

Fundamental Indexing

Investors are generally divided into two camps: 1) those that follow the “efficient market theory” that at any given time the market price of a stock is the best estimate of the stock’s “true value” and 2) those that believe the market constantly misprices stocks leaving some over-valued and others under-valued. If you are in the first group, low cost index or “passive” investing makes the most sense while those in the second group favor “active” stock pickers who believe they can “beat the market” and find those under-valued stocks. At Mosaic, we don’t completely believe the market is always “efficient” but, on the other hand, we don’t believe active stock pickers can consistently pick enough “winners” to overcome their management fees and high turnover (which increases trading expenses and income taxes) which are all significant drags on performance. We acknowledge that individual stocks may be mispriced periodically but don’t think it is possible to consistently be able to take advantage of it. We therefore focus on what we can control and strive to keep investment expenses and taxes low by using passive funds. But can this approach be improved? Our Mosaic Investment Committee has been doing some important research on “Fundamental Indexes”.

Traditional indexes are “market cap weighted”. An example would be the Russell 1000 which represents the 1000 largest US companies ranked by their stock market value (number of shares outstanding times the stock price of that company). If Apple Computer has indeed surpassed ExxonMobil as the most valuable company in the US, it will soon have the largest weight in the index. However, if you believe stocks can be over- or under-valued, a problem with market cap weighted indi-

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Addressing End of Life Care

When nearing the end of life, many people reach a point of wanting to avoid the extra procedures normally expected of emergency caregivers. A relatively new document called the *Physicians Orders for Life Sustaining Treatment* (“POLST”) can help you express your wishes in an accepted format, so that your wishes will be respected.

Until recently, an “Advance Directive” was the only accepted tool which a person could use to state wishes for the end of his or her life. An Advance Directive generally contains information about a person’s desire to be mechanically ventilated, artificially fed, and his/her desire for comfort care, for example, but it does little to protect a person from unwanted emergency medical care like CPR or transfer to a hospital. Separately a Do Not Resuscitate Order (DNR) can protect a patient from unwanted chest compressions, electrical shocks, and artificial breathing. End of life advocates realized that neither form addresses many of the emergency decisions.

With the use of a POLST form, emergency and medical personnel get from the patient clear orders regarding which actions to take in the event of an emergency. It includes the patient’s desire to have or

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ces is they will hold more of the over-valued stocks and less of the under-valued stocks simply as a result of weighting the index holdings using stock price. For example, if a tech stock is trading at a ridiculously high price/earnings (PE) ratio, a market cap index will hold a larger amount of this stock than a similar sized company trading at a reasonable PE ratio. If the stock price falls the whole index will be impacted by the mispricing.

Fundamental indices take a different approach. While also ranking stocks by size, they instead measure companies by their broader “economic footprint,” using four equally weighted factors to do the ranking: sales, cash flows, book value, and dollar value of dividends paid. They combine these four factors to generate a list of the “largest” stocks. Note that this method completely ignores the stock price. The market may be over- or under-valuing that tech company mentioned above but that has no impact on where the stock ranks in a fundamental index. The Fundamental methodology does not completely avoid owning “over-valued”

stocks; it just holds them based on more fundamental economic factors, not their stock market value.

