



# Mentor Monthly Missive

Financial Planning News

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## Don't Feel Sorry for the Punished Small-Company Stocks

Small stocks have been punished this year. As of Oct. 10, the S&P 600 SmallCap Index was down 8.21% since Jan. 1. In contrast, over the same period the S&P 500 Index of large-cap stocks was ahead by 3.13%.

We view this as a potential buying opportunity rather than a reason to bail out. In our portfolio construction process we allocate amounts specifically to the small-company asset class (defined as roughly \$500 million to \$2 billion in market capitalization) knowing that its performance frequently diverges from that of large companies, as it has been doing of late.

An 8.21% loss is pretty close to bear-market territory for the small-caps. Although we don't pretend to know when small-caps will bottom and bounce back, we do know that markets tend to revert to their mean performance. And that's what we are confident will happen with the smalls

What is behind the small-cap downturn has been valuations. The smalls have been just too pricey, relative to their earnings.

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### Mentor Capital Client Corner

#### Tax Planning Continues Now

We're coming down to the wire for income tax planning for 2014. Most strategies for minimizing taxes and avoiding unpleasant surprises must be implemented between now and Dec. 31.

It's a good time to review your withholding and estimated payments to make sure they'll be sufficient to avoid penalties and interest. If you'll be facing a big tax bill next April or a big tax refund, you still have time to adjust.

Bunching deductions and deferring income are always good strategies, due to thresholds for some itemized deductions.

We know that taxes are the last things on your mind, as we head into the holidays. But it pays to take a close look before it's too late. We can help – just give us a call.

## Meet our Wealth Managers

**Mentor Capital Management Inc. was founded in response to the belief that a consumer's best interests are served when his or her financial planner is Fee Only. Advisors of Mentor Capital strive to provide objective, prudent and thoughtful advice to clients based on their personal goals and objectives.**



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## Don't Feel Sorry for the Punished Small-Company Stocks

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As of Sept. 30, the P/E ratio for the S&P 500 was 18.42; for the S&P Small-Cap 600, it was 20.82. Another valuation measure, return on shareholders' equity (ROE), was 10.87 for the S&P 600, 20.97 for the S&P 500. ROE measures the profit a company (or the companies in an index) generates based on the money shareholders have invested in that company. The higher the ROE, the greater the profitability

Writing in the July issue of the journal of the American Association of Individual Investors, John McDermott and Dana D'Auria noted that small-cap stocks beat large-cap stocks on an annual basis only about half the time between 1926 and December 2013.

“While we are unable to forecast future returns, we can look at historical stock returns for evidence of a small-cap premium,” the authors said. “The well-known small-cap factor index called “SmB,” (small minus big) was created by professors Eugene Fama and Kenneth French to measure the performance of U.S. small-cap stocks relative to U.S. large-cap stocks. The annualized return of SmB from July 1926 through December 2013 is 2.22%, providing evidence for a small-cap premium. However, SmB is positive in only a little more than 50% of calendar years, evidencing that small-cap outperformance in any given year is far from a sure thing and more like the flip of a coin.”

In other words, to benefit from the small-cap premium, the asset class must be held for an extended period of time.

As we do each quarter, we are methodically reviewing client portfolio allocation among all the classes, small-cap stocks included, to determine whether rebalancing is in order. When actual exposure to an asset class deviates by a set percentage from its target, we rebalance, selling high-performing classes and buying low-performing ones.

A note: We believe the best way to capture the characteristics (risk and return) of an asset class is to invest in a low-cost exchange-traded fund. Mentor Capital client portfolios right now contain the iShares Russell 200 ETF (IWM), the Vanguard Small-Cap ETF (VB) and the Schwab Fundamental U.S. Small Company ETF (FNDA).



### Correction

An article in the September newsletter about investing in REITs contained an error.

To avoid double taxation, a REIT must pay out 90% of its net operation income to its shareholders, although it may distribute 95% of its net operating income. We apologize for the error.

# What Happens to my Credit Card Debt?

If you're like millions of Americans, you have credit card debt—and you may wonder what will happen to the debt upon your demise. Essentially there are two main factors that will determine who is responsible for your credit card debt after you die: whose name or names are on the account and where you live.

