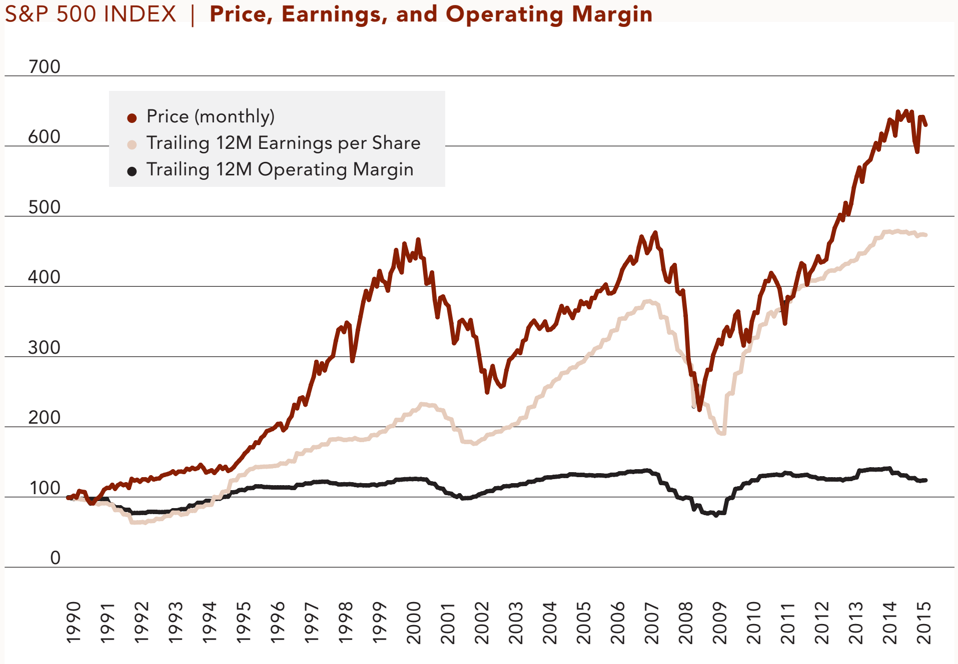
S&P 500 INDEX | **Price, Earnings, and Operating Margin**



Source: Bloomberg. Normalized as of 1/31/1990.

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based on what corporations are earning in the current environment. The spread between the S&P 500 Index against the trailing 12-month earnings of its constituents currently indicates that market prices have been expanding faster than earnings. However, when the spread becomes stretched, indicating that the market is expanding exponentially faster than the fundamental metrics, the market typically slows and contracts in subsequent periods. While this is not a perfect indicator, it is one piece of a larger, complex, valuation puzzle.

With the market indicating a possible inflection point, investors should position themselves for more volatility and lower price appreciation relative to the bull market run we have seen since the 2008 financial crisis. Now that the FOMC has provided additional clarity on the interest rate "normalization" path, one level of uncertainty has been removed in the market. News headlines typically focus on top-line (revenue) and bottom-line (earnings) growth; however, corporate margin expansion, or retraction, can be a decent indication of future growth potential as well. Given the uncertainty in the macro environment, corporations have looked to increase efficiencies, cut costs, and control company-specific items. The chart on the previous page shows the S&P 500 Index constituents reaching their highest operating margins (black line) moving into 2015. While some of this is due to technology efficiencies, which are gained over time, it is also important to realize that companies have trimmed the "low hanging fruit" available to help boost bottom-line growth; margins appear to be stretched in the broader market and are contracting moving into 2016. This could be one explanation for the slower earnings growth, along with the slowing of financial engineering fueled by inexpensive debt.

Given the fall in commodity—specifically oil—prices, the Energy and Industrial sectors experienced a challenging year in 2015. Both sectors appear to have gone through a "re-pricing" scenario relative to the broader market. While Energy and Industrials, as a whole, traded lower, the broader market stayed relatively flat in 2015. This is important because, while some of the companies in the Energy and Industrial sectors are beginning to look like attractive value investments, the multiple-contraction (price relative to earnings) has reset expectations relative to the broader market. If the market enters a bear market, these stocks could have more pain before they begin to turn around, especially those strongly correlated with the domestic economy. Companies that grow their businesses below the U.S. gross domestic product (GDP) rate will likely receive multiples lower than the broader market; these companies are typically cyclical and more exposed to broader market downturns.