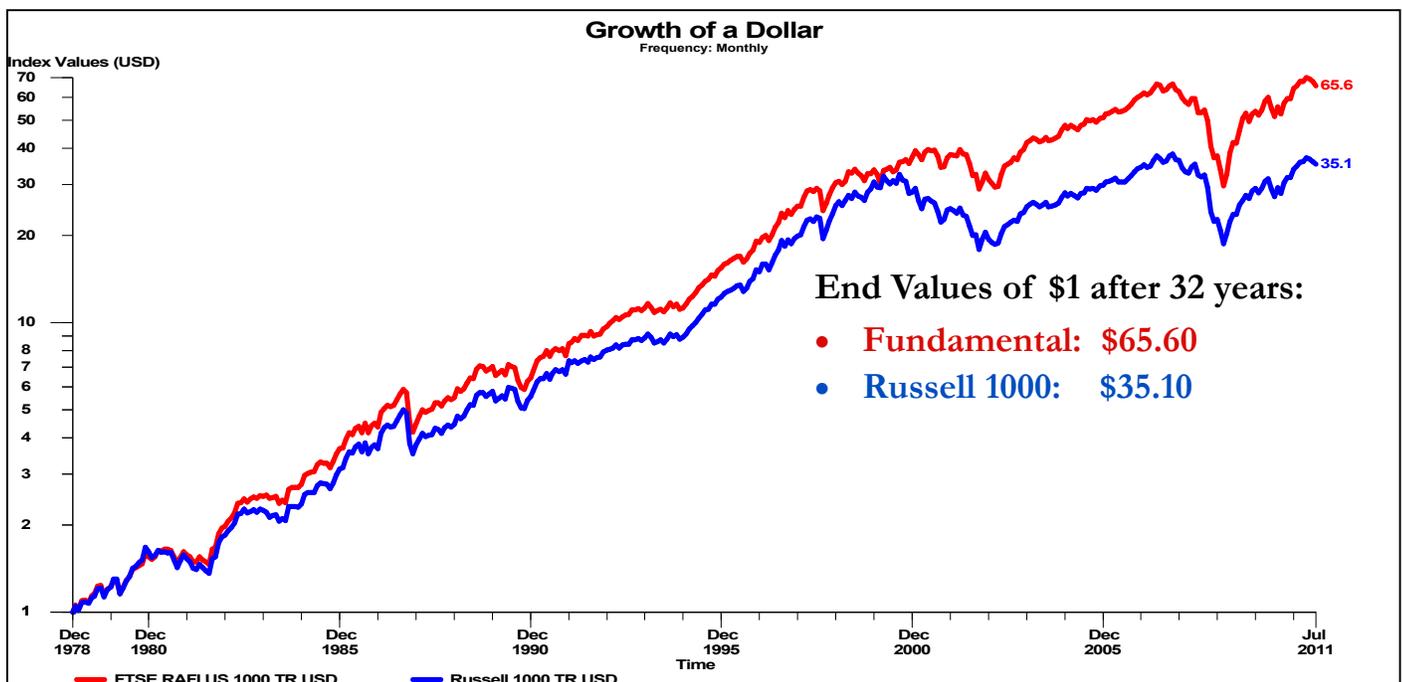
So what’s the bottom line? How does the performance compare? By systematically avoiding putting too much in over-valued stocks and too little in under-valued stocks, the Fundamental Index approach has proved to have much better long term performance than traditional market cap weighted indices.

As an example, below is a chart comparing the Research Associates Fundamental Index (RAFI) 1000 index of large US companies to the market-weighted Russell 1000 index. The chart shows how each has grown since the beginning of 1979 and how the Fundamental Index has outperformed the Russell 1000, with a few exceptions. Similar results are found when comparing the RAFI US Small and International indices to their corresponding market cap index.

We are convinced the Fundamental Index is a better way to approach holding a diversified portfolio. Client portfolios will soon begin to see inclusion of the RAFI Index when we can do it without significant tax cost.

Fundamental 1000 Index vs. Russell 1000 Index

Monthly Values since 1979.



AROUND THE OFFICE

At the Podium:

Norm and Linda Boone were keynote speakers at the San Francisco Money Show in August. Norm was also interviewed by KRON TV for his reactions to the market when it dropped 500+ points in one day. In June, **Kevin Gahagan** spoke to the North Bay Investors' Forum on the subject of "Inflation – Investment Strategy in Times of Uncertainty." In July, Kevin lectured at the University of San Francisco where he spoke to MBA students on the state of the markets and the advisory profession. In July, **Sabrina Lowell** was a panelist for *AdvisorTech 2012: What Should You Buy Next?* The webcast, with nearly 1,000 attendees, focused on software choices available to advisers and the best ways to integrate new technology. For advisers, technology is not only a major investment and expense, it also can influence business practices.

Exotic Travel:

Norm and Linda spent much of July touring southern Africa. In Zambia, Botswana and South Africa, they spent lot of animal-watching time, as well as getting a feel for Johannesburg, Cape Town and the South African wine district. It's a beautiful country and they'd highly recommend the trip. **Susan Morse** and her husband, Frank, spent over two weeks in Turkey in May visiting numerous Greek and Roman ruins, famous mosques, spending time w/local Turkish families and local politicians, and four days on a gulet in the Aegean sea. Turkey is currently quite vibrant, people are friendly, and the food is great. **Sabrina** spent two weeks in Spain including SCUBA diving in Ibiza and Costa del Sol's La Herradura Bay on the Mediterranean, a day exploring 14th Century Moorish palaces at The Alhambra in Granada, visiting the Del Prado, and of course enjoying Spain's great food!

