Celestial WEALTH MANAGEMENT

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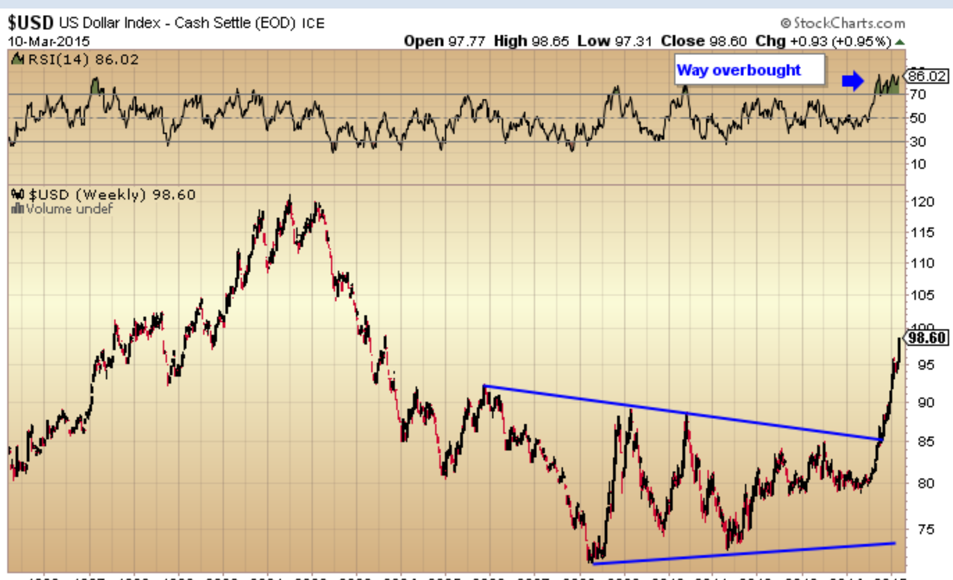
I. Negative Interest Rates?

The Dow Jones Industrial Average and the S&P 500 both made new highs in February. These new highs coincided with a concentrated burst of optimism carrying sentiment back to multi-decade extremes. Lacking a correction since 2011, more and more investors are taking on risk at a pace they may not realize by chasing what is "working".

At the end of February, Germany has five year bonds that sported a negative yield for the first time in history! That means investors are paying Germany for the priveledge of holding their bonds, apparently due to lack of other alternatives. Think about that for a minute. Investors in German bonds are accepting a guaranteed loss over five years irregardless of currency fluctuations. For a point of comparison, the United States five year Treasury bond yielded 1.57% as of the end of February.

One can see why capital is currently flowing into the U.S. bond market. It seems many in Europe are selling Euros and buying dollar denominated fixed income. In my opinion, this is the number one reason why the dollar has been in the midst of its largest rally in 15 years. The second largest reason is that so far in 2015 twenty countries have cut interest rates. The U.S. is one of the only countries that has been extracting liquidity from the market rather than adding. That being said, according to the RSI momentum indicator, the U.S. dollar is way overbought and has the potential for a significant pullback.



All performance referenced is historical and is no guarantee of future results
All indices are unmanaged and may not be invested into directly.

Previously in the first half of 2010 and the second half of 2011 the U.S. dollar rallied significantly**. Interestingly, each of those dollar rallies impacted U.S. exports, slowed economic growth, increased saving and either preceeded or accompanied a U.S. stock market correction greater than 15%.** It is possible that economic growth slows enough that the Fed delays the expected interest rate hike in June. This could coincide with a correction in the U.S. dollar.

II. Portfolio Construction

This seems like an opportune time to talk about diversification. An easy way to think about diversification is the statement, "Don't put all your eggs in one basket." That idea is predicated on the belief that if eggs are split up amont a variety of baskets, that all baskets will not break at the same time. Sound advice, but how does that hold up in a bear market such as 2000-2003 or 2008? When we experience a significant bear market, the majority of asset classes experience a severe downturn at the same time. The key to weathering a bear market and preserving profts made from a bull market is risk management. As famed money manager George Soros once said, "It's not whether your're right or wrong that's important, but how much money you make when you are right and how much you lose when you're wrong."

Most investors are not putting hard earned capital into the financial markets to gamble. Most investors are looking for a return greater than they could get in cash or CD's. Most investors realize that in order to potentially achieve those returns they need to take on various risks.
Risk can come in various forms…

- Risk of permanent loss of capital
- Risk of temporary loss of capital (volatility or drawdown)
- Illiquidity Risk (not being able to access capital)
- Interest rate risk (risk that a fixed-rate bond will decline in value as a result in a rise in interest rates)
- Currency risk (risk that the purchasing power of a given currency declines over time)
- Inflation risk (risk that the purchasing power of your home currency declining over time)

There are many other types of risks but these are just a few of the most prominent risks for investors.

