LYKE Financial Inc.

Investing Insight

LYKE FINANCIAL, INC.

# 2012 Investment Overview

**Highlights:**

After a flat 2011, the US stock market posted a strong first quarter as the US economy showed signs of improvement and perceptions of the European debt crisis improved. The S&P 500 had its best first-quarter rally in 14 years, closing near a four-year high and a 12.6% total return. When the second quarter began, markets retreated as Europe's debt crisis returned to center stage and signs of slowing global growth emerged—especially in China, where lower world demand had begun to affect exports.

By June, US stocks had surrendered all of the year's gains as markets weighed how credit problems in Spain and the anticipated Greek elections would affect the euro zone's sovereign debt problems. The US economy showed more signs of weakness. Stock markets around the globe stumbled in the second quarter, with non-US stocks suffering the most. During the summer the markets improved as European tensions eased on increased European Central Bank loans to Spain and Italy. There was also rising speculation that the Federal Reserve was prepared to deliver additional monetary stimulus to the US economy. Throughout the summer, analysts reduced their estimates of expected corporate earnings growth as an economic slowdown threatened to reduce profits.

In September, the Fed announced its third round of quantitative easing to push long-term interest rates lower and encourage more borrowing and investment. The Bank of Japan also announced an ambitious plan to stimulate its economy. These central bank actions helped drive the markets during the third quarter. The S&P 500 surged 15% from its June 1 low and reached a five-year high on September 14. US economic indicators sent mixed signals, but the economy reportedly expanded at a 3.1% rate for the quarter—the fastest pace since late 2011. Mortgage rates reached historical lows, and year-over-year home prices rose for the first time since the 2007 financial crisis.

In the fourth quarter, investor attention turned to the close US election and the prospect of gaining certainty regarding future government spending, taxes, growth policy, and regulation. Stocks fell in the weeks following the election as investors gauged the prospects of continued political gridlock and the economic impact of spending cuts and tax hikes, known as the "fiscal cliff." The S&P recovered its earlier losses by late December, however, and as the year ended, lawmakers scrambled to reach a compromise.

**Market Summary:**

<u>All major US market indices were up substantially for 2012</u>. The S&P 500 with dividends included, logged a total return of 16%. The NASDAQ Composite Index gained 15.9% for the year, and the Russell 2000, a popular benchmark for small company US stocks, returned 16.3%. The Dow Jones Industrial Average gained 7.3%.

<u>Non-US developed market indices performed even better</u>. The MSCI World ex USA Index, a benchmark for large cap stocks in developed markets outside the US, returned 16.4%. The MSCI Emerging Markets Index returned 18.2%. *(Continued on page 3)*

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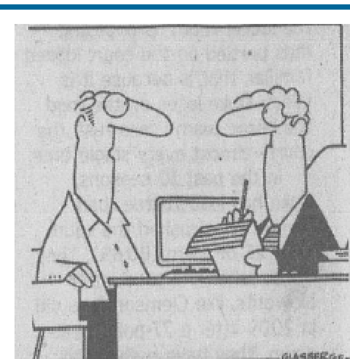
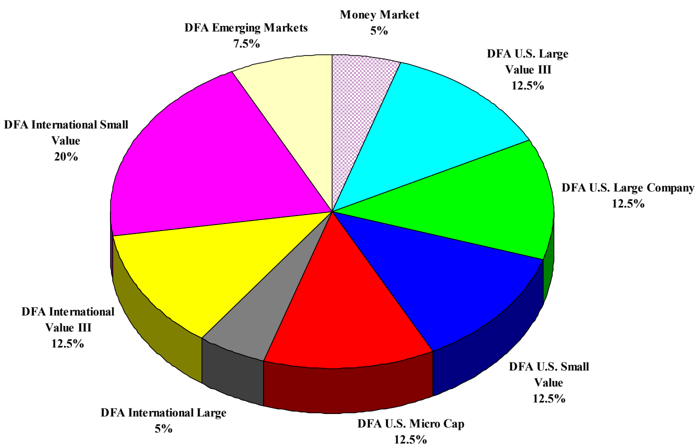


