STRATEGIC PORTFOLIO BALANCE[sm]

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This is our client communication newsletter and it is researched, written and distributed by:

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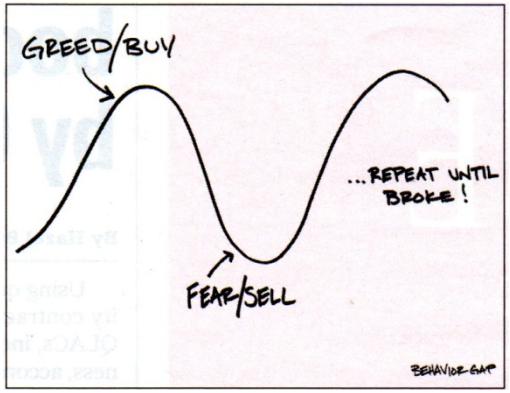
Rough Quarter Finally Ends

We have to go all the way back to year 2011 to find any quarterly market performance as bad as this one has been. But I believe that this painful meltdown is mercifully concluding. Although we could still experience more downward pressure before the end of the year, I am cautiously optimistic that the worst is finally behind us. My optimistic "crystal ball" forecast doesn't negate the fact that right at this moment you should be taking virtually all of your retirement income from your cash accounts rather than from your investment accounts. Now is the best time to leave your investment money "on the table" so that it can benefit from what could become a very strong recovery. (Extra investments made right now could pay off handsomely in the long run!) So, patience, my friends. Patience!



I recently attended a very entertaining presentation by one of my industry's more animated speakers and all-around likeable guys, Carl Richards CFP®. The overly-simplified illustration above is one of the visual aids that he uses to explain why so many do-it-yourselfers are continually unsuccessful at investing. Although the underlying fundamental reasons that drive booms and busts are usually different through every market cycle, the irrational overreactions by many do-it-yourselfer investors remain the same. They are often driven to buy due to greed and are driven to sell because of fear. Investors like us are able to see beyond unfavorable times like these and we keep our expectations realistic during boom times. I like to believe that this is largely due to expert coaching and prescient advice! (Though I must admit that it doesn't always work!)

I get a big kick out of analyzing the underlying fundamentals that drive market booms and busts. This most recent quarter is no exception. I fully acknowledge that a retrospective understanding of these drivers may not help us to avoid the next meltdown, but I find it fascinating nonetheless! (This article may get a little bit "wonky" from this point forward. So, if you stop reading, please make sure you at least move to the next article about Donald Trump. It's lots of fun!)

The most obvious driver of this quarter's meltdown has been China. We knew their markets would collapse at some point because their unsustainable 10% annual growth rate over the past few years was being propped up by the construction of literally miles of new apartment buildings and numerous huge new shopping malls, all of which are still entirely vacant except for any resident spiders! International investors were happy to continue propping up China's markets as long as the construction binge continued and further profits could be realized. But when recent selling pressure turned into an avalanche of sell orders, China did what only a highly centralized government could do. They began selling their most liquid investments to raise cash for the open-market purchase of Chinese stocks in an attempt to artificially prop up the inflated value of their government controlled stock market. China's most liquid investments are U.S. Treasury securities and they have been selling them as fast as the rest of

