JANUARY 2015

Advisor

BALTIMORE - WASHINGTON FINANCIAL ADVISORS

B | W | F | A

President's Address

LOOKING FORWARD: 2015 AND BEYOND

ROB CARPENTER
PRESIDENT & CEO

"BE ALWAYS AT WAR WITH YOUR VICES, AT PEACE WITH YOUR NEIGHBORS, AND LET EACH NEW YEAR FIND YOU A BETTER PERSON." — Benjamin Franklin

Time moves inexorably forward, and with it come inevitable changes. Some change comes without warning, and we do our best to adapt. But you won't be surprised that we at BWFA prefer to anticipate change by being as prepared as possible beforehand. This year, we continued to do that by making great strides in every department: Investment Management, Financial Planning, Tax Service, and Business Services.

Looking ahead to 2015, I'm inspired by the words of Walt Disney: "Times and conditions change so rapidly that we must keep our aim constantly focused on the future... Keep moving forward, opening new doors and doing new things." In that spirit of innovation and opportunity, BWFA has been moving forward by focusing on our expert staff and by adding new services to improve the ways in which we help you, our clients, to reach your goals.

As we grow, our clients often ask us how big the firm will become. We understand this concern—personalized service is as important to us as it is to you. And while the firm needs to open "new doors" and do "new things," we will always continue to provide exceptional, individualized service and to remain steadfast in our commitment to our core values. Our clients—and the service that we provide you—are our primary focus.

We value your feedback. When we asked a few clients how they would like to see the firm grow, **some of their answers included:**

- Keep a close, special relationship between BWFA and the client
- Hire trustworthy professionals who care
- Continue to provide service that always keeps the best interest of the client in mind

We will never lose sight of these critical tenets. They have always guided us, and they will continue to guide us into the future. This is what makes our firm unique and our relationship with our clients so special.

When you have great clients and a wonderful team of dedicated professionals who share a passionate commitment to realizing a common purpose, anything is possible. I am proud to lead our team, and we cannot wait to do even more for you and your families in 2015.

Robert Carpenter

COVER PHOTO: York County, Pennsylvania

Do you know someone

WHO COULD USE GUIDANCE WITH THEIR INVESTMENTS?

MAYBE YOU KNOW SOMEONE WHO IS RETIRED OR NEARING RETIREMENT AND COULD BENEFIT FROM OUR SERVICES?

WE ASK YOU, OUR EXISTING CLIENTS, TO RECOMMEND OUR SERVICES TO FRIENDS OR FAMILY MEMBERS THAT COULD BENEFIT FROM OUR SUPPORT.

BY HELPING US GROW OUR "FAMILY OF CLIENTS," WE GET TO SHARE OUR PASSION WITH MORE PEOPLE JUST LIKE YOU.

PLEASE CONTACT MEGHAN AT MMANAS@BWFA.COM

JANUARY 2015 TABLE OF CONTENTS

2 **PRESIDENT'S ADDRESS**
ROB CARPENTER | President & CEO

4 **FINANCIAL PLANNING**
MARK STINSON | CPA, CFP®, MBA
Director of Planning

5 THAD ISMART | CFP®
Financial Planner

6 **INVESTMENT RESEARCH**
PHILIP WEISS | CFA, CPA
Chief Investment Analyst

8 **INVESTMENT MANAGEMENT**
BOB RAY | MBA
Financial Advisor & Portfolio Manager

10 JIM EDWARDS | CFP®
Financial Advisor & Portfolio Manager

12 MICHAEL LAVIÑA
Portfolio Manager & Director of Trading

13 JOSEPH A. CAPUTO
Chief Information Officer
& Associate Portfolio Manager

14 **TAX SERVICES**
BENJAMIN DORSEY | CPA, CFP®, CDFA™, MST
Director of Tax Services

16 **BUSINESS SERVICES**
BRIAN MACMILLAN
Managing Director Mergers & Acquisitions