## **Whose name is on the account?**

If the card is only in your name, your estate is responsible for the debt. As the estate goes through probate, the executor or administrator of the estate will make a determination of the assets and debts of the estate and pay off debts in the order that state law requires. If assets remain after that, they will be distributed to heirs according to your will or, if you don't have a will, state law.

Remember that not all assets go through probate, however; things like insurance proceeds, IRAs, and 401(k)s usually go to beneficiaries without being counted as assets in the estate; accordingly, beneficiaries receive those regardless of debts, and an executor or administrator of an estate can't use them to pay off credit card debt.

If you share your credit card account with someone else, *i.e.*, someone else also signed the application, that person could be held responsible for the debt; if there is another person listed on the account but only as an authorized user, they will not be responsible for the debt. An authorized user is generally someone who can use the card but didn't sign the application and doesn't pay the bills.

## **What happens if the estate's assets don't cover the debt?**

If your estate is solely responsible for the debt and there isn't enough money in your estate to cover it, the debt ends there. The credit card company has to write it off, and neither your heirs nor anyone else can be held responsible for it.

## **What about community property states?**

One caveat to all of above information comes in so-called "community property" states, in which assets, and sometimes debts, accumulated throughout a marriage are considered marital or joint property. States that have community property rules are Alaska, Arizona, California, Idaho, Louisiana, Nevada, New Mexico, Texas, and Washington, but provisions vary regarding debts, so be sure to inform yourself of your specific state law on the issue.

### **Have a question?**

Do you have a question or want more information about any of the issues discussed in Mentor's Monthly Missive? Are you concerned about whether the financial decisions you're making are right for you? Would you like a second opinion about an action you're thinking of taking or something recommended to you by a stockbroker or insurance agent?

We offer a no-obligation initial consultation that might help. Please phone to set an appointment with one of our advisors. It could be the most financially worthwhile 45 minutes you've ever spent!



## Market Commentary from Vanguard & Co.

It was a good week for economic news. Inflation remained below the Federal Reserve's 2% target rate, home sales showed growth, and The Conference Board's Leading Indicator Index was positive.

For the week ended October 24, 2014, the S&P 500 Index rose 4.1% to 1,965 (for a year-to-date total return—including price change plus dividends—of about 8%). The yield on the 10-year U.S. Treasury note rose 7 basis points to 2.29 (for a year-to-date decrease of 75 basis points).

### Drop in energy prices help hold rise in consumer prices to 0.1%

The Consumer Price Index (CPI) reversed August's decline, gaining 0.1% in September and 1.7% over the last 12 months. When setting monetary policy, a key indicator the Federal Reserve considers is CPI inflation, which it's currently targeting at an annual rate of 2% or below. A 0.7% decline in the energy index wasn't enough to offset increases to shelter and food, both up 0.3%, and medical care commodities, up 0.5%. Gasoline prices, which fell 1.0%, extended their downward movement for a third month. Cost indices for new and used vehicles, as well as apparel, remained unchanged from the previous month.

"A sustainable increase in prices continues to be challenged by lower oil prices, and by deflationary pressures from recent weakness in the global economy," said Vanguard economic analyst Vytas Maciulis. "This could potentially slow down price growth in the near term and diverge from the Federal Reserve's inflation target of 2%. It will be interesting to see how much these conditions will affect the Fed's monetary decision when they meet next week."

### Existing-home sales rise yet again

Existing-home sales rose 2.4% in September to an annualized 5.17 million. Sales are at their strongest pace in 2014, according to the National Association of Realtors. While the number of existing homes sold exceeded analysts' consensus expectations of 5.10 million, it's still 1.7% less than September 2013's total of 5.26 million. The median existing-home price was \$209,700, up 5.6% from the previous September. This was the 31st consecutive month of year-on-year price gains.

### Leading indicators up for the 12th month out of last 14

The Conference Board's Leading Economic Index (LEI) rose 0.8% in September to 104.4. The increase—the 12th in the last 14 months—was slightly above economists' consensus expectations of 0.6%. The Conference Board economists expect moderate growth for the U.S. economy through the end of this year, according to the LEI press release.

### The economic week ahead

Economic reports scheduled for release this week include: an advance look at durable goods, along with The Conference Board's Consumer Confidence Index on Tuesday; the Federal Reserve's monetary policy statement on Wednesday; GDP on Thursday; and employment costs and personal income on Friday.

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