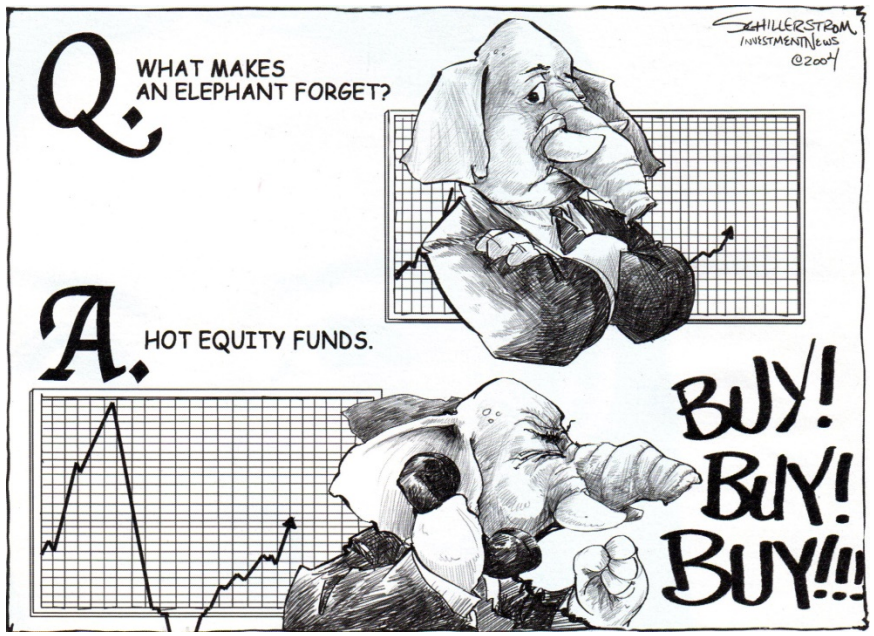
the world will buy them. (I will watch with great interest to see how much less we will owe them after this ends.) China's wholesale dumping of U.S. Treasury securities has become an integral part of what happened to our markets in the past few months.

A general rule of thumb is that when stocks go up, bonds go down. This is because greed during rising stock markets drives more investors to liquidate their lower-performing bonds so that they can reinvest the money into higher-performing stocks. But when stocks go down, bonds generally go up as money from the sale of slumping stocks seeks the relative safety of bonds. But, this quarter saw both stocks and bonds decline in tandem. Why? Because China was unloading U.S. Treasury securities as fast as they could, flooding the market and depressing bond prices.

But this time we can't place very much blame on China. The most impactful factor that contributed to this quarter's stock market decline is less obvious to anyone except investment geeks. Here is a little bit of background information to set the stage. Most investors do not have the time, the desire or the knowledge to accurately perform portfolio optimization using linear regression analysis like I do. Linear regression analysis is a type of calculus that was first applied to the design of investment portfolios back in the 1950's. It has been continually improved since then and is mostly utilized today for designing and

managing only the largest portfolios because of its complexity.

For the sake of expediency, most small investors will instead use one or more of the many overly-simplified portfolio design strategies available. And there are a whole lot of them! Strategies such as "Dogs of the Dow," "Sector Rotation," and even the rise and fall of dress hemlines have been relied upon by investors seeking simple rules of thumb. Clearly, most do-it-yourselfers have a job and a life that are unrelated to investing! Therefore, they lack the time and the desire to actually perform a more relevant and in-depth mathematical analysis. The most recent layman's strategy now being widely used is known as "Risk Parity." And it is a huge culprit in our recent market downturn.