17 **COMMUNITY SPOTLIGHT**
THE COLUMBIA ORCHESTRA

18 **WHAT'S HAPPENING AT BWFA**
MEGHAN MANAS
Office Manager

Financial Planning

IRS CREATES "MEGA-SALE" ON EMPLOYER RETIREMENT PLAN TAXES

MARK STINSON
CPA, CFP®, MBA
DIRECTOR OF PLANNING
mstinson@bwfa.com

I AM PUTTING ALL MY MONEY IN TAXES—THE ONLY THING SURE TO GO UP. – Henny Youngman

The IRS has proved Henny Youngman wrong—at least in one case. If you have made "after-tax contributions" to your employer-sponsored retirement plan (401(k), 403(b), TSP), the IRS has given you a holiday gift: you can transfer these contributions to a Roth IRA or, given the right circumstances, substantially increase after-tax contributions to your employer's plan.

On September 18, the IRS released Notice 2014-54, "Guidance on Allocation of After-Tax Amounts to Rollovers." In this notice, the IRS confirmed that employees who have made both pre-tax and after-tax contributions to employer-sponsored plans can transfer the pre-tax contributions to a traditional IRA and the after-tax contributions to a tax-free Roth IRA. Under current law, contributions to a Roth IRA will grow tax-free and will not be taxed when withdrawn. It is this tax-free treatment of asset growth that makes Roth IRAs so attractive.

However, as with anything IRA- or Roth IRA-related, the details become a bit complicated. For example, which contributions count as after-tax contributions and which count as pre-tax contributions? **Let's begin by looking at the three ways you can contribute to an employer-sponsored retirement plan:**

1. **Pre-tax contributions:**
   An employee's taxable income is reduced by these contributions.
2. **After-tax Roth contributions:**
   An employee contributes after-tax dollars to a Roth plan and is not taxed on the growth of these funds when they are withdrawn.
3. **After-tax regular contributions:**
   An employee contributes after-tax dollars to the employer-sponsored plan, and the growth is taxed when the funds are withdrawn.

Some plan participants might have after-tax contributions in their plan if, for example, they are a long-time employee and after-tax funds from an old plan were transferred to a new plan. Other employees might have chosen to contribute after-tax funds. As noted above, these after-tax contributions can be transferred to a Roth IRA so as to benefit from tax-free investment growth. However, plans have restrictions as to when you can transfer funds out of a plan (and into a Roth IRA). Some plans do allow limited transfers while you are an employee (called "in-service distributions")—but usually only after age 59½. In addition, plans may allow transfers only annually or semi-annually.

Now for the fine print:

- Not all plans allow after-tax contributions (so you wouldn't be able to benefit from the IRS "holiday gift").
- IRS Notice 2014-54 does not apply to after-tax contributions to IRAs (only to employer-sponsored retirement plans).

Check with your human resources department to determine if you currently have after-tax contributions in your plan and might be able to benefit by transferring them to a Roth IRA. Also, ask for a "Summary Plan" document to determine what your plan allows. If your plan allows after-tax contributions, keep reading...

MEGA BACK-DOOR ROTH

For those in the right circumstances, the IRA notice opens the door to a tremendous way to save money tax free. In fact, this strategy has a name—"Mega Back-Door Roth"— **and it is available only if the following circumstances apply:**

1. The employer plan must allow after-tax contributions.
2. The employee must have enough disposable income to make after-tax contributions to their plan.
3. The plan must allow for periodic in-service distributions of the employee's after-tax contributions and their earnings.
4. The employer plan must pass the non-discrimination tests. After-tax contributions are subject to non-discrimination tests that require plans be designed so that they do not unlawfully favor highly compensated employees.

The Mega Back-Door Roth benefit can be substantial. Employer-sponsored plans have an "overall limit" of $53,000. Employees who are age 50 or more are permitted an additional $6,000 "catch-up" contribution in 2015. If all the pieces fall in place, an employee could transfer, for example, $28,000 in after-tax contributions to a Roth IRA.

