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CJM Wealth Advisers, Ltd.

Seeing the Forest Through the Trees

David D. Greene, CFP®

We have an immense amount of information to filter through these days. Even if we carved out the political news and Facebook posts and focused solely on the financial information, that data set comes in at a fast and furious pace. So individual investors have to sort through the huge mess of data to try to make sense of it all. What should I do if the S&P 500 just crossed over its 50-day moving average? What are the implications of the dollar weakening? Are valuations stretched or not? There is so much to digest, it can be hard to know if the stock market is up or down for the year.

Let's start by clarifying that the stock market is doing well so far this year. In the US, the S&P 500 is up over 9% and international stocks are performing even better with double digit returns on the MSCI EAFE index. Economic indicators, such as GDP growth coming in at 2.6% for the second quarter, and continued low unemployment rates suggest that the US economy is doing fairly well. These positives seem to run counter to daily headlines of threats from North Korea, global terrorists tragedies, and a potential downturn in the stock market. With all of these "trees" blocking our view, how are we to see the forest?

Identifying and prioritizing a few major financial goals is one of the most important steps, as this helps guide decision making. Whether it is saving for a home purchase or renovation in the near future, saving for your children's college education, or planning for an early retirement in 10 years, you need to know what it is and have a plan to achieve it. Making decisions based on that blueprint will enable you to step back and see the bigger picture. You can still be aware of the weekly gyrations of financial markets but not consumed by them.

My family and I were fortunate enough to enjoy a recent trip to Costa Rica. What an amazingly beautiful country in so many respects! The natural beauty is breathtaking. However, the Costa Rican culture was even more impactful. They have a saying – Pura Vida – which means 'simple life' or 'pure life'. It is more than just a saying; it is a way of life. They focus on what is important to them and ignore what they cannot control, layering on generosity and a positive spirit that is palpable and inspiring. We could all learn a bit from their perspective to appreciate the simple things in life and focus on the forest, not the trees. •

Valuation measure	Description	Latest	25-year avg.*	Std. dev. Over-/under-valued
P/E	Forward P/E	17.5x	16.0x	0.5
CAPE	Shiller's P/E	30.1	26.2	0.6
Div. Yield	Dividend yield	2.1%	2.0%	-0.2
P/B	Price to book	2.9	2.9	0.0
P/CF	Price to cash flow	12.2	10.6	0.8
EY Spread	EY minus Baa yield	1.3%	-0.3%	-0.8

Kevin's Corner: P/E-ering Into the Future

Kevin E. Donovan, CFA

Stocks have been hitting record highs on a regular basis over the past couple of years and that has pushed valuation measures to high levels as well. We have seen terms like "fully valued", "richly valued" and the dreaded "overvalued" used to describe the markets since at least 2013 when the S&P 500 surged 32%, yet the markets have risen each year since then, so let's look at current valuations and what they can tell us.

There are many different ways to measure stock valuations but we will focus here on the price/earnings (P/E) ratio, one of the most well known yardsticks we use to look at value. The P/E is simply the price of the stock or index divided by its earnings. While the P/E is well known, there are many different ways to measure it. For example, we could use actual earnings over the past year or we could use the average inflation-adjusted earnings for the past 10-years (the Shiller P/E). These two measures, however, are backward-looking, in contrast to the actual stock market, which is always looking ahead. For this reason, I prefer to use the forward P/E ratio, which uses the future expected earnings for the next year.

As you can see in the chart above, there is no doubt that at 17.5x earnings the current P/E on the S&P 500 is higher than it has been in a long time and it is well above the 25-year average of 16.0x. However, this does not necessarily mean that the market is due for a dramatic sell-off for at least three reasons.

The first reason is that the current P/E ratio at these levels is still only about one-half of a standard deviation above the 25-year average. One standard deviation is a typical definition of overvaluation and we are still well below the 19.2x it would take to reach that level.

Secondly, a drop in the stock market is not the only way for the P/E ratio to go down. Remembering our fractions lessons from school, a higher denominator means a smaller value. In this case, if earnings expectations rise and prices remain the same, the P/E ratio will decline. For the past several quarters, earnings have been coming in higher than expectations. Our economy keeps growing slowly, and now U.S. companies with overseas operations are beginning to benefit from the long-delayed improvement in international economies. Combine that with a slightly weakening dollar, and we have a good setup for an increase in future earnings expectations.

Finally, the P/E ratio is an inaccurate predictor of short-term market moves. Studies have shown that there is very little correlation between the level of the P/E ratio and the return on the S&P 500 over the next twelve months so it should not be used to try to time the market.

Even though the relationship with short-term market moves is weak, there is a stronger correlation between it and lower market returns over longer periods of time, such as the subsequent five-year period. Of course, the P/E ratio is just one of many tools we can use to try to determine whether or not the market is overvalued. •

How Assets Impact College Aid Eligibility on FAFSA and CSS Profile

We've all read headlines that highlight the soaring costs of attending college. Naturally, our clients are concerned about helping their children and grandchildren to cover this cost, and the rising costs only increase this concern. Planning ahead by using a 529 plan to save for college can be a great option, but navigating the financial aid landscape can be equally important. We came across the article below and wanted to share an excerpt because it is a very helpful guide.