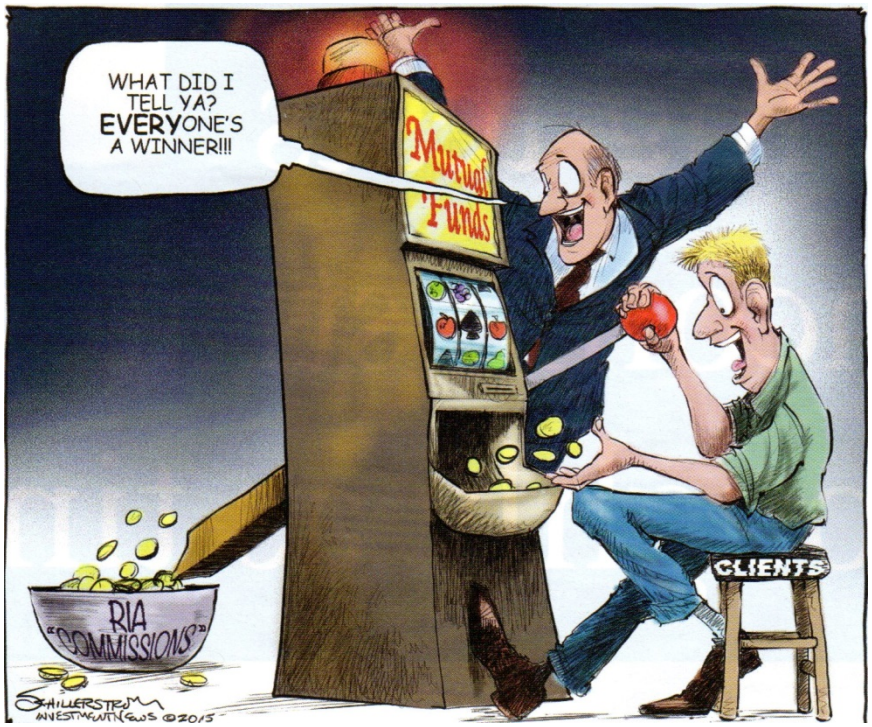


Risk Parity essentially strives to design all portfolio sectors so that they carry equal risk to all others. For example, if a portfolio is 50% stocks and 50% bonds, the stock portion is inherently much riskier even though it comprises an equal percentage of the total portfolio's value. So an aficionado of Risk Parity will buy bonds using borrowed money (leverage) which has the effect of increasing the risk of the bond portion of the portfolio until its risk equals that of the stock portion of the portfolio. If an investment portfolio has five equal parts instead of just two, each part comprising 20% of the total portfolio, leverage and options are applied to the lower risk parts until each represents 20% of the total risk of the portfolio. (Whew! Sorry about all of that geek-speak!)

So, when stocks plummeted during this past quarter, followers of Risk Parity saw risk increase dramatically in the stock portions of their portfolios triggering

sell orders. Normally that cash would be redeployed into bonds through greater leverage to keep the risk equal in all portfolio sectors. But bonds fell as well increasing their risk. The result was that the Risk Parity mathematics have been screaming "sell, sell, sell" for all sectors, further driving prices down which increased risks even more, triggering even more selling pressure further increasing risk, etc., etc. Risk Parity has been a case of self-fulfilling prophecy that has only recently begun to stabilize.

Meanwhile, all of this selling pressure across all types of investments has created many opportunities to buy artificially undervalued investments when one ignores their Risk Parity and focuses on fundamental Fair Market Values. Insiders have been increasing their share buy-backs, evidence that savvy people get it while do-it-yourselfers do not. When investments begin their recovery (and they will) it could be even more dramatic than the math might suggest it should be as Risk Parity aficionados begin pouring money back into the markets, further driving prices up, up, up!



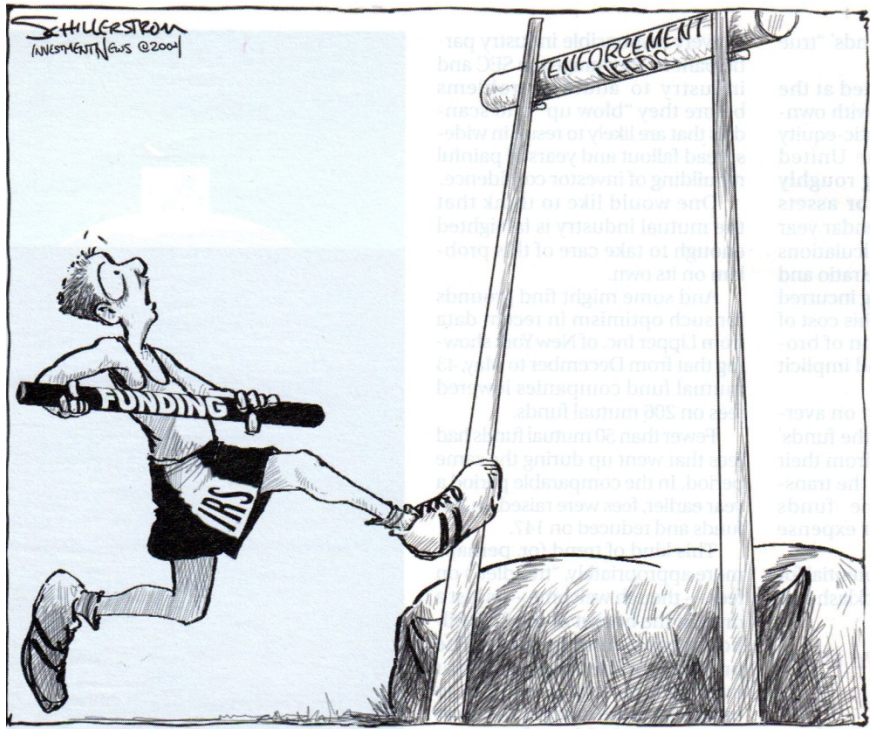
So, the moral of this story is that market volatility has recently increased rather dramatically due to the latest investment strategy dogma. As a result, we will have to be much more diligent about ignoring the frightening drops as well as the overly-exuberant rises. Now more than ever it is important to watch my "Retirement Funding Sources" dial that appears in every issue of this newsletter