One of the keys to diversification is to find investments, managers or strategies that perform differently in different investment environments. If all areas of your portfolio rise together, they will most likely fall together. When constructing a portfolio I first look for active managers that compliment each other. They often have a repeatable investment strategy that has stood the test of time, not the latest fad. Often they have certain risk management parameters built in to their management style.

Last week, the cyclically-adjusted P/E ratio of the S&P 500 surpassed 27, versus a pre-bubble norm of 15. According to John Hussman, never before have their 10-year return estimates on all conventional asset classes declined below 2% simultaneously. *"We have seen negative risk premiums on stocks before, but never in an environment where interest rates provided no way out of the situation."*

After 2008, many investors realized they were less interested in "making as much as possible" but were instead interested in prudently managing the risk of temporary loss of capital. **Essentially, investors decided they didn't want the market to control their portfolio.** This is one of the pillars at Celestial Wealth Management. In my opinion, through true diversification of low or uncorrelated assets and tactical risk management* via hedging or valuation based allocation decisions, investors can build portfolios that are appropriate for their level of risk tolerance while striving to achieve their long term goals. There is buy and hold (passive investing), there is buy and hope (invest and forget) and there is active management. Active managers react to changes in the global financial markets in real time. It is very hard for me not to see the logic in that for my clients. After 2008, many investors and financial advisors questioned the value of diversification. I think that was the wrong question. Diversification helps when done appropriately. The right question was to ask what true diversification is.

**Asset allocation does not ensure a profit or protect against a loss. Tactical allocation may involve more frequent buying and selling of assets and will tend to generate higher transaction cost. Investors should consider the tax consequences of moving positions more frequently.*

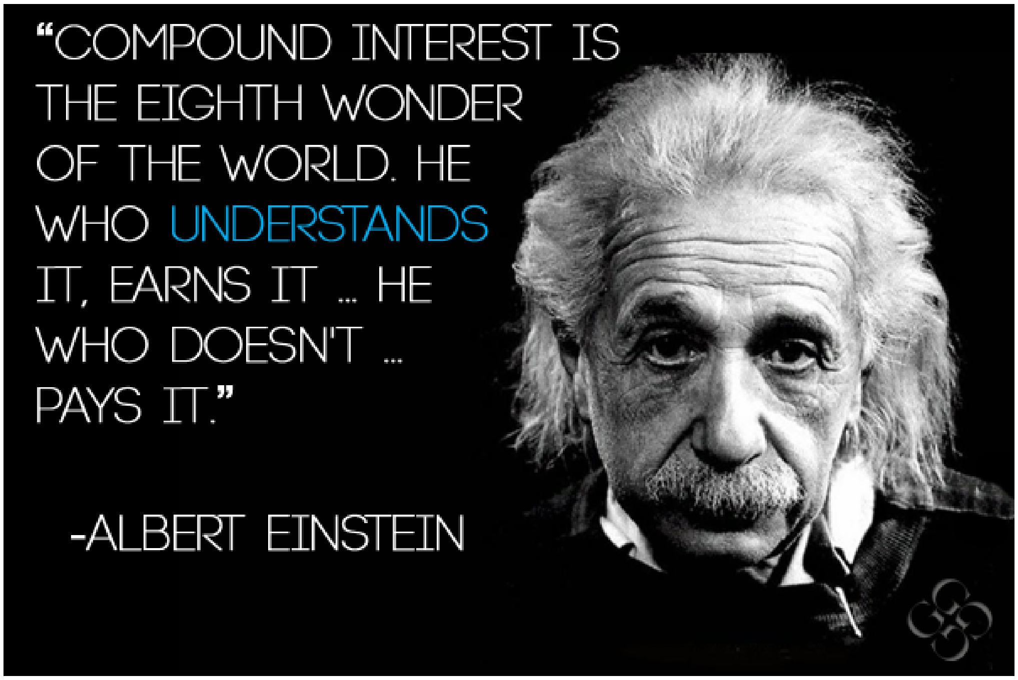
III. International Stock Markets

Currently, there are significant deflationary pressures in the Eurozone. It seems through the strength of the U.S. dollar, America may soon begin importing some of that deflation and that may cool the recent U.S. stock market rally. Conversely, in Europe, while the economies in Europe have not improved, the price action in industrialized international stock markets has improved significantly in anticipation of the European Central Bank (ECB)'s initiation of quantitative easing (QE) similar to the U.S. and Japan. For analysis purposes, I am using the MSCI International Index.

All performance referenced is historical and is no guarantee of future results. All indices are unmanaged and may not be invested into directly. The MSCI EAFE Index (Europe, Australasia, Far East) is a free float-adjusted market capitalization index that is designed to measure the equity market performance of developed markets, excluding the US & Canada.

