DVI

David Vaughan Investments

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With the Benefit of Hindsight

It always amazes me how quickly investment sentiment can change. At one moment, risk averse investors are clamoring for dividend yield, reasonable valuation and low volatility as evidenced by the strong year utilities enjoyed in 2014. Now, emboldened by an improving economic back drop and lower unemployment rates, those same investors can turn on a dime and become risk seeking and embrace high flying growth stocks such as the biotech industry. (Exhibit 1) This is certainly not new investor behavior, it has been going on for decades, but it doesn't mean that when dramatic shifts like this occur that I can't shake my head in bewilderment, especially at a time when market indices are approaching or sitting at all-time highs. So all in all, it was a lackluster quarter for Value and Income oriented equity investors, a view of the world that as many of you know is at the heart of DVI's DNA.

In this post Great Recession market environment, the performance of low volatility stocks has been in decline relative to high volatility (high beta) stocks since the summer of 2012 (Exhibit 2 on page 4). There was a bit of a resurgence in the fall of 2014, but the relative performance shortfall by low volatility names regained momentum in Q1 2015 as evidenced by the resurgence of Growth stocks. It is a common occurrence throughout market history for investors to gain greater confidence and seek out greater risk as the memory of recent market declines fades into the sunset.

With the benefit of hindsight, it sure would have been nice to be at the right place at the right time with the right investment philosophy to capture this recent sentiment transition. However, despite an industry that continues to market itself as accurate predictors of near term price action, DVI admits this capability is outside our sphere of competence. We continue to focus our strategies on risk reduction and expend our energies on those action items that will create purchasing power over longer

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Performance and Valuation Summary

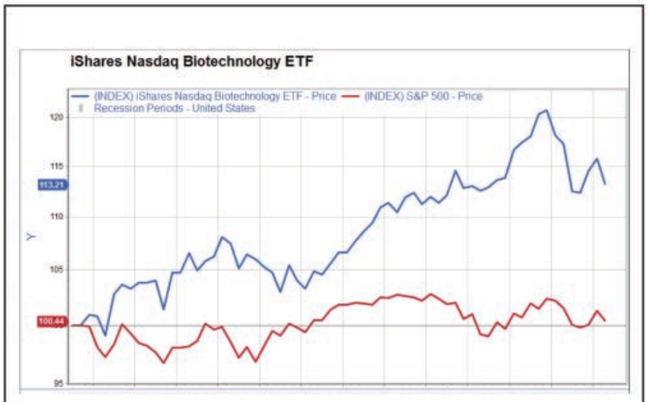
% Total Rate of Return

	Large Cap Value	Large Cap Blend	Large Cap Growth
Q1 2015	-0.07%	1.00%	3.80%
2014	13.50%	13.70%	13.00%

Valuation

	Large Cap Value	Large Cap Blend	Large Cap Growth
Current P/E	16.4	16.9	19.3

Source: JP Morgan Asset Management



Source: Factset

Exhibit 1 – The Growth Stock Phenomenon in Q1 2015

Route To:

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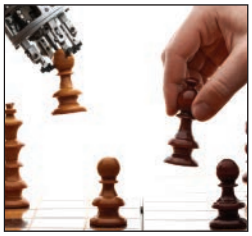
Man vs. Machine

Brian Christensen, CFA
Senior Vice President



In the last five years a new financial planning platform has been developed and launched under the term Robo-Advisor. A Robo-Advisor is an online wealth management service that provides automated, algorithm-based portfolio management advice without the use of human financial planners. Robo-Advisors generally use the same software as traditional advisors. However, they only offer portfolio management and do not get involved in more personal aspects of wealth management, such as taxes and retirement or estate planning. Let me break down the definition to better explain.

The paramount feature of a Robo-Adviser is that decisions are made using mathematical algorithms and delivered to the client via a computer. Recommendations and advice are not shaped by a human being analyzing the client's unique individual needs and circumstances, but rather by an algorithm designed to determine the client's needs and recommend appropriate solutions. The non-human component and on-line delivery is fundamental to the definition of Robo-Advisor, not the advice itself, as it seeks to create potential efficiencies by removing the human advisor from the relationship.