PLANNING FOR DIGITAL ASSETS

THAD ISMART
CFP®
FINANCIAL PLANNER
tismart@bwfa.com

HERE'S HOW:

Description	Without age 50 Catch-up	With age 50 Catch-up
Employee's pre-tax or Roth contributions:	$18,000[1]	$24,000[1]
Employer's matching pre-tax contributions:	$7,000[2]	$7,000[2]
Employee's after-tax contributions (which will transfer to a "Mega" Roth IRA):	$28,000[3]	$28,000[3]
Total Contributions:	$53,000	$59,000

[1] IRS 2015 contribution limit
[2] Employer pre-tax match amount varies by employer
[3] Plug in amount to reach "overall limit"

And if you have employer company stock in your plan, you might have additional benefits.

If you have any questions about after-tax contributions to your employer-sponsored plan, contact **Mark Stinson** at **410-461-3900** or **mstinson@bwfa.com**.

Many of us do much of our communicating and shopping online. Our email and social media accounts, along with many of the things that we purchase—songs, books, movies—exist only in electronic form, often behind password-protected accounts. Even though many of the "digital assets" that we accumulate live in a "cloud" and are only accessible with an Internet connection, they are still things that have real value.

YOU CAN PASS ON YOUR DIGITAL ASSETS BY CREATING A DIGITAL ESTATE PLAN...

But what happens to our digital assets when we pass away? Just as you create an estate plan to ensure that your tangible assets pass as intended, you should also create a digital estate plan to ensure that your digital assets pass as intended.

When you sign up for many online accounts, you agree to their "terms of service" (ToS). (In case you're wondering, no, nobody ever reads these.) Many of these ToS agreements indicate that your username and password are never given out to anyone, even the executor of your estate. This may sound great at first, but imagine all of your music, books, and other digital media that you purchased from iTunes, Amazon, or Google inaccessible to anyone who does not know your passwords.

Only a small number of states—including Rhode Island, Oklahoma, Connecticut, Indiana, and Idaho—have laws governing an executor's accessibility to online property. With Maryland yet to pass any such legislation, it is becoming increasingly important to provide some direction to your executor and heirs regarding the disposition of your digital assets after you pass away.

You can pass on your digital assets by creating a digital estate plan, which is simply a list of your digital assets that hold value—monetary, sentimental, or otherwise. The list should include:

- The name of the account
- The content of the account
- Username
- Password
- Security questions
- Instructions for the disposition of the account, including the name of the person who is to oversee the disposition

This list should be kept in a secure place, such as on a thumb drive, which you should store in a fireproof safe along with your estate documents. This way, it can be easily updated as your digital assets grow.

It is important to know that, while you might have specific instructions regarding how you would like your digital assets to be distributed, the assets are ultimately subject to the terms of service you agreed to when you opened the account. The instructions you leave for the executor could violate the ToS and, consequently, might not be permitted. If there is an account that is particularly valuable to you, you should contact the service provider to get a clear understanding of the disposition options for the account and the assets it contains after you pass away.

Investment Research

BEHAVIORAL INVESTING

PHILIP WEISS
CFA, CPA
CHIEF INVESTMENT ANALYST
pweiss@bwfa.com

Why do investors often have a tendency to sell stocks when they are low and buy them when they are high? When investing, our emotions can often overrule our well-thought-out plans. As the market bottomed during its last bear phase in 2009's first quarter, most investors were afraid of adding new money. More savvy investors realized that while the timing of the next upturn was far from certain, there were opportunities to acquire shares of high-quality companies at attractive prices that could lead to strong long-term gains. Concerns about avoiding losses outweighed the potential for long-term gains and kept many investors on the sidelines.

In his book *The Intelligent Investor,* which was first published in 1949, Ben Graham, the father of value investing, said, "The investor's chief problem – and even his own worst enemy – is likely to be himself." Unfortunately, these words still apply. Emotion, bias, and overconfidence are just three of the numerous behavioral traits that can negatively impact investment returns. Behavioral finance has become a recognized part of the investment lexicon.

