WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

Investments & Wealth Management July 2013

Greetings! Hope you are well and enjoying the summer. It's been a tough couple of months for us since bond prices peaked and interest rates bottomed in early May. During June, pricing pressure intensified on financial assets with Chairman Bernanke's statement that the Federal Reserve's asset purchases will be scaled back later this year if the economy continues to improve. The 10- year Treasury yield was 2.49% at the end of June, up from 1.63% two months ago. Central banks control short-term interest rates, but longer-term rates are at the mercy of global capital flows. The flow of money into bond funds over the past few years has been daunting, and the billions of net redemptions in June may be just the beginning of a reversion to the mean. Treasury yields are still substantially below historical averages, so we have assumed a defensive posture with our fixed-income holdings. During the quarter we reduced bond fund exposure and raised cash to preserve capital. Keeping duration short with nearer-term maturities is the best defense in a rising rate environment. Duration measures interest rate risk, so a 3-year average duration means your value will drop 3% for every 1% rise in interest rates. We made the decision to sell most bond funds to lock in a profit (or cut the loss for newer clients), to preserve capital. We always have the option to buy them back at a lower price.

There are also better fixed-income alternatives in the form of ETF's. Exchange-traded funds typically track an index, and they come in all different flavors. ETF's generally carry a cost advantage over actively managed funds, along with the flexibility to buy & sell during the trading day with a limit order at a specified price. Our newest addition for a "relatively safe" income investment is a bond ETF that pays a monthly dividend with a 4.1% yield, the **Pimco 0-5 Year High Yield Corp. Bond Index ETF**. With a two-year duration interest rate risk is minimized. We have continued to hold the **Doubleline Total Return Bond Fund** which held up better than most during the bond rout since lead manager Jeffrey Gundlach is defensively positioned with a 3.2-year duration. His expertise in mortgage-backed securities generates a current yield of 4.8%. We continue to hold many individual corporate and municipal bonds which are structured in a ladder of different maturity dates primarily in the 1 – 7 year range.

For the past three months the average net return for our managed accounts was -1.48%, and year-to-date we are +1.49% net of fees. Accounts with more equity exposure achieved higher returns. Compared to the last few years, these results are disappointing but we have made changes within fixed-income, and with the bull market maturing many stocks are near all-time record highs, so we prefer to error on the side of caution and patiently wait for opportunities to add positions at more favorable prices. Our best performers last quarter included **Actavis, Berkshire Hathaway, DuPont, Intel, and Wells Fargo**. Detractors were **Apple, IBM, Lennar, Eli Lilly, Qualcomm and gold**. We took profits on Actavis, reduced our Apple position, and eliminated gold. It appears the twelve-year bull market in gold has come to an end, as bullion has continued to sell off, with inflation fears receding and the dollar gaining strength.

Equities – Knowing that dividends have historically provided about ½ the total return for stocks, we own many mature companies that reward shareholders with a quarterly cash payout. The frosting on the cake is when our companies increase the dividend. A favorite low-cost way to play this theme is with the **SPDR S&P Dividend ETF**. This basket of 86 blue chips tracks the S&P dividend aristocrats index. Only companies that have increased their dividends annually for 20 consecutive years qualify. The current yield is 2.7%, with total returns substantially higher.

We recently added a couple of new picks in the health care sector. Irvine-based **Edwards Lifesciences** is a turnaround play that has missed estimates the past two quarters and is 40% off its 52 week high. This heart valve specialist was spun off from Baxter in 2000. Edwards serves patients in nearly 100 countries and has pioneered transcatheter heart valve replacement which avoids traditional open-heart surgery. Their newest product is not yet FDA approved in the U.S., but has been used widely in Europe and just gained approval in Japan on June 24th. With many emerging countries adopting western eating habits, cardiovascular disease is not going away.

Abbvie is a recent spin-off from Abbott Laboratories. Spin-offs in general have been good investments since management can focus on improving a narrower segment of the former conglomerate. Abbvie is a biopharmaceutical company with a diverse product portfolio which includes Humira for rheumatoid arthritis. The company is reasonably valued with a nice 3.7% dividend yield.

Real Estate Investment Trusts (REIT's) – These exchange-traded vehicles are required to pay out at least 90% of their taxable income annually to avoid tax at the corporate level. This feature generates an above average cash dividend to investors. Selling pressure in this sector created an opportunity to pick up shares of **Realty Income Corp**., an Escondido based triple net lease company. They own retail properties in 49 states leased to regional and national chains. Some of their largest tenants include Fed-Ex, L.A. Fitness, Family Dollar, AMC Theatres, and Walgreens. They have a 98% occupancy rate with built in escalators on the leases which allows the company to increase their dividend. The current yield is 5%. At this time, we have purchased shares only in retirement accounts due to accounting and tax-related issues when shares are held in accounts which are not tax-deferred.

Inheriting an IRA – A surviving spouse has a unique right in being able to roll the decedent's IRA into his/her own IRA. The surviving spouse can then name his/her own beneficiaries and delay required minimum distributions until they reach age 70½. The surviving spouse also has the ability to convert the IRA to a Roth IRA if desired. If the surviving spouse is under age 59½ and needs to tap the account, the IRA should not be rolled over. In this case, it is better to re-title the existing account with the current custodian to avoid penalty tax on any withdrawals prior to age 59½. Non-spouse beneficiaries may not combine an inherited IRA with their own IRA. In this case the inherited IRA will be subject to required minimum distributions (RMD's) over the life expectancy of the beneficiary; however they can always take out more. Non-spouse beneficiaries are not subject to withdrawal penalties, but ordinary income tax does apply. It's generally best to withdraw only the RMD, since the balance continues to grow tax-deferred. If an IRA has more than one beneficiary, the custodian typically splits it into an IRA for each heir. The deadline for this is December 31 of the year after death. IRA's with individually named beneficiaries automatically avoid probate, so a revocable living trust typically does not come into play with an IRA.

Retirement and Tax Planning – If you are age 50 or over and still working, be sure to take advantage of the "catch-up" provision with your retirement savings plan. This provision allows an additional annual contribution of $5,500 for a 401(k), 403(b), or 457 plans. This amount is on top of the $17,500 maximum elective salary deferral. Total of $23,000 pre-tax, so go for the max Regular and Roth IRA annual contribution limits have also increased to $5,500 this year, plus a $1,000 catch up for those age 50 and over. Please check with us for rules regarding eligibility and deductibility of contributions.

If you have any questions or comments regarding your portfolio, please let us know. Thank you for your trust and confidence. We work hard to earn it.

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