Moving into 2016, investors are very cautious. Enhanced clarity domestically will be offset by uncertainty globally. Corporate capital returns (dividends and share repurchases) will continue to play a substantial role in the long-term total return of the U.S. equity market. The chart below represents the annual calendar year returns of the S&P 500 Index over the last 50 years. What becomes evident is that the U.S. equity market is up more often than it is down. The average calendar year price return over this time period was approximately

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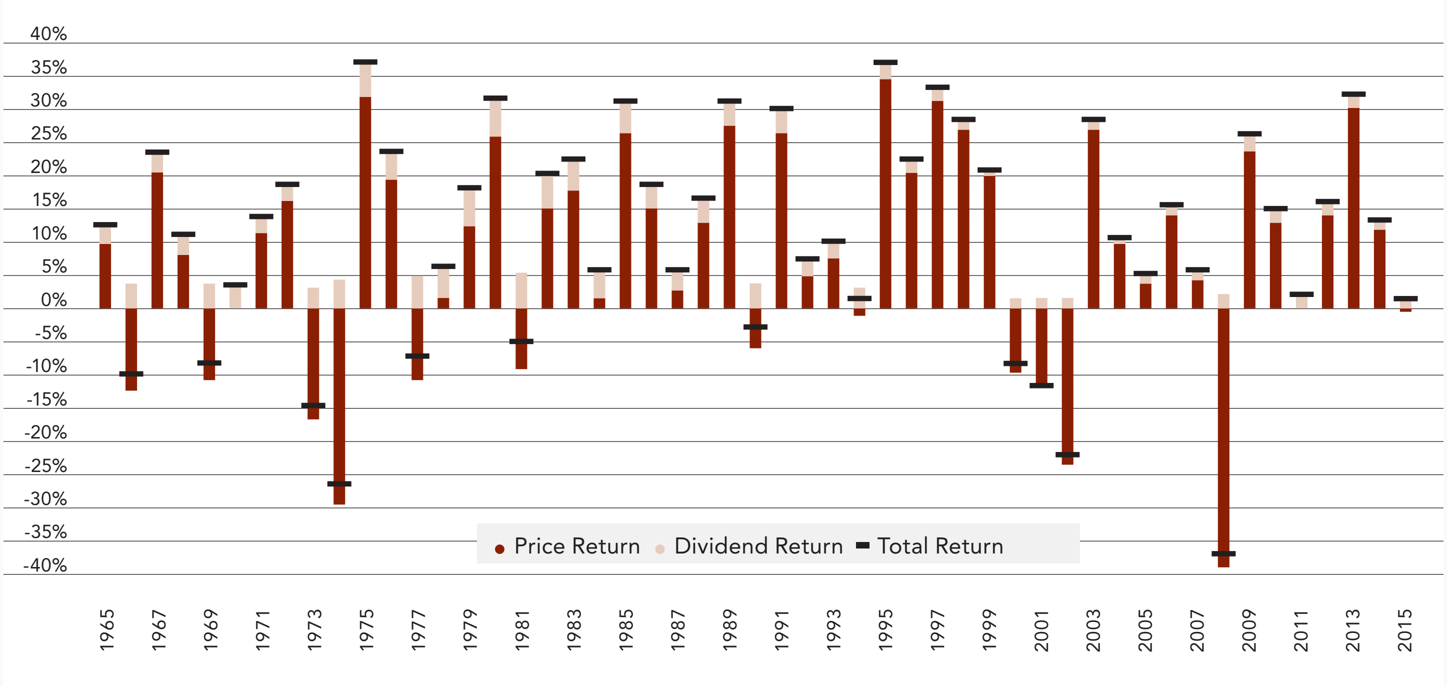
S&P 500 INDEX | **Dividend Return vs. Price Return**



Source: Bloomberg

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10.9%, with up markets contributing approximately positive 15.8% and down markets contributing approximately negative 13.3%. Dividends have and should continue to be a large portion of total returns over time and can help portfolios weather weak markets. 2015 was an extraordinary year as a negative price return with a positive total return (including dividends) is quite rare; it has previously only occurred in 1994 and 2011.

> “Dividends have and should continue to be a large portion of total returns over time and can help portfolios weather weak markets.”

While some investors place great emphasis on price return, Clifford Swan approaches portfolios from a total return perspective. The data above suggests a slowing equity market, however, these signs have been seen before. The market appears to be determining whether the U.S. equity market is simply taking a breather before its continued bull run, going through a healthy correction, or if we are moving into a broader “re-pricing” environment.

During our 100 years of counseling investors, we have seen virtually every market scenario possible. While we do not time the market, we do use short-term dislocations between intrinsic value and price to take long-term positions in high-quality businesses. These companies typically have strong competitive advantages, solid balance sheets, and proven management teams. We will continue to rely on our long-standing philosophy moving into 2016 and take advantage of an anticipated volatile environment. ◆

5 WAYS YOUR FAMILY CAN CREATE AND BUILD WEALTH

By Linda Davis Taylor

While we are still in the early part of 2016 and resolutions are top-of-mind, I am excited to introduce a new column on family strategy. After all, what better resolution than to refocus your family's strategy? This column will explore the non-financial aspects of family wealth. For this inaugural article I will offer a framework for how a family can approach creating and building wealth.

When you think of your family, *mission statement* and *strategy* are probably not the first terms that come to mind. But, as I explain in my recent book, *The Business of Family: How to Stay Rich for Generations*, when families are organized with a business mindset, parents set up their kids for future success.

I've found that families who truly understand wealth tend to invest in their families with as much discipline as they do with their business.

