WALKER FINANCIAL ADVISORS, INC.
Registered Investment Advisor

Investments & Wealth Management July 2014

Strategy – Our basic philosophy remains unchanged which is to hold a balanced portfolio of individual securities (dividend stocks & bonds), along with mutual funds for managerial expertise, and ETF's for targeting sectors. We are risk averse and look for value that is mispriced by the market. It has gotten a lot tougher lately to find much discounted merchandise with the run up in prices that we've had. A pull back of 5% or so in the equity markets would not be surprising this summer or fall, given that we're in the seasonally weak time of year. We control risk through the portfolio construction and security selection process, while taking into account the age and objectives of each client. The economy continues to gradually improve, so we would use any correction as an opportunity to add to, or upgrade, our equity exposure. We have been favoring large-cap dividend paying stocks and international stock funds lately for new buys.

Stock Bubble? – The Dow just topped 17,000 for the first time and the S&P 500 is at an all-time record high, so a rational person has to ask if we're in another stock market bubble? The recent IPO mania and high margin debt are warning signs of market excess and reminiscent of 1999. But the similarities end there, since earnings are significantly higher now and valuations more reasonable. In January 2000, near the tech bubble peak, the S&P 500 trailing P/E ratio was 29. In January 2008, before the housing bubble popped, the same P/E was 21.5. Today the trailing P/E for the S&P 500 is 19.5. The long-term average is 15.5, so valuations are no longer cheap, nor are they in bubble territory either.

Bonds & Interest Rates – Treasuries have surprised everyone this year and rallied in price, with yields reversing lower and the 10-year bond yield dropping to 2.55% from 3%. This U.S. rate is still 1% higher than German or Japanese interest rates, so foreign investors continue to finance our deficit spending and invest in dollars. Can we always count on them to step up at future Treasury auctions? As economic growth picks up there is a real risk that interest rates will move higher, which hurts most bond prices. This process is likely to slowly unfold over the next few years, as the Fed gradually normalizes monetary policy and eventually raises the Fed funds rate. This is not the time to reach for yield and extend maturities, so we have become more defensive.

For conservative money, we still like the shorter-term **Pimco 0 – 5 Year High Yield Corporate Bond ETF**. With duration of less than one year, interest rate risk is low. The monthly dividend produces a 4.4% current yield. In addition, a floating-rate bank loan fund gives us a smooth ride and a hedge against higher interest rates down the road. The **Loomis Sayles Senior Floating Rate and Fixed Income Fund,** with a 5.4% current yield, is our top choice.

Our gains were padded last quarter by the rally in bond prices that we do not expect to repeat. As a result, we have taken profits in our best performer, the **Pimco Dynamic Income Fund** to nail down a 12.4% gain, including dividends, over our six-month holding period. A strengthening economy and accompanying higher interest rates would hurt this leveraged fund, so we sold it to nail down the gain. We are more tactical and willing to sell a bond fund or ETF versus a good stock or equity fund. We do continue to hold **Doubleline Income Solutions**. The closed-end

fund came out last year near the top in the bond market, and we got interested after it got crushed in last year's selloff. Now trading at a 6% discount to the net asset value, the fund has a 45% emerging market stake, 6.7-year duration, and leverage to enhance the yield. Current distribution rate is 8%.

Municipal Bonds –The muni market has been on fire this year and we have ridden the wave with individual tax-exempt bonds, and the **American Century CA High Yield Municipal** fund. We have a trailing sell stop price for this fund to protect our gain if the share price violates our downside threshold of $10/share. Monthly dividends are 100% tax-exempt (Fed & CA), so the 3.9% current yield works out to a much better taxable equivalent yield for our higher bracket clients.

International Stock Funds – Equity markets worldwide do not move in tandem and owning some foreign shares can dampen the risk of an all U.S. stock portfolio while also enhancing returns. We currently favor Europe for attractive relative valuation and Asia for the best economic growth at a reasonable price. Most of our exposure is via actively-managed funds with the **Oakmark International** fund our top pick for European exposure. **Matthews Asia Growth & Income** provides the smoothest ride of any Asian investment, and the **Grandeur Peak Global Reach** stock fund gives us a proven management team, and a small asset base. We also continue to hold the **iShares Korea ETF** which was acquired a year ago when pricing was more favorable.

Common Stocks – It's easy to become attached to a stock after it has gone up, and can be difficult to say goodbye and sell, but mediocre performance can only be tolerated for so long when other stocks in the sector are moving up and your stock is stuck in neutral. So last quarter we finally cut **IBM** loose. Revenue has now declined for eight quarters and debt is increasing. In two years, the new CEO has failed to make a difference. We plan to replace them with a better growth & dividend opportunity. **Caterpillar** was also sold last quarter to protect our profit when this cyclical company announced numbers showing weak international sales. Energy holdings **Chevron** and **Exxon Mobil** remain two of our largest positions that are safe harbors in a storm and serve as insurance against global unrest and instability in the Middle East.

New Holdings - For our moderate to aggressive accounts, we own **WisdomTree Investments** (WETF). This is the management company for the WisdomTree ETF family. It is seeing steady asset inflows as investor's gravitate to their unique brand of dividend weighted and country specific exchange-traded funds. We also own and recommend their small cap dividend ETF, symbol DES. **Yandex, NV, Class A** (YNDX) was added to a few of our higher risk accounts after its share price was torpedoed following the Russian invasion of Ukraine. Headquartered in the Netherlands, Yandex is one of the largest internet companies in Europe, operating Russia's most popular search engine. The company also has operations in Ukraine, Kazakhstan, Belarus and Turkey. The company trades on NASDAQ in the U.S., and has a partnership with Google. Internet adoption in Russia is in the early stages with big market potential once the current geopolitical skirmish blows over.

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

Scott Walker