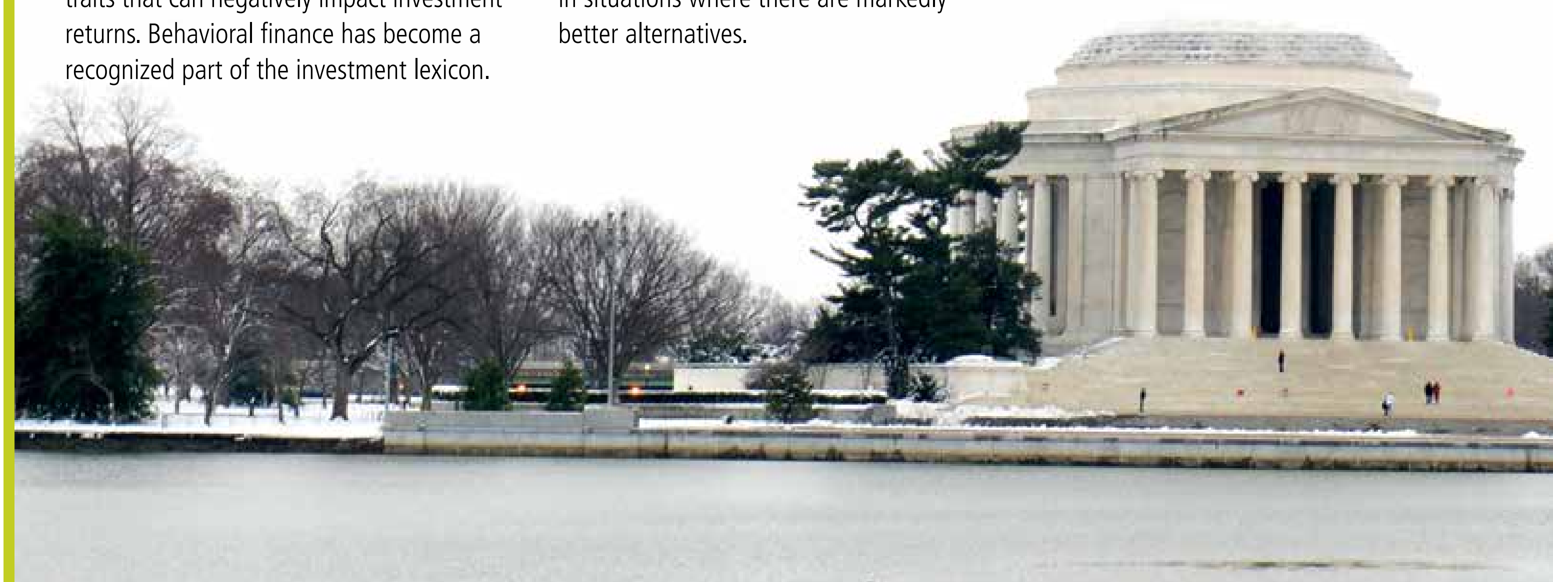
Behavioral finance is a relatively new field that seeks to combine behavioral and cognitive psychological theory with conventional economics and finance to provide explanations for why people make irrational financial decisions. Behavioral principles can be applied to an investment process to help investors avoid, or at least minimize, some of the mental mistakes that can so often hamper returns.

Behavioral finance practitioners and academics alike agree that human beings are flawed, which, of course, we are. We can and do make bad decisions, particularly when confronted by uncertainty. It is hard to imagine anything more uncertain than the financial markets. As a result, investing is rife with examples of irrational behavior. Pioneers in behavioral finance, such as Daniel Kahneman, a psychologist who won the Nobel Prize in economics in 2002 and the author of *Thinking Fast and Slow*, often present compelling examples of the ways that people can make poor choices in situations where there are markedly better alternatives.

In the discussion that follows, we will describe some common behavioral biases as well as ways in which they can potentially be addressed.

SUNK-COST FALLACY (SCF)

Have you ever started a book and realized you were not enjoying reading it and finished it anyway? If so, you may have fallen victim to the sunk-cost fallacy. When you continue to put time, energy or money into something because you have already made an investment in it and refuse to cut your losses and acknowledge that you cannot get back those "sunk costs" you are likely under the grips of the sunk-cost fallacy. In financial terms, this bias refers to the concept of "throwing good money after bad" or doubling up on an investment when you believe in the story behind the stock, even though the business' performance does not justify the additional capital.



One way to help minimize the risk of the SCF is to take a fresh look at a stock that works against you before committing new money. As part of this process, you should also attempt to understand the point of view of those who think differently.