Implementation of a Robo-relationship is as expected, delivered all electronically, using index based exchange trade funds (ETF's) for the investments. Asset allocation is driven by what appears to be very basic factor analysis using age, income, size of portfolio, and time horizon as primary inputs. By design, all is intended to be automated which drives what seems to be the Robo-Advisors major selling point – lower fees. Robo "advice" is priced from 0.15% to 0.35% of assets under management plus whatever the expenses of the investment funds may be. All-in, one would expect total fees to run from 0.30% to 0.50% depending upon the investment implementation. It very much feels like a do-it-yourself solution.

So what's missing? In two words, the relationship. We pound the table regularly about the fact that what DVI offers is a relationship. A relationship built on trust, years of experience, a successful long-term track record, and the ability to understand the needs and wants of our dear clients. All things that will never, ever be replaced by some computer algorithm.

In 2001, The Vanguard Group introduced the concept of the Advisor's Alpha. In its most basic form, alpha is excess return above some benchmark. Vanguard's Advisor's Alpha seeks to quantify the value added of relationship-oriented services such as estate and tax planning, retirement planning, asset allocation, asset location, rebalancing, and behavioral coaching among others. In their most recent update, Vanguard suggests the potential value added from best practices in wealth management is as much as 3%. The largest component identified by Vanguard is behavioral coaching. Behavioral coaching becomes most significant during market extremes when investors are tempted to abandon the investment plan that has been carefully crafted for them. A Vanguard study of actual client behavior found that investors who deviated from their initial investment strategy trailed benchmarks by 1.5%. Investing evokes emotion and when emotions erupt it is DVI's responsibility to make sure the investment plan that was thoughtfully created at an emotionless time remains intact.

Finally, let me confess that technology scares me. Technology is wonderful and certainly makes us more efficient, until it doesn't work. What happens to the Robo-Advisor computer systems when the market erupts in chaos, and it will, Robo-clients begin to question their strategies and system resources become strained? Click the chat button on your Robo-Advisors website and see if anybody answers. People, real people that can hold a conversation with their ears, eyes, and mouths, not just their thumbs, are the difference makers. Someone who is tied to your values and your plan… and isn't named HAL.

An Overview of Health Savings Accounts

Stephanie Ricketts, CFP®
Relationship Manager

Over the past several months we have been experiencing an uptick in the opening of Health Savings Accounts for our clients. In light of this recent trend, we thought it would be timely to provide an overview of these accounts and their benefits.

A Health Savings Account (HSA) is a tax exempt trust or custodial account that is established with a qualified HSA trustee to pay or reimburse certain medical expenses. HSA's were created in 2003 so that individuals covered by high-deductible health plans (HDHPs) could receive tax preferred treatment of money saved for medical expenses. No permission or authorization from the IRS is necessary to establish an HSA, but in order to qualify one must be covered under a HDHP, cannot be enrolled in Medicare and cannot be claimed as a dependent on someone else's tax return.

According to the industry trade group America's Health Insurance Plans, the number of enrollees with HSAs rose to nearly 17.4 million in January 2014, up from 15.5 million in January 2013 and there has been an average annual growth rate in these accounts of approximately 15% since 2011. The state of Illinois has the highest level of HSA enrollment at 1,054,916, followed by Texas (1,042,642) and Ohio (802,511). Growth in the popularity of HSAs has occurred not only due to the tremendous increase of participation in HDHPs, but the even bigger attraction is the tax benefits that come along with investing in HSAs.

Contributions to HSAs aren't subject to tax, investment earnings on the assets in the account aren't taxed from year to year, and withdrawals are tax free, provided they're used on qualified health-care expenditures. For individuals who are already making the maximum contributions to 401(k)s and IRAs, there's a lot to like about yet another tax sheltered investment vehicle. And unlike 401(k) accounts and IRAs, there are no age requirements for withdrawals, no income limits and no required minimum distributions.

