WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

OUR PLEDGE TO CLIENTS: TO PUT YOUR INTERESTS FIRST AT ALL TIMES. TO ADHERE TO THE HIGHEST ETHICAL BEHAVIOR IN FULFILLING OUR FIDUCIARY DUTY. TO OFFER OUTSTANDING SERVICE WITH EXCELLENT PERFORMANCE.

Investments and Wealth Management January 2015

The U.S. energy renaissance is on hold following a collapse in oil prices last year, down 45% to under $50/barrel. There is likely further to go since the recent high was reached only last June, and OPEC has vowed to continue pumping. The news is not good for many energy producers and service companies, but the economy is set to benefit overall from the lower cost of fossil fuel. International capital flows have favored the U.S. with a strong dollar. Large company stocks and investment-grade bonds both rallied in price last year. The gains were broad based in technology, financials, real estate, utilities, and health care. Energy, telecom, and international equity funds crimped our returns last year.

Investment grade corporate and tax-exempt municipal bonds were big winners in 2014. Strong demand from wealthy individuals, banks, and insurance companies has led to record high prices for these bonds. High yield, or non-investment grade bonds have turned lower. Approximately 17% of high yield bond market is comprised of energy related companies. Although it's early in the decline, we are becoming more interested in this space while closely monitoring prices and news of any impairments.

The Fed has now stopped the quantitative easing program and has signaled an intent to begin raising short-term rates later this year, provided that the economy continues to show strength. This does not mean that long-term interest rates will follow suit. Much to everyone's surprise, long-term interest rates dropped last year. The 10-year Treasury yield went from 3.04% to 2.17%. Given competing government bond yields overseas, the path of least resistance in the U.S. is flat to lower. Germany, Switzerland, and Japan all have 10 year government bond yields below 0.50%, so they are flocking to the U.S. treasuries for a higher yield and a stronger currency.

The current U.S. stock bull market began in March 2009, is intact and we are still trading well above long-term support levels. Valuations are a bit stretched at this point, so the upcoming quarterly earnings reports will hopefully provide more fuel for further price increases. We are cautiously optimistic for 2015, believing that global stock markets will continue to grind higher. We always look to last year's laggards for turnaround candidates, so international equity funds, telecom stocks, and high yield bonds are on the shopping list for 2015.

Municipal Bonds – The muni market continues to fire on all cylinders as governmental entities have seen tax revenue increase due to the improving economy. Most new bond issues being brought to market are being done to refinance higher interest bonds that are being "called" or redeemed by the issuer. Muni bonds are typically callable five years after being issued. Demand has been brisk for a limited supply of these tax-exempt securities so prices have continued upward.

The big price rally means that new individual bonds are being brought to market at very low yields, so we have gravitated toward actively managed no-load funds to capture higher yields. We own the **American Century CA High Yield Municipal** and the higher quality **Vanguard CA Intermediate Term**. Last quarter we added the **Franklin CA Tax-Free Advisor Class**, with a 4.1% current tax-free yield. Franklin has historically been offered with a sales charge or load, but we bought a newer share class that carries no load and designed for clients of independent fee-only advisors. The top two holdings in the Franklin muni fund are local revenue bonds issued by the Foothill and San Joaquin Tollroads.

Open-End Bond Funds – For conservative money, our top choice is currently the **Doubleline Total Return Bond Fund**. Lead manager, Jeffrey Gundlach and his L.A. based team are experts in mortgage-backed securities. They keep risk low with a 3.2 year duration, while still producing a current yield over 4%. Last quarter, in light of sector outflows and an eroding share price we sold the Loomis Sayles Floating Rate Fund. We bought more of the higher-quality Doubleline fund, and also increased our position in the **Loomis Sayles Strategic Income Fund**. This multi-sector fund has a value tilt and is skippered by veteran manager Dan Fuss. The Boston based team does a great job of blending fixed-income securities to offer a smooth ride with a current dividend yield of 3.5%, and 2014 total return of 5.9%.