Congratulations:

Geoff Zimmerman was honored with the "Service Above Self" Presidential Award at the Rotary District Awards ceremony this past July.

Education - A Continuing Affair:

During the summer, **Susan** attended a CFA Society presentation on investing in frontier markets (think

Africa) and an Institutional Investor Conference on items of importance to financial advisors in June in Newport, Rhode Island. In August **Sabrina** attended her annual Study Group meeting, this year in New Orleans. Discussion over the four days focused on withdrawal strategies for clients in retirement, leveraging technology, and succession planning within wealth management firms. In July, **Mary Ballin** and **Ricci Victorio** attended the first of a multi-part seminar series with The Coaches Training Institute. They expect to continue their studies to enable them to coach clients, as appropriate, when the need arises.

Giving Back to the Community:

Sabrina joined the Board of The Junior League of San Francisco (JLSF), in June as Fundraising Council Director overseeing the League's three large fundraising events: Cookbook, Home Tour, and Fashion Show, which enable JLSF to provide \$250,000 a year in community grants and services. Following her passion for education of her children, **Mary** has joined the board of her daughter's middle school PTA as Financial Secretary. Mary also continues on as a Girl Scout Co-Leader of her daughter's troop of 12 girls as a mentor and guide. **Glenda Wong** is actively engaged in the Auxiliary of the Fine Arts Museum of San Francisco, helping it raise funds. **David Lawrence** recently took part in emergency responder training and is now a CERT member.

Furthering the Profession:

In August, **Sabrina** was one of 18 financial planners from around the nation invited to participate in a two day Summit discussion in Lake Geneva, WI, for the Financial Planning Association (FPA) exploring the future of the industry. **Mary** begins her 3rd year as a board member of the Tri-Valley Estate Planning Council; this year as Secretary.

Other Fun Stuff:

Susan and **Kevin** successfully competed in the Olympic Club's "Jim Lucius Shootout." Playing five 9-hole matches against their flight competitors, Susan and Kevin tied for first in their flight – though ultimately losing in a "card-off." **Glenda** ran the San Francisco Giants Half Marathon in August.

IRA Distributions – An Annual Reminder

Please note, if you are over 70 ½ years old and have a traditional IRA, 401(k), etc., you are required to take a set percentage of the aggregate of your retirement account assets (as measured on December 31 of last year) each year. If you don't take this Required Minimum Distribution (RMD) then you are subject to a penalty: 50% on the balance of the amount not withdrawn, on top of the normal ordinary tax that is due (e.g., if you have an RMD of \$20,000, you would owe a *penalty* of \$10,000 plus you would still have to pay an additional amount of \$5,600 in ordinary taxes assuming you were

at a 28% marginal rate). Two special exceptions: if you have an *Inherited IRA* you are required to take an RMD regardless of age; if you have a *Roth IRA*, then no RMDs are ever required.

If you are 70.5 this year or older, you need to withdraw a minimum amount each year from your retirement accounts.

If you have any questions on whether or not you are subject to an IRA RMD or if want to figure out if you are in full compliance, please call us at Mosaic. We will most likely be contacting all clients in early September who have taxable IRAs and should be taking RMDs but have not made the appropriate withdrawals to date.

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refuse CPR, to be taken to a hospital, and whether to receive artificial nutrition. The POLST is part of the patient's permanent medical record, and transfers with the patient from facility-to-facility—at home, in a nursing home, a long-term care facility, and in the hospital.

States vary as to the form of the POLST document and other specifics but the general form is the same. Eleven states, including California, have fully endorsed the program and about 20 others are developing the program. Anyone who has a chronic or life-limiting illness or anyone reaching advanced age should consider having a POLST document in addition to an Advance Directive and a DNR. The standard procedure is to print it out on brightly colored card stock (pink in California and most other states) and attach it to the outside of a patient's refrigerator at home or put it in the freezer. Emergency personnel are taught to look for it there. Learn more at the POLST website at <http://www.ohsu.edu/polst/>.

What Does the POLST Include?

The POLST paradigm has three or four sections (depending on the state) in which a person can choose his or her desired medical intervention.

It may include "do not resuscitate" and "comfort measures only" orders, and it may indicate whether to

administer CPR (cardio-pulmonary resuscitation), antibiotics, intravenous fluids, feeding tubes, artificial respiration, and other medical interventions. Unlike the advanced health care directive, the POLST governs medical issues that are considered very likely to arise in the near term, and therefore most suitable for those expecting to die within a year.