*"I do have a diversified retirement plan: 30% hopes, 30% wishes, 40% prayers."*

# Portfolio Returns:
# January 1, 2012—December 31, 2012*

## AGGRESSIVE GROWTH

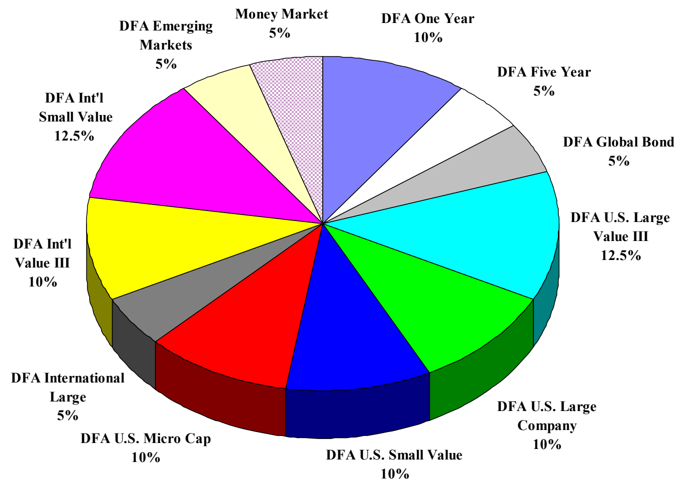
### 95% Equities/5% Fixed




**Rate of Return 17.53%**

## LONG TERM GROWTH

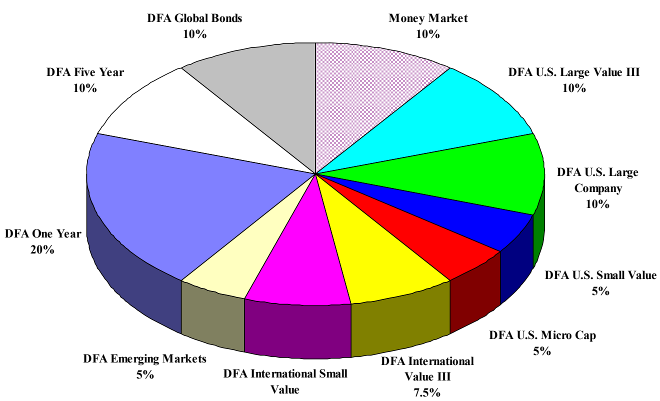
### 75% Equities/25% Fixed




**Rate of Return 14.68%**

## BALANCED GROWTH

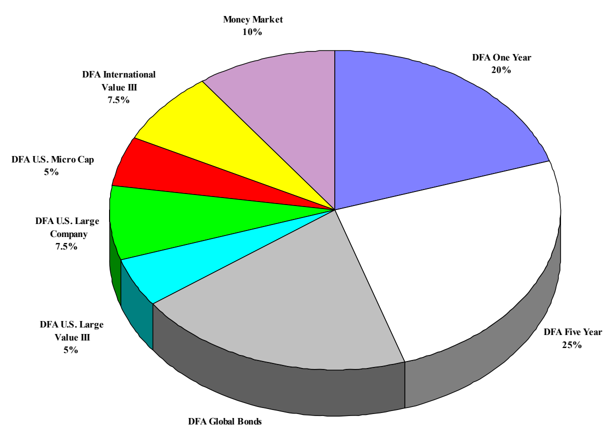
### 50% Equities/50% Fixed




**Rate of Return 8.94%**

## INCOME & GROWTH

### 25% Equities/75% Fixed




**Rate of Return 3.68%**

**Individual returns may vary slightly based upon assets, size and fees charged.*

(Continued from page 1)

Most country market returns were positive, although the dispersion of returns was broad. Among the 45 equity markets tracked by MSCI, only three—Chile (-0.1%), Israel (-6.2%), and Morocco (-12.6%)— posted negative total returns (gross dividends) in their local currency. Turkey, Egypt, and Belgium were the top three performers, with returns of 55.8%, 54.6% and 38.5%, respectively. Greece 4.1%, Portugal 3.3%, Spain 3.1% and the Czech Republic 0.2% had the lowest positive total returns (gross dividends; local currency).

*By Bryan Harris, Advisor Byline, Senior Editor, Dimensional Fund Advisors, Inc.*

# Big Gains and Underperformance

Larry Swedroe, a noted financial writer and columnist, shares an interesting story regarding the Mensa Investment Club. For those of you not familiar with the original concept of Mensa—it is an exclusive, international group whose membership requires one to be among the extraordinarily intelligent.

According to the group's website:

Membership in Mensa is open to persons who have attained a score within the upper 2% of the general population on an approved intelligence test that has been properly administered and supervised. There is no other qualification or disqualification for initial membership eligibility.

Now, that is super smart. Brilliant, in fact.

A high correlation between intelligence and investment success would be a common assumption you could easily reach. The reasoning goes: having significantly better than average (Mensa-like) skills should naturally translate to significantly better than average investment success.

