October 1st, 2013

Money Matter$

A Quarterly Newsletter from Sommers Financial Management

Ph. (503) 397-1545 www.sommersfinancial.com

Volume 11, Issue 4

Investing in Real Estate, and other "Alternatives" in your IRA

by Adam Sommers

Did you know that you can buy the house next door as a rental with money in your IRA? Well, *you* can't—but your IRA can. Your IRA is basically it's own entity, and has nearly limitless ability to invest in all kinds of odd-ball—or hair-brained—investment ideas. **There is a small list of "prohibited transactions"**. Beyond lending or renting to yourself or family and investing in antiques and collectibles with IRA dollars, the world is pretty much your IRA's oyster. Officially, your IRA can't sell naked calls or use leverage, but done inside an LP or LLC it can. In short, you don't have to open a brokerage or bank account and buy only stocks, bonds, mutual funds, ETFs, CDs, and annuities inside your IRA; **the banks and brokerages just don't want you to know it**.

In 2013, we began suggesting to clients looking for "alternative investments" inside their IRA to review IRA Services Trust Company. As with all of our investment-related suggestions, IRA Services Trust is not paying us to write this, and we receive no referral fees to recommend them. Prior to discovering their IRA services (no pun intended), we had always shied away from alternatives in IRA accounts because of two huge inefficiencies. One, most IRA custodians of alternative investments charge at least $300/year and have other horrendous ancillary fees. Two, as your advisor, it was extremely difficult to communicate with other trust companies. Fortunately, **IRA Services Trust seems to have solved both issues**. For a 'one-holding' IRA, their annual fees are reasonable at around $115.

Obviously, TD Ameritrade does not typically have an annual fee; but if you want to hold a "non-standard asset" in your TDA account, they charge $250/year!

So for those of you interested in real estate investing and have all of your money tied up in your 401(k) or IRA, IRA Services Trust just may be your answer. Or, if you've heard about the Naked Alpha Fund and want to invest some of your retirement funds in that strategy, IRA Services Trust will act as your trustee/custodian. Recently, **clients have been lending on private notes secured by real estate, earning over 10% per year with the help of IRA Services Trust**.

If you're interested in something other than traditional stock/bond investments in your IRA, we are here to advise and facilitate.

> Your IRA … has nearly limitless ability to invest in all kinds of odd-ball—or hair-brained—investment ideas.

5-Year Returns

Dow Jones Industrial 30 Average: 7.9 %

S&P 500 Large Company Index: 8.9 %

NASDAQ Composite Index: 16.2 %

Russell 2000 Small Co. Index: 11.6 %

SFM's 'MODEL 25' PORTFOLIO: 8.8 %

SFM's 'NAKED ALPHA' FUND: 17.8 %

(see back page for current stock holdings in the Model Portfolio)

ETF Extra — Barron's 400 ETF (BFOR)

The new Barron's 400 ETF allows you to own some of America's most promising companies in a single share. Its underlying index collects some of the most fundamentally sound and attractively priced stocks from all corners of the U.S. stock market, using a disciplined stock-selection process. Four key attributes distinguish this ETF from other broad market benchmarks:

1. FUNDAMENTAL SELECTION
2. EQUAL WEIGHTING
3. DIVERSIFICATION & LIQUIDITY
4. REBALANCE DISCIPLINE

BFOR's Notable Statistics

Inception Date:	June 4, 2013
ETF Sponsor:	ALPS Advisors
Current price/share:	$ 27.18
Avg. Daily Volume:	55,656
Total Assets in the Fund:	$ 76 Mil.
Expense Ratio:	0.65 %