Source: How Assets Hurt College Aid Eligibility on FAFSA and CSS Profile, Forbes 2/14/14

Two College Aid Forms: The FAFSA And CSS Profile

The process of applying for need-based financial aid for college begins by students and parents completing one or two financial aid forms, the FAFSA (Free Application for Federal Student Aid) and/or the CSS Profile. Any college or university that awards federal student aid must require that students complete the FAFSA in order to determine eligibility for federal aid (it works for most state aid too). Most colleges and universities nationwide use the FAFSA as their sole application for need-based financial aid. Students applying for aid at those colleges only need to complete the FAFSA. However, there are about 300 colleges, which require that the CSS Profile be completed in addition to the FAFSA. Those colleges use the CSS profile to assess the student's eligibility for their own institutional aid dollars.

Typically, "Profile" colleges are very selective private colleges, including the Ivies, but the University of Michigan at Ann Arbor, Georgia Institute of Technology and the University of North Carolina at Chapel Hill are examples of flagship state universities that require the Profile, not just the FAFSA.
There is also a group of 26 colleges that make up what is known as the 568 Presidents' Group, which was formed by the presidents of those institutions for the purpose of assessing students' ability to pay for college using a "consensus" methodology. The 568 Presidents' Group schools also require students to complete the CSS Profile, but they treat students' assets and parents' home equity different (more favorable to families) than the institutional methodology does. Thus, there are two financial aid forms but three methodologies of calculating a student's expected family contribution (EFC).

Three College Aid Formulas

Need-based aid eligibility is based on the formula (Cost of attendance – Expected Family Contribution (EFC) = Need). Expected family contribution (EFC) is the minimum amount the family is expected to contribute toward the cost of college, and is calculated using three different methods: Federal Methodology (FM), Institutional Methodology (IM) and Consensus Methodology (CM). All three EFC calculations are based on the income and assets of the parents and student as reported on the two financial aid forms, the FAFSA (FM) and the CSS Profile (IM and CM). ►

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Which Assets Count

◀ Retirement assets such as 401k, 403b, IRAs, SEP, SIMPLE, Keogh, profit sharing, pensions and Roth IRAs are not included in the calculation of EFC under any of the three EFC methodologies. Assets that aren't in retirement accounts --- balances in checking, savings, CDs, brokerage accounts, money market, investment real estate, stocks, bonds, mutual funds, ETFs, commodities and 529 college savings and prepaid plans---do get included in the EFC formulas. Trust funds must be reported regardless of whether or not the funds are currently available to you or your child. On the FAFSA, if only interest or principal will be available, the present value should be calculated by the trust officer and reported accordingly.

Parents' total reportable assets will vary depending upon the EFC methodology, and from the reportable asset value a savings (emergency reserve) allowance of about $30,000 to $50,000 is subtracted to arrive at an available asset value. Parents are expected to use up to 5.64% (Federal) and 5% (Institutional and Consensus), of those available assets each year on college. Family controlled small businesses with fewer than 100 full-time employees, home equity and non-qualified annuities are not counted in the FM, but they are in the IM and CM, although, under the CM home equity is capped at 1.2 times the parent's adjusted gross income.

Retirement assets do not get counted, but your prior year's contributions to qualified retirement accounts do get counted as untaxed income, and are added back to your adjusted gross income in the income portion of the aid formula. Life insurance cash values are not counted under any of the formulas, but a few highly selective colleges will ask about policy cash values in their supplemental questions on the CSS Profile. Personal assets like cars, clothes and household items do not count under any of the formulas, but collectibles do. ●

Did you Know...

...CJM teamed with a local law firm that specializes in estate planning to create two educational videos that answer the most common questions we get from clients relating to estate planning. We have found, after nearly 40 years of servicing clients, that estate planning can be one of the most difficult topics to address. With the help of Dan Vaughan and Martha Sotelo, from the law firm Vaughan, Fincher and Sotelo P.C. in Vienna, Virginia, we created a two part video to demystify this complicated topic.

These videos can be found on our website at www.cjmltd.com under the Resources tab.

In Part 1 of this series, we focus on some of the basics of estate planning. We cover several of the various estate documents you may need and explain how they are used. We also touch on other subjects including probate, naming beneficiaries, creating wills and trusts, and much more.

In Part 2, we cover a few topics beyond the basics including gifting strategies, estate taxes and the importance of implementing your estate plan after your documents are completed. ●

CJM Fun in the Sun!

New Baby on Board!

Parker and his wife Beckie are very excited to announce the birth of their first child, Skyler Moon Rucinski-Trasborg. She was born on Wednesday, August 23rd at 1:46 p.m., weighing 8 pounds 7 ounces. Both mother and baby are doing well and we will all be heading home from the hospital to spend several weeks together.

CJM News

Every year Northern Virginia Magazine showcases their 'Best of NoVA' lists. We are thrilled to have our Planners on the Top Financial Professionals list again this year! Please join us in congratulating Tracey Baker, David Greene, Brian Jones, Tim Jones, Jessica Ness and Parker Trasborg!

Northern Virginia 2017 TOP FINANCIAL PROFESSIONALS Magazine

Since 1978, CJM Wealth Advisers, Ltd. has been working with affluent individuals, families and business owners to address financial concerns no matter how acute or broad they may be. With a collective focus on helping our clients live the life they want, we understand that financial planning needs to be done with a purpose in mind. Otherwise, what is the use of planning at all?

What is your purpose? Is it to…

…*create a retirement income stream to last a lifetime?*

…*minimize investment risk and maximize return?*

…*prudently plan a legacy for your heirs?*

…*carefully position a business for a future sale?*

We offer our clients real solutions by being objective and approachable while delivering excellent client service.

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