This chart shows the developed international market performance since 2005. You can see from the chart that developed international markets are still far below their 2008 highs. Each dashed blue line shows a cross over in the short and intermediate moving averages. Basically, those crossovers act as entry and exit points. After weakness in the latter half of 2014, international developed markets have had a very solid rally and recent price moves have resulted in a crossover to the upside. The first buy signal since late 2012. Since Japan and Europe are running massive liquidity programs and trade at valuations roughly half of the United States, I feel they may offer much greater value and dividend yield for investors.

IV. The Magic of Compounding



We live in a world of high speed trading. Many "investors" hold securities for seconds, days or weeks. They aren't real owners, they are renters. Jumpy algorithms sell or buy based on some obscure piece of news in a remote part of the world. However, there is one, more permanent strategy that has powered investor returns for decades... compounding dividends and dividend growth over time.

Dividends provide a segment of return that is ALWAYS positive; there is no such thing as a negative dividend. Increases in dividends provide increased positive cash return, and consequently should increase the value of the instrument that produces that return over time. Positive fluctuations in cash flow are normal; negative fluctuations (dividend reductions) are rarer. Over time, reinvesting income that increases can result in annual yield from income alone that's far higher than anyone can reasonably expect from total return in the equity markets. In my opinion, the best way to get a high yield on capital in retirement is not to chase it but to wait for it to grow. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.

Yield on original investment is the income yield you would have today on an investment you made at some point in the past. An investor can potentially achieve annual INCOME returns at multiples of their original yield during an ordinary adult life. These aren't "paper gains" that you see on your investment statement, these are repeatable cash flows each and every year.

I believe the key is not to chase "high yielders" but to look for seasoned, quality companies with great business models in durable markets. These types of companies can be the cornerstone of a retirement portfolio because they can keep the compounding going. Over-leveraged companies or new companies may not be as durable. Attempt to avoid decreases in dividends by focusing on financial strength whenever possible.

Investment management firm Miller Howard has a great calculator on their website called the YOI Calculator. While I cannot put the web address here, if you google Miller Howard, you should find it. It is an interesting tool to play with.

V. Investment Ideas

- **Rather than trying to "beat the market", focus on beating the rate on cash. Plan for lower volatility and liquidity while seeking positive returns.**
- Equity valuations are very rich but masked due to the distortion of the Treasury curve. I believe volatility will return to the markets and think long/short managers are best positioned to capture this volatility by owning companies with strong businesses, barriers to entry, and good valuations and selling short weaker companies with high debt loads that have risen sharply with the broad market rally. I think this strategy of hedged equity may have the potential to produce attractive risk-adjusted returns if and when investors begin to question the valuations of companies. Stock investing involves risk including loss of principal. No strategy ensures success or protects against a loss. Long positions may decline as short positions rise, thereby accelerating potential losses to the investor.

- In 2013, the Affordable Care Act began implementation. There will be many winners and losers in the healthcare industry as a result of the biggest change in the healthcare industry's history. With the largest portion of the U.S. population entering their golden years, healthcare needs will become even more important. Long/short Healthcare seems to be a very attractive way to invest in a sector with lots of potential and lots of potential pitfalls. Investing in a specific sector involves additional risk and will be subject to greater volatility than investing more broadly.

- Exposure to foreign currencies and local denominated debt in countries that are net-creditors may make sense. Diversifying currency and bond risk around the globe in countries where you are compensated for the risk you are taking may be a strategy to be considered. Investors around the globe have the opportunity to diversify from their home currency, shouldn't you? International currency investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

- Supply problems remain high across the energy asset class. While there isn't a current shortage of energy on the planet, it is taking more and more energy to discover, drill, transport and refine it. Long term demand should continue to grow globally, particularly in China, India, and other developing countries.

- Potential food shortages due to inclement weather and higher demand from the emerging Asian middle class could result in a boon to agricultural land and potash fertilizer companies. International and emerging market investing involves special risks such as currency fluctuation and political instability and may not be suitable for all investors.

- Tight supply and a depressed single family home market are combining to keep apartment buildings full while driving rents higher. The number of potential renters continues to expand as a large cohort or echo boomers enters the workforce. Rents have been increasing as the desire to remain mobile and inability to secure home financing keeps renting attractive. In addition, low supply of new rental units should allow this space to flourish. Apartment REITS typically offer dividends and potential appreciation opportunities. Investing in Real Estate Investment Trusts (REITs) involves special risks such as potential illiquidity and may not be suitable for all investors. There is no assurance that the investment objectives of this program will be attained. The payment of dividends is not guaranteed. Companies may reduce or eliminate the payment of dividends at any given time.

- Precious metals mining companies have been extremely beaten down over the past two years. Mining is an industry that spans hundreds of years. These companies have been through good times and bad. Companies that mine for commodities are often highly cyclical, meaning they have sustained moves both up and down. When investing in the mining space it is important to be a contrarian. Ideally, you would want to accumulate miners when sentiment is poor around them and sell them when sentiment is positive. Historically this has been a good strategy.

No strategy ensures success or protects against a loss.

Regards,

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