SFM's ORIGINAL "Model 25" STOCK Portfolio

Company Name	Value Grade	Cash Flow	Risk Grade	Market Cap
Apple, Inc.	B+	A-	B	Mega
American Eagle Outfitters	A-	B-	D	Mid
BB&T Corp	C	A-	B	Large
CA, Inc.	B-	A-	C	Mid
CF Industries	B-	A+	C	Mid
Coach, Inc.	C	A-	B	Mid
Chevron	A-	C	B	Mega
Corning	A-	D	B	Mid
IBM	B-	B-	A+	Mega
Intel	A-	C	A-	Large
JP Morgan Chase	C	A	A-	Mega
Marathon Petroleum	A+	B-	C	Large
Microsoft	B-	B+	A+	Mega
Oracle	D	A-	A-	Large
Occidental Petroleum	B-	B+	B	Large
Qualcomm	D	A-	A-	Large
RPC, Inc.	A-	A-	C	Small
Rio Tinto	A+	A-	B	Large
Southern Copper	C	A-	A+	Large
Siemens	A-	B-	C	Large
Seagate Technology	B-	A-	C	Mid
Terra Nitrogen	B+	A+	B	Small
Taiwan Semiconductor	A+	A-	A+	Mega
Vale	A+	D	B	Large
Exxon Mobil	B-	B-	A-	Mega

SFM ORIGINAL Model "25" Portfolio vs. A Relevant Benchmark

	SFM Model 25	S&P 500 Index
3-Month Return:	**3.9 %**	4.7 %
12-Month Return:	**9.7 %**	16.9 %
3-Year Average Annual:	**12.9 %**	15.8 %
5-Year Average Annual:	**8.8 %**	8.9 %
Since Inception (6/1/2003):	**17.8 %**	7.2 %

Commentary & Ramblings

By Adam Sommers

Moving is expensive. Traveling is expensive. Owning a business is expensive. Water is expensive (it was sure nice having our own well the past eight years). **Health insurance appears to be getting MUCH more expensive** beginning in 2014. All this cost realization has been thrust in front of me the past three months as we made our way down to Tucson.

You know what else are getting expensive? Stocks. We track how "undervalued" or "overvalued" stocks are using a combination of trailing P/E ratios, projected forward P/E ratios, earnings growth rates, and the yield on the 10-year U.S. Treasury bond (an alternative to stocks as a place to invest your cash). Six months ago 10-year US Treasury bonds paid 1.6% per year for the next ten years. Now they pay 2.7%—that's **a 70% increase in a very short time**. Given the surge in the stock market and the change in 10-year treasury yield, it appears stocks have come from being under-valued by 25%+ to over-valued by about 1% over the past six months.

As we saw during the tech bubble, stocks can become ever more over-valued, and for a long period of time (stocks have been under-valued by 20-30% since 2009 — four years!), so **it doesn't mean it's time to sell your stocks and head for the hills**. But it sure makes it hard to find bargains.

So if stocks aren't attractive, that must mean bonds are, right? Well, if you think locking in a 2.7% yield for the next 10 years is attractive, you probably haven't been reading my drivel very long. Bonds of course have credit risk, or the risk of the issuer defaulting. **But the bigger risk these days is interest rate risk**: the risk that interest rates continue their rise off the lowest level in generations. As you may have heard, as interest rates rise, bond values fall. Why would I want your bond paying 1.6% from six months ago if I could get 2.7% from a new issue? You'd have to discount what you're asking for your bond to make it equate to a 2.7% yield for me to even sniff at it. And that's your basic lesson on interest rate risk.

So if we don't see a lot of value in stocks or bonds at today's levels, where do we turn for return on investment going forward? We are looking for "alternative" investments; investments that are not necessarily correlated to stocks or bonds. We have been reducing our bond exposure in client portfolios, and replacing it with a mix of cash and alternatives. Some of the alternative investments we're using include option strategies (using puts and calls), real estate investments, MLPs, commodities, floating rate notes, and private lending.

In the first few months of my Arizona adventure, I've been able to research, review, and build strategies to solve these investment conundrums. I won't begin marketing an Arizona branch until **our Oregon branch is operating smoothly and our strategies and processes are outlined and nailed down**.

For example, I developed a way to use HVPW (highlighted in our July 2013 newsletter) — along with options to manage the downside risk—that I project should earn 7-15% per year (of course not guaranteed). If you're interested in learning more or discussing alternative strategies, please give me a call.