when you are deciding where you will take withdrawals to fund your retirement income. Or you could just allow me to manage your portfolio for you. Fee-only, no product biases, no commissions, no sales. As a fiduciary, your success is my only focus!

Trump's Tax Reform Proposal

In case you live under a rock, let me announce this sobering reality: Donald Trump is not only running for President, he is currently the GOP front runner! Let that soak in for a minute…

Thus far, he has promised to hire "top people" to flesh-out the details of his platform. But we do not yet know who those "top people" will be, let alone what it is that they will do. But Trump did recently release some details about his income tax reform proposal. It's worth a moment of your time to understand who would benefit the most.



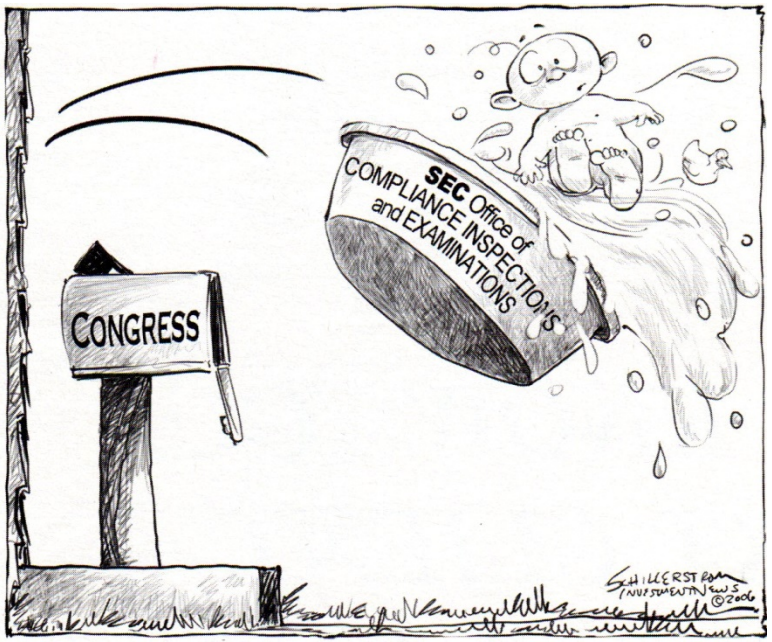
Trump says his tax plan *"reduces or eliminates most of the deductions and loopholes available to special interests and to the very rich."* Although he did not provide even a brief list of loopholes that he proposes to close, he did offer his suggested tax percentages for the new plan. Currently, income over $300K

is taxed at 39.6%. Trump's plan lowers that to 25%. His own income was $362 million last year. Even without loopholes, Trump would personally save almost $53 million every year!

Next up, Trump wants to eliminate Estate Taxes. That would save Trump's heirs around $400 Billion upon his death!