LOSS AVERSION

In some ways, the SCF is closely related to another bias called loss aversion. This happens when we try to avoid losses because they feel too painful. In short, it is much more painful to sell a stock at a loss than it is to sell a stock for a profit. In his classic book on investing, *Common Stocks and Uncommon Profits*, Philip Fisher wrote, "More money has probably been lost by investors holding a stock they really did not want until they could 'at least come out even' than from any other single reason." One way to combat this bias is to remind ourselves that the money that remains tied up in the losing stock is keeping us from another, potentially better idea. In addition, if the losing investment is in a taxable account, selling it can also cut your tax bill. Viewing the sale of such losers as "tax loss harvesting" is another way to make recognizing a loss more palatable.

ANCHORING

The concept of anchoring draws on the tendency to attach or "anchor" our thoughts to a reference point – even though it may have no logical relevance to the decision at hand. For example, some investors may purchase shares of companies that have fallen considerably in a very short amount of time, simply because the share price has dropped sharply. In this case, the investor is anchoring on a recent "high" that the stock achieved and consequently believes that the drop in price provides an opportunity to buy the stock at a discount. However, just because a stock traded at a specific price does not necessarily mean that price was justified. When it comes to avoiding anchoring, there is no substitute for rigorous critical thinking.

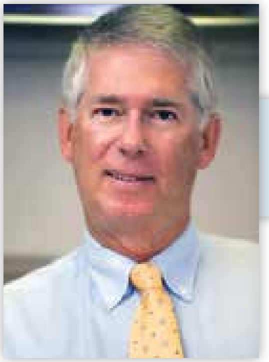
Be especially careful about which figures you use to evaluate a stock's potential. Successful investors do not just base their decisions on one or two benchmarks; they evaluate each company from a variety of perspectives in order to derive the truest picture of the investment landscape.

SUMMARY

Whether you realize it or not, the psychology of investing says you have naturally held cognitive biases that could affect the way you make decisions about your portfolio. It is important that investors be aware of these potential biases and also consider ways to combat them, so that they do not negatively impact performance.

NOTE: *For a discussion of two other behavioral biases, readers can also read the following BWFA Weekly Economic Updates on* ***bwfa.com****:*
CONFIRMATION BIAS *– July 7, 2014*
RECENCY BIAS *– February 18, 2014*

Investment Management



BWFA IS BULLISH ON AMERICA

BOB RAY
MBA
FINANCIAL ADVISOR & PORTFOLIO MANAGER
rray@bwfa.com

As we usher in 2015, the United States appears poised to once again be the engine that drives worldwide growth. This has not happened in over twenty years. We have had strong growth as well as recessions during this time period, but never has the world been more dependent on the US economy for growth. So, it's time to wave the Stars and Stripes. America is back!

The past few decades have witnessed strong growth from China and the emerging markets and steady growth from the industrialized world, including the United States. This balance has meant that the world was less dependent on the US than we witnessed in the 80's. But today, Europe is stuck in a zero growth environment, China is struggling to maintain a growth rate half of what it was ten years ago, and the emerging market economies of Russia and Brazil are pinched by the rapid decline in oil prices at the end of the last year. The United States still has the largest economy in the world and now the rest of the world will look to the USA to solve its economic woes.

In terms of Gross Domestic Product (GDP), the USA leads the world at approximately $17 trillion per year. China is roughly half our size at $8 trillion and Japan follows at roughly $5 trillion. If we add up all of the European Union countries' GDPs they would equal approximately $16 trillion.

The US economy is expected to continue its dominance in 2015 led by growth in consumer spending and higher capital expenditures. The consensus of growth forecasts have led the markets to anticipate that US interest rates will rise this year and this has resulted in continued strength for the US dollar. The continued increase in jobs and the decrease in the unemployment rate will eventually lead to higher wages and increases in domestic spending. The demand for goods and services will increase US imports, thus benefitting China, Europe, and the emerging markets. Capital inflows to the US markets, including equities, are expected to continue in the new year as the United States has the most favorable growth outlook and the strongest currency.