So How Much can I contribute to my HSA this year?

The 2015 contribution limit for self-only coverage is $3,350. The contribution limit for family coverage is $6,650. For those age 55 and over, the contribution limit is increased by $1,000. Note that the high deductible health plan out of pocket maximum for single coverage is $6,450 and $12,900 for family coverage.

In addition to a straight contribution there is a one-time allowance for individuals to roll over IRA account assets to an HSA (but an HSA cannot be rolled over to an IRA).

Can I contribute once I'm retired?

You can just as long as you continue to be enrolled in a high-deductible health care plan. However, once you are enrolled in Medicare (part A or part B), you can no longer make HSA contributions.

What is the criteria of a tax-free distribution?

Distributions used exclusively to pay for qualified medical expenses are excludable from gross income. Amounts paid as voluntary premiums under part B of Medicare are deductible as medical care, as are voluntary premiums under part A (basic Medicare). Other out of pocket expenses such as deductibles, co-pays and co-insurance are included as is over the counter medication, but only if prescribed.

Qualified medical expenses do also include premiums for qualified long term care insurance, up to annual limits. These limits are determined based upon your date of birth and are grouped in ten year increments. Qualified long term care is further defined as an insurance contract that must provide only coverage of qualified long term care services, must not pay or reimburse expenses to the extent expenses are reimbursable under Medicare (or would be but for a deductible or coinsurance amount), must be guaranteed renewable and must meet other detailed requirements under code section 7702B.

Does it ever make sense to use my HSA exclusively as a tax sheltered investment?

Clearly it is appealing to use your HSA to cover out of pocket health care costs as they are incurred but the strategy of delaying withdrawals can be a great idea for those who can afford to do so. Even though the HSA has restrictions on what the money can be withdrawn for, it carries more generous tax benefits than any other tax-sheltered account. And as with any tax sheltered account, the tax-savings benefits compound the longer the money is left in the account. By contrast, a taxable account, carries no such benefits.

The risk of being left with a large excess balance in an HSA later in life is probably pretty slim. Fidelity estimates that the average retired couple will spend $220,000 on medical expenses for the duration of their lives. And in the fortunate event your health care expenses are much lower than that, you can still use HSA funds for any other expenditures once you reach age 65. Note that in this instance the withdrawals will be treated similar to an IRA however, and those withdrawals will be taxed (but NOT penalized if over age 65). And lastly it is worth noting that you can reimburse yourself for qualified health care expenses from your HSA even years later; there is no time limit.

What happens to the balance remaining in my HSA after I die?

The HSA can and should have a beneficiary designation. If your spouse inherits your HSA, the account becomes his or her HSA and is subject to the same rules. If someone other than a spouse inherits the assets, these assets are includible in that individuals gross income and the HSA ceases to exist.

Please contact us at DVI if you have interest in learning more about HSAs and assistance in determining if it is a suitable or viable account option for you.

With the Benefit of Hindsight

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periods of time. As Warren Buffett once remarked, "Rule No. 1: Never lose money. Rule No. 2 : Never forget Rule No. 1."