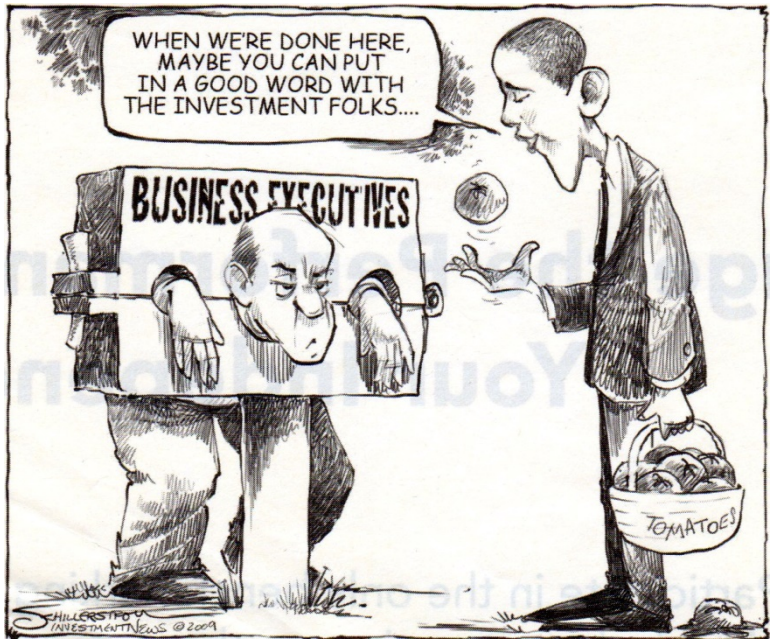
Corporate income taxes would be reduced under Trump's plan from 35% to 25%. Because most of his corporate income (like many other U.S. corporations) is sheltered through offshore trusts that are domiciled in international tax havens, this might help him save several hundreds of millions. But because of the opaque nature of offshore trusts, we cannot know for sure.

Another claim is that Trump's plan would *"provide major tax relief for middle income Americans."* This dubious claim is entirely unclear without more detailed information regarding his plan. That's because the loss of all of the deductions that are popular with the middle class could raise taxes for middle income earners more than any savings due to a lower income tax rate.



In typical grandiose Trump fashion, he said, *"We are reducing taxes, but at the same time if I win, if I become President, we will be able to cut so much money and have a better country. We won't be losing anything other than we will be balancing budgets and getting them where they should be."* Even the very conservative Tax Foundation had a hard time with this one. They estimated that Trump's plan would result in lost revenue of $12 Trillion over the next decade

and that as yet unrealized increased economic activity due to lower tax rates would only reduce that cost by $2 Trillion. Another conservative think tank, Americans for Tax Reform, a group that advocates the premise that lower taxes will pay for themselves through increased economic activity, said that, *"Trump's cuts are so large that [offsetting revenue from increased economic activity] won't happen even under the most optimistic scenarios. It just doesn't square up!"* Martin Sullivan is the chief economist at a nonprofit tax analysis group who was an expert at the Congressional Joint Committee on Taxation said that, *"… adopting Trump's plan without increasing the deficit doesn't look possible"* without taxing retirement savings currently in pensions and 401k's before any withdrawals are taken.



A couple of weeks ago a few other candidates released minimal details about their income tax reform plans. It is no surprise that all GOP candidates share the common denominator of granting multi-billion dollar tax breaks to the very wealthy. (Hillary said she would raise taxes on short-term capital gains without giving any other details.) Jeb Bush wants to reduce taxes to 20% on interest, dividends and capital gains. (Keep in mind that most rank-and-file middle class middle class workers don't even have any taxable investments in stocks, bonds, etc.) Jeb Bush would reduce individual tax brackets to 28%, 25% and 10% while the corporate tax bracket would fall from 35% to 20%. Marco Rubio would eliminate all taxation of capital gains and dividends, again mostly again mostly benefiting the ultra-rich. Rand Paul would levy a 14.5% tax on interest, dividends and capital gains as part of his "Flat Tax" plan wherein everyone pays

the same income tax percentage, everyone from struggling students to the ultra-wealthy.

So, back to the center ring of this circus. I continue to be both horrified and wildly entertained at the same time while Donald Trump bullies, ridicules and bloviates his way to the top of the Republican polls. I'm not a gambling man. But I'll bet my dollars to your donuts that, after he is finally drummed-out of the race, we will ultimately discover that his entire Presidential campaign was just his way of assuring increased ratings for his next reality TV show!