THE PERFECT STORM

The United States is in the middle of a perfect storm. We have the cheapest energy costs in the industrialized world, historically low interest rates, and an excess supply of labor. This has led to manufacturing companies returning production to the United States instead of outsourcing to developing countries. This trend is expected to continue in the new year as fiscal policies replace monetary easing as a driver of growth.

Few of us ever dreamed that the US would eventually be heading for energy independence. Alternative energy sources have been marginally successful, but the real driver of our low-cost energy has been the emergence of fracking. This technology has given us the ability to reach oil and natural gas deposits that previously we had not been able to reach, or were uneconomic to pump out of the ground. The more oil and natural gas produced from the Bakken, Marcellus, Eagle Ford, and other US basins, the more the downward pressure on worldwide energy prices. Lower energy prices not only benefit US consumers, but dramatically help US manufacturers. Energy is a key cost component in many industries. This cost advantage will help offset higher US labor costs and encourage companies to bring home manufacturing that had been based overseas. The jobs should follow the plants. However, there are still a few caveats.

TAX POLICY A KEY DRIVER

We expect that the new Congress, working with the Administration, will lower corporate income taxes in 2015. The US has one of the highest corporate tax rates in the world. This has resulted in corporations moving their operations overseas in search of a lower tax bite. Other companies with strong overseas sales have left billions of dollars overseas rather than pay up to 35% tax to bring the profits home. Lower US corporate tax rates would propel smaller US companies that now pay 35%, and allow larger companies with funds trapped overseas to bring the dollars home. This will facilitate growth in the US as well as add some marginal tax revenues that will help reduce the US budget deficit.

Lower corporate tax rates have the support of both political parties. The lack of structural reforms to the tax code over the past few years has not allowed US companies to take advantage of the newly found cheap energy. This has not been missed by foreign companies as most foreign car manufactures now have facilities in the US. If these problems are resolved, we would expect to see billions of dollars flow home. This should lead to more manufacturing here in the US and higher paying jobs.