So, let's test the hypothesis.

Larry Swedroe points out in his June 2001 *SmartMoney* magazine article that the Mensa Investment Club from 1986 to 2001 averaged a 2.5% investment return per year. Over the same time period, the S&P 500 index earned 15.3%.

Now you may be thinking, "how can a group with staggering IQs underperform an unmanaged reference standard stock index by 13%?" To illustrate the difference on a hypothetical $10,000 investment, the underperformance nets the Mensa Investment Club a measly $15,000 and the simple, boring S&P 500 yields a whopping $84,500.

Wow!

History's compelling lesson is in a way an attempt to make fun or somehow shame the Mensa Investment Club. If you are a Mensa Member, you have plenty of other reasons to be proud. The fact that no amount of intelligence can consistently and predictably outsmart a random, unpredictable, globally-influenced stock market isn't shameful. It's just reality.

However, for us non-Mensa folks, this is yet another valuable reminder. We must be ever vigilant about making the faulty assumption that achieving investment success requires you to work with the "best and brightest" gurus of Wall Street.

Surely Wall Street's investment management elite are made up of highly intelligent people. But don't fall for the misconception that brains equate to long-term market outperformance. In fact, their advanced degrees in academia are often marketed with the notion that, once achieved, they can somehow accurately forecast markets, sectors and cycles. But the evidence simply doesn't support the premise.

Even so, according to Bank of America Merrill Lynch, only 68% of large-company stock mutual fund managers failed to beat the Russell 1000 index after fees.

In another study, Goldman Sachs found that in 2012, 65% of "core" large-capitalization funds failed to beat the S&P 500.

Put another way, if you knew in advance that you'd have only a 1 in 3 chance to find a market-beating

# Meeting Expectations

All DFA portfolios are designed to deliver "market rates of return." DFA is not trying to "beat" the market by employing crystal ball type strategies, only working to achieve market returns, historically outpacing 90% of the active managers who attempt to beat the market.

To evaluate your portfolio, it is helpful to look at the various DFA funds and **compare them** to the specific markets in which they are invested:

| | 12/31/12 Return* |
|---|---|
| **DFA U.S. Large Co.** | **15.82%** |
| S&P 500 Index | 16.00% |
| **DFA U.S. Large Value** | **22.17%** |
| S&P 500 Value | 17.68% |
| **DFA U.S. Micro Cap** | **18.24%** |
| Russell 2000 | 16.35% |
| **DFA U.S. Small Value** | **21.72%** |
| Russell 2000 Value | 18.05% |
| **DFA Emerging Markets** | **19.16%** |
| MSCI Emerging Market Idx | 18.22% |
| **DFA Int'l Large Company** | **17.75%** |
| MSCI EAFE Large Co Idx | 17.32% |
| **DFA Int'l Large Value** | **16.81%** |
| MSCI EAFE Value | 17.69% |
| **DFA Int'l Small Value** | **22.26%** |
| MSCI EAFE Sm Cap Index | 16.87% |
| **DFA One Yr. Gov't Bond** | **0.93%** |
| BarCap 1-3 Yr. Gov't | 0.51% |
| **DFA Short-Term Gov't Bond** | **1.59%** |
| BarCap 1-5 Yr. Gov't | 0.97% |
| **DFA 5 Yr. Global Bond** | **4.80%** |
| Citi World Bond Index | 1.65% |

**Morningstar 12/31/12*

(Continued on page 4)

manager, would you risk your capital and take the bet? Bare in mind that statistically "beating" the market in these studies includes managers posting returns that are as little as 1/10th of 1% better than the index.

## 2012 & 2013—Tax Planning

Signed into law by President Barack Obama on January 2, 2013, the American Taxpayer Relief Act of 2012 (ATRA) addresses the tax side of the "fiscal cliff," permanently extending certain tax provisions of the Economic Growth and Tax Relief Reconciliation Act of 2001 (EGTRRA) and the Jobs and Growth Tax Relief Reconciliation Act of 2003 (JGTRRA). It provides a permanent patch for the alternative minimum tax (AMT), extends a number of individual and business tax provisions, and increases the top marginal income tax rate and capital gains and dividends rate on top of earnings.

A few highlights are:

Higher tax rate—a new rate of 39.6% is added to income over $400,000 single, $450,000 married.

Capital gains and dividends—law raises rates on capital gains and dividends from 15% to 20% for taxpayers whose income exceeds $400,000/$450,000 threshold.