Tesla Making Gasoline Irrelevant

Don't buy that new gas-guzzling SUV anytime soon! Elon Musk's company, Tesla, has announced that they are on track to offer an all-electric vehicle with a 750-mile range per charge by year 2018! The lofty price tag in excess of $100K for the Model S has been reduced to about $40K for the new gull-wing door Model X. Musk believes that even this price tag will be cut in half after his Giga-Factory being built in Nevada begins to manufacture high power-density batteries. It will be fully operational within the next couple of years.

But it gets better! Musk did what is normally unthinkable in a capitalistic "free-market." He opened all Tesla patents to any and all takers, for free! The result is that there are now more than a dozen auto manufacturers introducing all-electric models for purchase, not at some unspecified time in the future but right here, right now.

All-electric vehicles have, up until this point, been little more than fancy toys for rich environmentalists who want to make a statement. However, the current front-runner, the Nissan Leaf, with a range of around 100 miles per charge, can be purchased brand new for under $22K (after federal tax savings). Add in the $20K cost for a typical solar panel array on your house and the reality of a gasoline-free commute around town is already a reality. Add another $3.5K for

a soon-to-be-released Tesla PowerWall battery storage system for your home's solar panels and the dream of being able to entirely disconnect your house from the grid will become a very real option!

Technology - Wall mounted, rechargeable lithium ion battery with liquid thermal control.

Models – 10 kWh $3,500 (For backup applications), 7 kWh $3,000 (For daily cycle applications)

Warranty - 10 years

Efficiency - 92% round-trip DC efficiency

Power - 2.0 kW continuous, 3.3 kW peak

Voltage - 350 – 450 volts

Current - 5.8 amp nominal, 8.6 amp peak output

Compatibility - Single phase and three phase utility grid compatible.

Operating Temperature - -4°F to 110°F / -20°C to 43°C

Enclosure - Rated for indoor and outdoor installation.

Installation - Requires installation by a trained electrician. DC-AC inverter not included.

Weight - 220 lbs / 100 kg

Dimensions - 51.2" x 33.9" x 7.1", 1300 mm x 860 mm x 180 mm

Certification - NRTL listed to UL standards

There are three major obstacles that stand in the way of transitioning away from gasoline-powered transportation. The first obstacle is that only a few rapid-charge stations exist, though more are being added every month (particularly on the West Coast). The second obstacle is that the U.S. still gets over 30% of our electric power from burning coal, a filthy, planet-killing habit that must stop! The third obstacle is that the majority of legislators in both political parties have been bought-and-paid-for by the fossil fuel industry. Unfortunately, passing legislation that would encourage a more rapid transition away from gasoline is little more than a pipe-dream in our current political reality.

But we are fortunate to be witnesses to one of the most profound energy-use transitions since the dawn of the Industrial Age. We will know we have finally arrived when pickup truck-loving red necks start buying all-electric trucks instead of the current internal combustion ones because the cost per mile driven will become so much less for electric than for pollution-belching behemoths! Yee-ha!

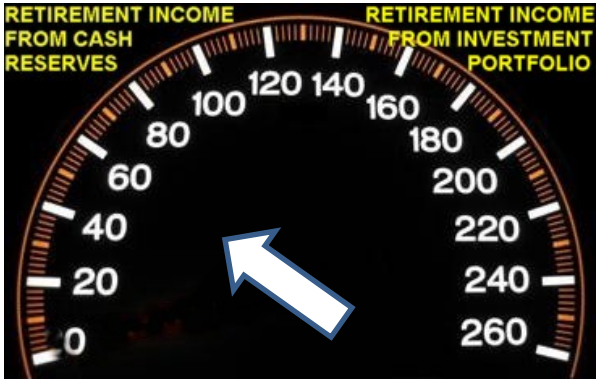
So this is yet another nail in the coffin of fossil fuels. Our decision last year to divest our portfolios from fossil fuels just keeps looking smarter and smarter!

Retirement Funding Sources

Theory: By utilizing non-correlated retirement income funding sources from which withdrawals are taken relative to the strength of their mutual divergence, it may be possible to extend the duration of the income stream being provided by a portfolio of securities so managed.