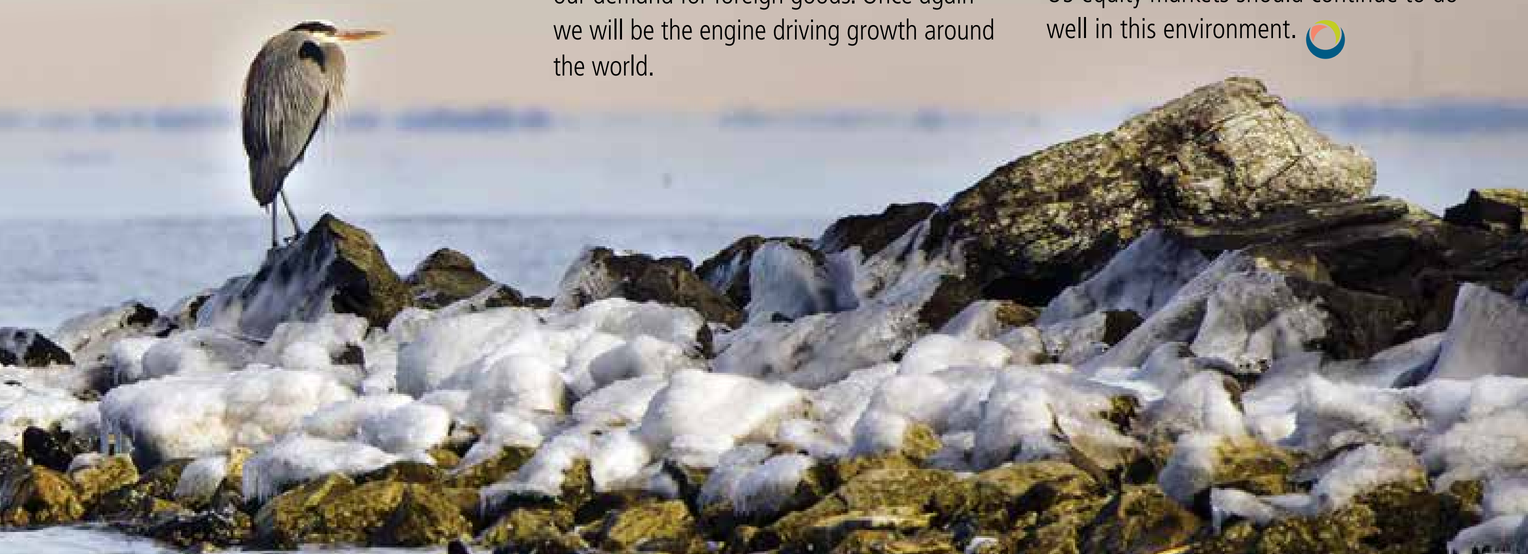
INTERNATIONAL EFFECTS OF THE STRONG DOLLAR

Over the past six months the US dollar has advanced more than 10% against its major trading partners due to growth forecasts and favorable interest rate differentials. This is good for America and our trading partners. The strong dollar will help keep the price of energy down, as oil is priced in dollars on the world markets. It also reduces the cost of imports, thus inflation will be kept under control. Our major trading partners will benefit as their currency depreciation will make them more competitive. As our economy grows so will our demand for foreign goods. Once again we will be the engine driving growth around the world.

However, not everyone will benefit. The losers will be the developing countries that export commodities. For example, Russia and Brazil will see their oil and minerals worth far less as the strong dollar forces commodity prices lower. India, an importer of oil, is expected to benefit marginally but will find its currency can't keep up with the dollar. More importantly the strong dollar will coincide with rising US interest rates, which will suck liquidity from the emerging markets. As the Federal Reserve Bank reduces liquidity, the deleveraging will affect all developing countries.

THE BOTTOM LINE

Given our forecast of continued strength in our economy and the dollar, the US equity markets will remain the asset class of choice. We do expect that interest rates will be rising in 2015, and this will lead to continued market volatility. But, the only reason to raise interest rates would be in response to a much stronger US economy. US equity markets should continue to do well in this environment.



Investment Management

THE IRRATIONAL EFFECTS OF FINANCIAL TRAUMA

JIM EDWARDS
CFP®
FINANCIAL ADVISOR & PORTFOLIO MANAGER
jedwards@bwfa.com

Financial trauma can occur through a variety of means. It can occur on a personal basis such as a job loss, bankruptcy, or divorce. It can also occur systemically through stock market and real estate losses like those experienced during the recent recession of 2008. Once the events have transpired, though, their effects can impact our future behaviors for years, if not a lifetime.

Our experiences with money and financial security are deeply rooted in all of us. These experiences activate our primordial concerns about safety and security. We cannot perform the essential functions of feeding, clothing, and sheltering ourselves without the means to somehow pay for these things. In fact, some neuroscientists have hypothesized that powerful financial losses or chronic poverty might register within our limbic systems (the part of the brain involved in our emotions and motivations, particularly those that are related to survival) creating an embedded neural circuit that overrides more reasoned thinking and decision making.

A good example of this is the effect that the Great Depression had on the habits of those who lived through it. Years of impoverishment taught people to continually save and to never throw away anything that might possibly be reused. If you have ever been around someone who lived through the Great Depression, you might have seen them saving used plastic bags or freezing and re-freezing every leftover scrap of food.

A compulsion to save, combined with reluctance to spend, became the paramount characteristic in the financial lives of those who survived this period of extreme poverty. But while the effects of the Great Depression on people's financial lives is a notable example, less storied and more personal events—financial losses due to personal bankruptcy, business failures, costly illnesses, and/or divorces—can have an equally powerful effect.

However, continually responding to these powerful shapers of our experience can sometimes lead us down the wrong path to chronic, repetitive errors in financial judgment. Because these powerful negative experiences connect to deep emotional states, they can mistakenly drive us into decisions that are irrational and/or unproductive.

For instance, the fear of loss can result in investors being overly conservative in their investment styles. Such persons might only invest in "safe" securities—certificates of deposits or money markets, for instance—subjecting themselves to real losses in purchasing power due to the effects of inflation over time. In other instances, one bad experience with a financial advisor could lead someone to decide that all financial advice is bad and that they cannot rely on anyone but themselves, even if it is in their best interest to get outside help. Such people continue to refuse advice, even when there is ample evidence that shows they might not be managing their investments well. If they were to use the same logic with their health, they could risk tragic consequences by refusing to seek a second opinion or even another physician, erroneously concluding that all medical advice is bad.