Closed-End Bond Funds – We own the **Doubleline Income Solutions** fund (DSL) in this space, which is also managed by Jeffrey Gundlach and his team. These funds are more volatile versus their open-end cousins, but also carry higher yields. This is the result of leverage, or short-term borrowing that's used to expand the holdings and increase the yield. This strategy works well in a flat to declining interest rate environment, so we are O.K. for now. The fund trades at a 7% discount to net asset value, and the monthly dividend provides an above average 9% annual yield. We have also reestablished a position in the **Pimco Dynamic Income** fund (PDI). This one is managed by Dan Ivacsyn, who was named chief investment officer when Bill Gross resigned. These types of funds are best used in smaller doses and in IRA accounts to shelter the large cash distributions.

Common Stocks –Retail stocks rallied last year as consumer spending has picked up as a result of more people working and lower gasoline prices. **Nordstrom**, **Costco**, **Starbucks,** and **Buckle** all benefitted from this trend. **Amazon** sat out the rally due to a string of disappointing quarterly reports. The ecommerce king is showing strong top line revenue growth, but is investing heavily for the future which is depressing current earnings. Their AWS (Amazon Web Services) division is a top choice for enterprise and governmental agencies looking to migrate data storage to the cloud, so we are sticking with them.

Financial stocks **Wells Fargo**, **Wisdomtree Investments**, and **Berkshire Hathaway** had a good year. Health care company **Abbvie** is making progress with Humira and a robust pipeline of promising new drugs. **Apple** had a great year with the introduction of the iPhone 6. **Qualcomm** was held back by a royalty dispute with Chinese manufacturers, but the company remains on the cutting edge of wireless technology. Other gainers last year included utility **Sempra Energy**, and industrial conglomerate **DuPont**. Increased competition held back our telecom stocks, but they both remain very profitable. **Verizon** is paying down debt from the Vodafone acquisition, but still pays out a dividend yield of 4.7%, while **AT&T** has a merger pending with Direct TV, and pays 5.5%.

Our energy holdings, **Chevron** and **ExxonMobil,** held up relatively well, but believing that additional downside risk is higher with Chevron, we sold this long-time position last quarter to reduce exposure to the integrated majors. Buying back shares at a lower price later this year is always an option. We continue to hold ExxonMobil, the 800 pound gorilla that will weather the storm and come out shining due to their low debt, high return on equity, and 2.9% dividend yield. The dividend has been raised annually for the past 32 years.

Pipeline companies are more insulated from commodity price swings, so we have established a new position in **Kinder Morgan, Inc.** (KMI). A recently completed corporate consolidation has eliminated the cumbersome MLP (Master Limited Partnership) structure and made KMI the largest energy infrastructure company in North America. They own and operate pipelines and terminals primarily for natural gas and refined petroleum products. Commodity price risk is minimized since most of this business operates as a giant toll road with fee based revenue representing 82% of cash flow. The company has a large $17 billion backlog which will drive future growth. Current annualized yield from the quarterly payout is 4.2%. Please note: Client holdings will vary based on inception date, objectives, and risk tolerance.

International Stock Funds – Most foreign stock funds posted modest losses for 2014, so they represent a reasonably good opportunity moving forward as a contrarian rebound play. We have maintained a 10 - 15% allocation for risk tolerant accounts to this sector given the compelling valuations in Asia and Europe. Our largest holding continues to be the **Matthews Asia Growth & Income** fund for lower risk exposure to the Pacific Rim. We have also maintained a position in the **iShares Korea ETF** for their high quality manufacturing prowess. **Oakmark International** was a disappointment last year, but portfolio manager David Herro is sticking to his value roots. Switzerland based Credit Suisse Group is a top holding, along with auto makers Daimler, Toyota, and Honda. Herro has a history of strong come backs after periods of underperformance, but patience is required. **Grandeur Peak Global Reach** gives us access to off the radar small and mid-cap stocks and remains closed to new investors.

If you have any questions or comments regarding your portfolio, or any changes in your health or finances, please let us know. Thank you for your continued trust and confidence.

Scott Walker