English Version: It is our recommendation that you accumulate between one- and three-years worth of basic living expenses and hold them in cash reserves. *(Even cash reserve accounts should be properly structured. We'll help!)* During periods of stock market weakness, you should avoid liquidating investments at a loss. Use cash instead. *(You must stay invested if you are to have any chance for recovery.)* During periods of relative stock market strength you should fund your retirement income needs by taking withdrawals from your investment portfolio while replenishing your cash reserves for the next time when *(not if)* the stock market suffers another significant correction. *(Of course, it is essential to skillfully structure and effectively manage your investment portfolio. We'll do that!)*

CURRENT RECOMMENDED SOURCES FOR WITHDRAWALS TO FUND RETIREMENT INCOME



LEGEND
0 - 87: Stop all withdrawals from investment portfolio. Use cash reserves.
88 - 173: Blend withdrawals from investment portfolio and cash reserves.
174 - 260: Take withdrawals from investment portfolio. Replenish cash.

If you like the concept of maximizing the lifespan of your retirement withdrawals but you do not wish to take on the responsibility yourself, please consider enrolling in our Strategic Withdrawal Management[sm] (SWM[sm]) service. We will deal with the management logistics while you deal with your golf swing.

Current Mortgage Rates

HOME MORTGAGE: The following are the national averages of mortgage rates (source: Bloomberg Business). Because mortgage interest rates change throughout each business day, these recent examples will not necessarily be applicable when you apply for your next mortgage. They are provided for illustrative purposes, only.

RECENT CONVENTIONAL CONFORMING FIXED MORTGAGE INTEREST RATES

30 Year Fixed Rate Conventional/Conforming, 30-Day Lock	
Current	Previous Month
3.85%	3.83%

15 Year Fixed Rate Conventional/Conforming, 30-Day Lock	
Current	Previous Month
2.92%	2.95%

- There are several other factors that affect the rate of your loan. Such factors include the state in which the mortgaged property is located, loan-to-value, FICO credit scores, cash-out refinance, high-balance loans, variable-rate loans, government programs (such as FHA or VA loans), non-owner occupied, self-escrow of property taxes and homeowner's insurance, etc.

You will need to provide your independent mortgage broker with the following documents when applying for a loan:

- Signed and dated loan application and mortgage documents.
- Most recent 2 month's pay stubs.
- Most recent 2 years W2's and tax returns.
- Most recent 2 months statements on all financial accounts such as checking, savings, retirement, stocks, etc.
- Property/casualty/liability insurance carrier.
- Official military, divorce, separation, child support documentation (if applicable).

Web Links

Full disclosure of all the services we provide and all the fees we charge can be viewed at the following link to our *SEC Form ADV Part 2A*:
http://www.colsonfinancial.com/sites/default/files/users/colsonfinancial/pdf/ADVnew.pdf

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Please contact our office if you prefer to receive these documents via snail-mail.

PLANNING AND INVESTMENT ADVISORY SERVICES

When we work with individual clients, we focus on two areas:

- **"Fee-Only" Financial Planning:** Together we calculate what you earn and what you spend (cash flow), what you own and what you owe (net worth), and we structure a course of action for the successful achievement of your financial goals. We have no broker-dealer affiliation. We do not sell any products. We earn zero commissions and we receive zero 12b1 fees.
- **"Fee-Based" Investment Management:** We provide affordable professional investment management with honesty, integrity and exceptional fiduciary care. Our portfolios are designed to be 99%+ fossil fuel-free. Our compensation amounts to a small fraction of a percent of the total of all of your family's accounts. We strive to earn investment returns at a risk level that you can accept while keeping the total of all expenses at a minimum.

A) We avoid all financial products that pay commissions. Product sponsors charge higher expenses in products that pay commissions. Higher expenses result in poorer investment performance.
B) The cost for our investment advice is fully disclosed, in actual dollars, not buried somewhere in a prospectus as "basis points."
C) We dispel the myths and misconceptions of any anecdotal advice that may be dispensed by your well-intentioned friends or relatives.

We believe that your financial success will be better achieved with ongoing professional investment management driven by an unwavering discipline to remain focused on your goals. If you have neither the time nor the desire to be a "do-it-yourselfer," please allow us to be your fiduciary. We will always place your best interests ahead of our own.