CPFA'S Quarterly Investment Letter

Comprehensive Personal Financial Advisors, LLC   **Fourth Quarter 2013**

The total return of the S&P 500 in 2013 far exceeded the increase in corporate earnings. This disparity highlights the dichotomy between investors and speculators.

While investors are probably very happy with the strong US equity performance in 2013, their delight is tempered by the poor performance of fixed income. Alternative investment strategies faired somewhere in-between.

As your investment advisor, our role is to manage risk in your portfolio through asset allocation and diversification. Simply put, diversification means you will probably never make a killing, but conversely, you should never get killed.

In 2013, our client's portfolios were under-weighted US equities. In light of a "richly-valued" equity market, we do not believe it would be prudent to increase our equity allocations in this environment.

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Quarterly Investment Commentary

Fourth Quarter 2013

2013 Financial Markets in Review

Equity Markets

We start off with this question: How much ***should*** *you pay for $1 in additional earnings?*

There is little question that the performance of the US stock market far exceeded the expectations of most market prognosticators. But in thinking about what the future may hold, it's also important to realize that the increase in market value in 2013 was not supported by company fundamentals. Allow us to explain.

As you know, the S&P 500 represents ownership of 500 underlying companies. If you were to accumulate the 2012 earnings of all 500 of these companies and divide that number by the shares of the S&P 500 index, you would find that each share of the S&P 500 earned $96.82 in 2012. This per share earnings amount grew to $107.45 in 2013--an impressive increase of 10.97%. However, the total return of the S&P 500 in 2013, including dividends paid, was 32.31%. This is a difference of 21.34%, which means that the investors' collective return outpaced the actual earnings of the underlying companies by a wide margin. To emphasize the point in another way, the actual companies comprising the S&P 500 would have done better investing in the index than they did by operating their businesses.

This example illustrates the difference between "investing" and "speculating." An investor makes decisions based on the fundamental economic characteristics of a company. A speculator, on the other hand, cares not about company fundamentals, but instead about whether a successor investor will be willing to pay more for the investment than he/she did.

Long-term investors did a lot of head scratching in 2013 as the return of the market far exceeded the earnings of the underlying companies. Speculators found many willing purchasers, and if they sold out of the market in 2013, they were probably well rewarded for their speculation. Speculators who are still in the market may be getting a tad nervous wondering if there are enough purchasers remaining who will pay even more.

For US equities, 2013 was indeed a banner year. For all other asset classes, 2013 left something to be desired. Consider the following:

• 2013 was the 5th consecutive positive year for the S&P 500
• At no time was the S&P down on a year-to-date basis for 2013
• The index experienced its lowest daily volatility since 2006
• This is the 6th longest bull-market in S&P 500 history
• It has been 29 months since the S&P 500 has suffered a 10% correction
• The bond market experienced its worst loss in 14 years and was down for only the 3rd time in 28 years

If you are seeking an explanation for the impressive returns in the US stock market in 2013, you'll have to look elsewhere. There are many market bulls out there, but we simply cannot find a plausible explanation that would satisfy a market investor. We'll let the speculators explain themselves.

Fixed Income

With the exception of high-yield and floating rate notes, most fixed income sectors produced negative returns as longer-term interest rates ticked up during the year. The yield on the 10-year Treasury increased by 1.26% during the year to just over 3%. This interest rate increase resulted in declines of 7.8% and 15.0% for the 10-year and 30 -year Treasury, respectively. It was a poor market for fixed income markets on the whole.

Alternative Investments

As we have written in the past, there is no universal index representing the alternative investment market. However, suffice it to say that on a risk/return basis, alternatives were better than fixed income, but trailed US equity returns badly. The reason we diversify into alternatives is an attempt to “insure” against a precipitous decline in equities. The "cost" (as measured by the difference in performance between equities and alternatives) of this portfolio insurance was quite high in 2013.

Asset Allocation Policy

The stock market has been on an unrelenting, dizzying ascent since the bottom of March 2009. We believed that the market did significantly over-sell during the financial crisis of 2008-2009, and that is why we vigorously advised against selling at that time. But its robust ascent since then exceeded our expectations and made us cautious entering 2013.

We began gradually reducing equity exposure in 2012, and continued to do so throughout 2013 in most of our clients' portfolios. Compared to the "classic" 60% equity/40% fixed income portfolio, this decision to reduce equity exposure had a meaningful drag on returns.

We view that our role is to manage the risk of our client portfolios, and we believed that the risk of the equity market was high entering 2013. Thus, to be prudent, we began to reduce equity allocations. We believe that the performance of equities in 2013, especially when compared to company fundamentals, has only made the risk of a meaningful correction even higher. Thus, we do not believe that it is in our clients' best interest to begin increasing equity allocations at this time. As Rob Arnott recently said, "Now is probably not the time to pick up the last nickel of return with the steam roller bearing down on you." Accordingly, it is our intent to remain on the low end of our equity policy allocation.

CPFA Holdings vs. the Indexes

At the end of this letter, we have included a table that reflects the 2013 performance of many of our key holdings compared to the appropriate index. Below are a few comments on the performance of certain holdings.

Fundamentally Weighted Equity Indexes

The fundamentally weighted equity index funds that we utilize generally performed well during 2013 compared to their market-weighted counterparts. With the exception of Foreign Small Cap and Emerging Markets, the Powershares ETFs outperformed their benchmark index during 2013. Similarly, all of the funds except Emerging Markets have provided attractive returns in excess of their benchmarks since inception.