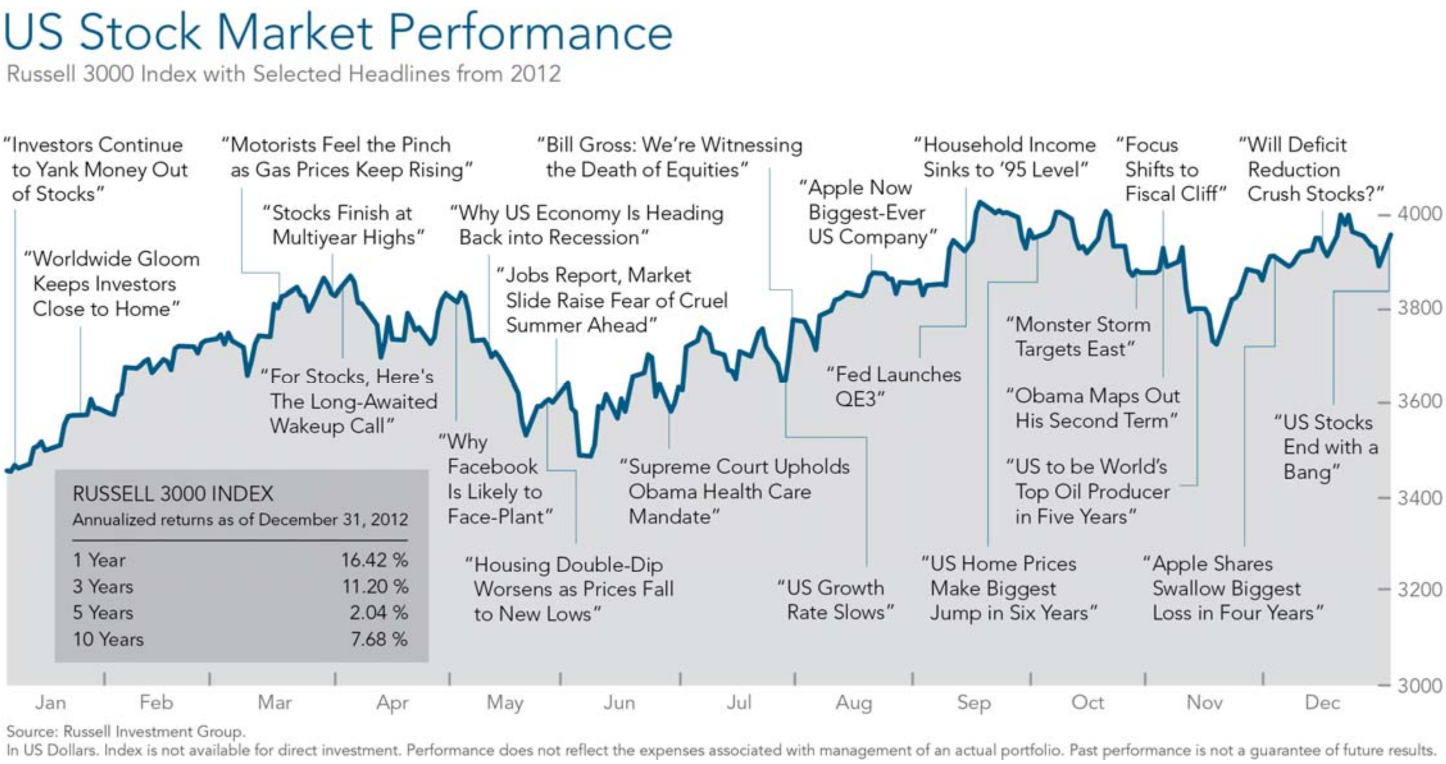
Restrictions on 401(k) rollovers to Roth accounts eased. Participants must pay income tax on transferred funds now but distributions paid out in retirement are tax free.

There is a big incentive to keep your income under the $400,000/$450,000 threshold for 2013. If you own your own business or control your own income, we have some tremendous tax savings strategies for 2013.

One tax savings plan is a cash balance plan that would allow most business owners to deduct up to $200,000 and often times up to $250,000. For example, if your net income was $625,000, you could implement the cash balance plan for $200,000 taking your income to $425,000 and below the threshold for additional and higher tax rates.

For 2012 we encourage you to make your IRA and Roth IRA contributions early. The limits are $5,000 if you are under age 50 and $6,000, 50 and over. These contributions need to be in our office by April 10, 2013 to be coded for 2012. Don't forget if you have the extra cash flow, you can make your 2013 contribution at the same time.

Wishing you the best in '13 you can have!





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*A copy of Part 2 Form ADV for Lyke Financial is available upon request.*