Here are five strategies for your family to use to create and keep prosperity:

1. COME UP WITH A FAMILY MISSION STATEMENT.

Business leaders know that if they don't deliver on their promises, they'll lose their customers. A family that wanders off course runs the same risk with even greater consequences.

Starting with a clear mission is the first step for businesses and families alike. A mission statement can be accomplished with just one sentence. Here's an example: “The mission of the Smith Family is to keep our family connected, be grateful for our good fortune, and share it with others.”

Just like a business, create a vision for your family that strikes a balance between staying rooted in your principles and planning for future success. A written mission statement is the touchstone that connects the two.

2. DETERMINE YOUR VALUES AND LEAD WITH THEM.

Values are guiding standards that act as a compass for how people behave. This is true for members in a business or in a family. When standards are clear, the family will not only weather a storm, it will grow stronger because of it.

Smart businesses make decisions with values up front; families should do the same. If a family believes that generosity is high on its list of values, its mission statement should say that members want to share their wealth. Then, the family should develop a strategy for giving to a cause they find important.

If family members believe that being open and honest is important to their future success, having a process encouraging good communication is essential.

The key is to open up a dialogue to discuss the family's principles so members remain connected and inspired. Being clear about values makes it easier to navigate the inevitable twists and turns on any family's path because you've identified what's most important to your family.

3. GET INPUT FROM ALL FAMILY MEMBERS.

Like a business, a successful family is all about its people—who require training, support and commitment to a purpose. They need mentoring to meet unexpected challenges and rewards to celebrate successes. These are investments in the family's human capital that are more than paid for by ensuring the next generation's success.

Hosting frequent family gatherings creates strong relationships that keep

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the family connected. Families need to work together to discuss values, set financial goals and establish a shared vision for the future.

Family discussions are necessary for fiscal strength. And a family strategy requires input from all its stakeholders—its members—in order to be optimized.

4. SET GOALS AS A TEAM.

Laying out goals and objectives is standard operating procedure with any business plan. The same ought to be true for families.

Wise families decide jointly what they want to accomplish financially and personally and then set about doing so as a team. Determining collective goals keeps people focused.

Seeking wealth for its own sake ultimately proves to be a hollow ambition. It's what is accomplished with the money that provides lasting satisfaction. This means part of every family's strategy must be choosing the things the family wants to focus on and working together to reach those goals.

Just as a business that starts without a plan won't be a business for long, families who set a plan can achieve fiscal strength. A company needs a dynamic vision to be competitive in the marketplace and, similarly, a family vision keeps everyone working together.

5. STRATEGIZE TO OPTIMIZE.

Good strategies are essential to achieving goals. So figure out: where should your family's energy be focused? How should its resources be allocated? What are the barriers?

Reaching family success is a campaign of the highest order, so it needs a plan, a staff, a timetable and markers along the way. New approaches are often needed to reach a lofty goal.

At home and in business, it takes courage to plan for the future. Companies and families can be tempted to cling to old ways, but holding on to short-term profits instead of investing in long-term gains is a hazardous strategy for both.

Although most of us don't have a strategy in mind when we start our families, it's precisely what we need to create a family that prospers beyond one generation. ◆

2016 TAX GUIDELINES ON GIFTS

TAX-FREE GIFTS

- Every individual is entitled to gift up to $14,000 (unchanged since 2013) per year to any other individual(s) free of federal gift taxes.
- A married couple can join together to make tax-free gifts of up to $28,000 (even if this amount comes from only one spouse's assets).
- The *annual gift tax exclusion* can also be used to contribute to qualified tuition programs (529 plans). Due to special rules for 529 plans, contributions to these plans exceeding the annual gift tax exclusion amount may be carried forward for up to five years.
- The current *lifetime gift exclusion* for each individual is $5,450,000 and is exclusive of the $14,000 per year exclusion referred to above.
- In addition to the annual and lifetime exclusions, an *unlimited gift tax exclusion* is allowed for amounts paid on behalf of an individual for permissible educational and medical expenses; however, these payments must be made directly to the educational or medical institution.

CHARITABLE GIFTS

If you are planning on making charitable gifts, we generally suggest that you use appreciated securities wherever possible. If you do decide to use appreciated securities, you are allowed a charitable deduction based on the full market value of the gift and will avoid a possible future capital gains tax, subject to certain limitations.

There are also charitable funds that accept contributions of marketable securities allowing you to base your deduction on the full market value of the gift in the year of transfer. You may then direct the proceeds from the gift to your charity, or charities, whenever you choose, even in a different year. Please speak with your counselor about how to best structure your philanthropic goals for 2016. ◆

OFFICES

Pasadena
177 E. Colorado Blvd., Suite 550
Pasadena, CA 91105
626.792.2228 | 626.792.2670 FAX

Evergreen
P.O. Box 2945, Evergreen, CO 80437
720.746.1244 | 720.294.9896 FAX

cliffordswan.com

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