Fixed Income

In the fixed-income asset class, we were generally on par with the market, as the core PIMCO funds generally trudged along-side their benchmarks. As you will see in the table, PIMCO's Total Return and Unconstrained Bond Fund returned consistent with their benchmark, returning -1.92% and -2.21%, respectively. We have confidence that Bill Gross and his team will continue to add value and successfully navigate rising rates, tapering, and understanding a new Fed chief.

Alternative Strategies

For 2013, this was a good news, bad news story. Our alternative investments provided a wide array of returns, ranging from a +33% return for EGLIX, (an energy MLP fund), to a loss of just over -7% for the Altegris Global Macro Fund. The other alternative holdings fell somewhere in between.

We would, however, like to address the 2013 performance of PIMCO All Asset All Authority, as it represents a meaningful position in most of our clients' portfolios. In our review of 2012, we pointed out the good news that PAUIX was double weighted in our alternatives allocation, as it was up over 17%. Well, the bad news is that the fund was still double weighted during 2013 and had a return of -5.5% for the year. There are two primary reasons for this negative return in 2013. First, the fund had a net short position in US equities for much of the year, and second, the fund also took positions in inflation hedging strategies as those positions became less expensive during the year. If the US equity market corrects and/or the threat of inflation becomes a reality, this positioning should pay off handsomely.

Another alternative strategy fund that bears special mention is Altegris Global Macro, which disappointed again this year with a loss of -7.37%. We have generally reduced or eliminated this fund from most accounts. While we theoretically like the global macro concept, the consistent underperformance of this fund has not met our expectations.

Where do we go from here?

Compared to the classic 60/40 portfolio, we were under-allocated to US Equities, and as mentioned above, this policy decision had a negative effect on overall portfolio returns. As we have written in the past, the detriment of proper diversification is that you will never make a killing; the benefit of proper diversification is that you will never get killed. In 2013, we missed out on making a killing in US equities. In future years, we are trying to avoid getting killed in a market crash.

Thus, we do not intend to make policy changes to our portfolios until the market conditions shift. We are pleased with our portfolio positioning, and believe we are well armed to reduce volatility and withstand a meaningful equity correction.

The Tax Man Cometh

As we get into the tax preparation season (and the payment of tax bills), here are some of the key tax increases effective for 2013, which may impact your tax liability relative to 2012:

• The top "bracket" of individual income tax rates has increased from 35% to 39.6% on taxable income above $450,000 for MFJ or $400,000 for single
• For taxpayers in that top bracket, the capital gains rate and rate on qualified dividends has been increased from 15% to 20%

• Personal exemptions and itemized deductions begin to be phased out at income above $300,000 MFJ or $250,000 for single

• An additional 0.9% “hospital insurance tax” on all wages and self-employment income over $250,000 MFJ or $200,000 for single

• An additional 3.8% “Medicare tax” on net investment income for all taxpayers with modified adjusted gross income in excess of $250,000 MFJ or $200,000 for single

CPFA’s Business Update(s)

Note of Annual ADV Offer to Clients

Next quarter existing clients will receive a page stating the material changes to CPFA, LLC’s most current Form ADV Part II. This document serves as our “brochure” to our clients and contains information and disclosures as required by law and also describes the products and services we offer, the fees we charge, and many other aspects of our business.

However, you are entitled to receive an entire copy of this Part II Form ADV, which serves as CPFA LLC’s SEC disclosure brochure at any time. If you would like a copy, contact John Hamel at jhamel@cpfallc.com or (303) 770-0154 ext. 120.

Return as of 12/31/13	*Ticker*	*Inception Date*	*Classification*	2013	Annualized Since Inception
Powershares FTSE RAFI US 1000	PRF	12/19/2005	Large - US	35.15%	8.48%
Russell 1000 Index				33.11%	7.40%
Powershares FTSE RAFI US 1500 Small-Mid	PRFZ	9/20/2006	Small/Mid - US	41.80%	10.62%
Russell 2000 Index				38.82%	8.01%
Powershares FTSE RAFI Dev Mkts ex-US	PXF	6/25/2007	Large - Dev ex-US	23.45%	0.45%
MSCI EAFE Index ND				22.78%	0.43%
Powershares FTSE RAFI Dev Mkts ex-US S/M	PDN	9/27/2007	Small/Mid - Dev ex-US	20.84%	3.69%
MSCI EAFE Small Cap Index ND				29.30%	2.64%
Powershares FTSE RAFI Emerging Markets	PXH	9/27/2007	Emerging Markets	-7.65%	-1.71%
MSCI Emerging Markets Index ND				-2.60%	-0.56%
PIMCO Total Return	PTTRX	5/11/1987	Bond Market	-1.92%	7.95%
Barclays Capital US Aggregate Bond Index				-2.02%	6.88%
AQR Managed Futures Strategy	AQMIX	01/05/2010	Alternative	9.40%	2.70%
Arbitrage	ARBNX	10/17/2003	Alternative	1.15%	3.60%
Eagle MLP Strategy	EGLIX	9/14/2012	Alternative	33.26%	23.90%
Altegris Macro Strategy	MCRIX	06/01/2011	Alternative	-7.37%	-7.01%
PIMCO All Asset All Authority Inst	PAUIX	10/31/2003	Alternative	-5.47%	7.04%
PIMCO Unconstrained Bond Inst	PFIUX	6/30/2008	Alternative Fixed	-2.21%	5.01%
PIMCO Low Duration Instl	PTLDX	05/11/1987	Taxable Fixed	0.10%	6.17%
Vanguard Interm-Term Tx-Ex Adm	VWIUX	02/12/2001	Non-Taxable Fixed	-1.48%	4.28%