POLST versus an Advance Health Care Directive?

An Advance Health Care Directive is designed to give instructions on desired medical interventions once a person has already had emergency treatment -- usually directed towards hospital or nursing home staff. The POLST is designed to instruct emergency personnel on what actions to take while you're still at home or on the way to the hospital.

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Who Needs to Sign a POLST?

In all states where the POLST is accepted and legal, a patient or their legal healthcare decision maker needs to sign the form. A physician must also certify that the decision the patient is making is consistent with the patient's current

medical condition and that the patient knows what they've asked for. In some states, a nurse practitioner or a physician's assistant may legally sign the form.

Aging and Money Management

How do you recognize when someone has perhaps lost the full ability to manage their own financial affairs? This is particularly important to ask as someone ages. Managing money is a necessary skill for people to remain living on their own or independently. And, as we age, we can lose certain cognitive skills that we once took for granted. For example, dad has always managed his money and kept a perfectly balanced check book but now he is confused by this very act or mom has watched over the portfolio all of these years but she is now feeling nothing but fear and anxiety over her investments. All of these can be signs of cognitive impairment, either as part of an illness such as dementia, Alzheimer disease or other aging related issues. These may appear slowly over time but can hit hard when mistakes begin to compound – utilities are shut off, tax payments missed, car repossessed or mortgage foreclosed.

According to the *Journal of American Medical Association* the classic signs of problems with money management are:

- Inability to count money
- Trouble paying bills and balancing a check-book, or remembering to do so
- Frequent concerns about stolen or missing money
- Calls from banks and other financial institutions about problems with accounts
- Falling prey to financial abuse, such as scams,

unscrupulous merchants or telemarketers or Ponzi schemes

What should you do if you recognize these symptoms with a loved one, or even yourself? The best way is through advanced planning. Creating a **durable power of attorney for financial matters**, which is a document that spells out who will be responsible for one's financial affairs during a period of incapacity (this is different from a health care power of attorney, which is specific to health care decisions only). Typically these financial powers of attorney appoint trusted family members, friends or outside representative. It is very important to choose the right agent to avoid misuse, deception, fraud or theft (according to one aging specialist, up to 30% of reported elder abuse relates to financial matters). The trusted person can set up automatic bill pay services, help with the longer term management of money and work with professionals, such financial planners, CPAs and estate planning attorneys. A great deal of sensitivity must be shown to the person with these early signs as they will often feel a great reluctance to give up something they have often handled so well and for so long. They should be a part of the conversation about the proposed changes and informed of major decisions.

If you have any concerns about the condition of a loved one, please feel free to call us. We have access to many professionals in this field with a wide range of expertise.

Addressing Changing Circumstances: The Value of Being Positive

The last decade of investing has been difficult—the dot.com bust, the Great Recession, and the more recent extreme volatility. For some, these have been experienced as a loss of future hopes.

Are you a “glass is half full” or “glass is half empty” type? Your answer is likely to determine how you experience things. What you believe to be true will manifest itself to meet your expectations—you'll get what you expect.

We can't stop change, but difficult as it may be, we can embrace it, welcome it and make it a partner of our success. To do otherwise emphasizes our fears, causing us to become victims of them.

Success (and luck) is impacted by your ability to be observant, creative, flexible and opportunistic. These are each choices. If you seek a good outcome in a situation, first honestly and objectively assess the problem before trying to find a solution. Take responsibility for your situation. Own your part in creating it and avoid blaming or the need to find fault.

Finally, it's critical that you gain insight into what you love and then pursue it/them. Energy and passion come from being involved in those aspects of life that you find positive and exciting. Problems tend to disappear when you are fully engaged in what you are doing. Change creates opportunity, if you can see it.

Thoughts to Live By

“This country has come to feel the same when Congress is in session as when the baby gets hold of a hammer.” --

Will Rogers

“Ask five economists and you'll get five different explanations - six if one went to Harvard.” -- **Edgar R. Fiedler**

“For every minute you are angry you lose sixty seconds of happiness.” - **Ralph Waldo Emerson**

“When I was young I thought that money was the most important thing in life; now that I am old I know that it is.” --

Oscar Wilde

“The trouble with weather forecasting is that it's right too often for us to ignore it and wrong too often for us to rely on it.”--

Patrick Young