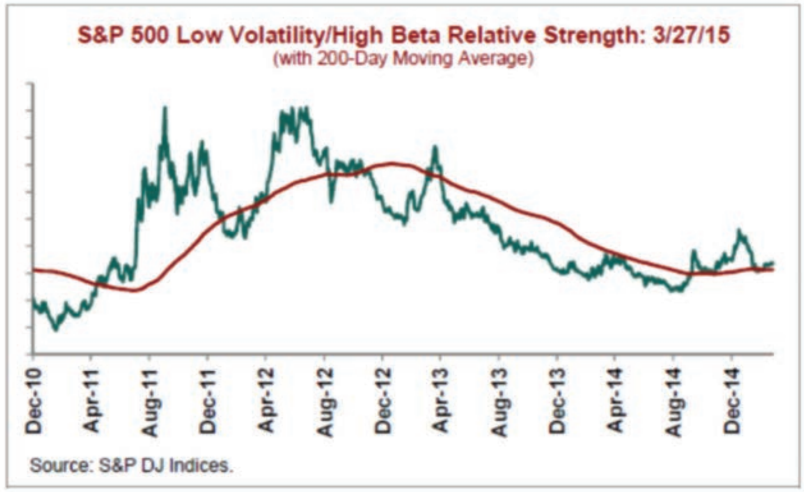

Exhibit 2 – Low Volatility Stocks Underperforming

Berkshire Hathaway Annual Report

It is an annual ritual of mine to read cover to cover the Berkshire Hathaway Annual Report. While others scour the New York Times Bestseller list for a good read over Spring Break, I have a PDF version of their 10-k on my iPad for both easy access and, quite candidly, the ability to enlarge the font size. I have been doing this now for over 20 years and enjoy it more each and every year. Years ago, I received the report via hard copy and every so often I would order a bound compilation of multiple years dating back to the mid-1980s. While reading these reports, you can envision Mr. Buffett reading both Rolling Stone and American Scholar magazines late into the evening with Coke in hand as he forms his very unique views of the world. I spent most of my career at the knee of such a man and it was always fun and entertaining!

This year's report has special meaning as it represents the 50th year in which Warren Buffett and Charlie Munger have guided the fortunes of Berkshire Hathaway. Despite Charlie working at Warren's grandfather's grocery store as a boy, Warren didn't meet the famed Harvard attorney until 1959 in Los Angeles upon the recommendation of an Omaha friend, at the tender age of 28. They have been life-long friends and business collaborators ever since. Charlie is famous for both his insightfulness, sharp wit and his extreme candor, "Warren think it over and you'll agree with me because you are smart and I am right…." Warren described an ill-timed exit of the company Tesco in 2014, which cost the company $ 444 million dollars. His leisurely sale of shares beginning in 2013 were critically described by Charlie as "thumb-sucking." However, Warren pays Charlie the ultimate compliment for the business design of today's Berkshire. For the decade of the 1950s, Warren successfully adhered to mentor Benjamin Graham's cigar-butt strategy, purchasing beaten down companies that still had a few free puffs left. "Though marginal businesses purchased at cheap prices may be attractive as short-term investments they are the wrong foundation to build a large and enduring enterprise. The blueprint he (Charlie) gave me was simple. Forget what you know about buying fair businesses at wonderful prices; instead buy wonderful businesses at fair prices."

As in year's past, the 2014 version has both humor and common sense investment insights and in some instances a little of both. Here are a few of my favorite quotes.

- In describing the recent business woes of Tesco: "In the world of business, bad news often surfaces serially: *You see a cockroach in your kitchen; as the days go by, you meet his relatives."*
- On the topic of stock trading and market timing: "No adviser, economist or TV commentator and definitely not Charlie or I can tell you when chaos will occur. *Market forecasters will fill your ear but will never fill your wallet."*
- When describing being inundated with acquisition ideas that do not come close to meeting the Berkshire Hathaway acquisition criteria: " A line from a country song expresses our feeling about new ventures, turnarounds, or auction-like sales: *When the phone don't ring, you'll know it is me."*
- As Buffet closes his remarks, he reflects upon his historical interest and several disappointing acquisitions of New England based textile companies, of which Berkshire Hathaway was one: " And now some good news: *The northern textile industry is finally extinct. You need no longer panic if you hear that I've been spotted wandering around New England."*

Despite building a company that employees 316,000 people through their various operating entities and has a market capitalization of over $ 350 Billion, Warren (age 84) and Charlie (age 91) don't appear to be slowing down nor taking themselves too seriously. Berkshire Hathaway is truly an American success story, and one we hopefully will be able to read many more chapters about well into the future. I only wished it paid a dividend…..

Will Williams
President