Traumatic financial events can also create a sense of hopelessness about the future. I have known clients who grew up in communist countries where their families and relatives lost everything to the state. Despite accumulating significant wealth in our democracy, they believe that what happened to their families will happen to them—so they do little-to-no financial planning.

In all of these situations, when powerful experiences are inhibiting good decision making, the best remedy is to ask, "What do money, spending, and saving mean to me?" The answers often help to make sense of behavior around money. By standing back from the deeper issue, we can begin to separate the negative behaviors related to past traumatic experiences from those that could be beneficial in the future.

If you or a loved one is stuck in financial neutral and could benefit from objective financial advice, give us a call—we are here to help.

Investment Management

MUTUAL FUNDS AND THE PITFALLS OF CHASING RETURNS

MICHAEL LAVIÑA
PORTFOLIO MANAGER & DIRECTOR OF TRADING
mlavina@bwfa.com

It is important for investors to understand the challenges and motivations that mutual fund managers face as they manage fund portfolios. For many of us, mutual funds are the primary investment vehicles in our employer-sponsored retirement plans. However, the misguided behavior of chasing returns has created an investing environment that works counter to the investor's goal of successfully investing for the long term.

THE WRONG INCENTIVES

Studies show that investors tend to chase returns. Earlier this year, YiLi Chien of the St. Louis Federal Reserve wrote *The Cost of Chasing Returns*. He used data from the Investment Company Institute that tracked the buying and selling activity of mutual fund shareholders over the last twenty-eight years. The data indicates that, as a whole, mutual fund shareholders tend to "chase returns" by buying more when past returns are high and selling when they are low. This behavior clearly hurts investors' long-term returns. It also incentivizes mutual fund companies to cater to this behavior by emphasizing the recent performance of their "top funds." Investment companies know investment dollars will flow into funds that "beat their benchmark." We have likely all seen an advertisement or two highlighting funds that have performed well recently. These advertisements likely encourage the type of return-chasing behavior that costs investors' money over time.

MANAGING TO A BENCHMARK

Most mutual funds are graded on how they perform relative to a benchmark. This incentivizes the manager to focus on relative performance with respect to a benchmark over short periods, as opposed to optimizing portfolios toward a long-term objective. For example, the S&P 500 is the most commonly used benchmark for funds that invest primarily in large, U.S.-domiciled firms. If a fund that is evaluated against the S&P 500 has performance that differs significantly from the index, questions are likely to be raised. If the performance is positive: Is the manager a future star and should the financial press be notified to promote her genius? Conversely, if the performance is negative in comparison to the benchmark: What is wrong with this manager? The incentive to focus on relative performance, which is more short-term in nature, rather than on identifying opportunities that present long-term value is clear.

SWIMMING AGAINST THE TIDE

The behavior of chasing returns puts fund managers in a position where they are swimming against the tide. The study referenced above indicated that as performance improves, more investors tend to buy into a fund. All too often this happens during the latter stages of a market cycle. Perversely, the fund manager is given larger quantities of money to invest after the market has gotten more expensive. At this point, there is more pressure on the manager to not hold cash, because the market is in the midst of a rally and shareholders in the fund want to participate. The end result is that fund managers end up buying more stocks as they get more expensive. Unfortunately, as the market cycle turns and performance suffers, investors tend to sell their fund shares. More than likely, holdings in high-quality stocks have just become a better value, but ironically the fund manager is in a position where he is forced to sell holdings in order to satisfy redemptions.

Mutual funds provide a relatively inexpensive way for the average investor to invest. However, the challenges and motivations of fund managers and investment companies that promote the funds should be understood by anyone that uses these products. The tendency of investors to chase returns and for fund managers to manage to a benchmark is generally counter-productive relative to the achievement of long-term investment goals. The prudent investor should always evaluate each investment in her portfolio on an individual basis based on the merits of each investment opportunity.

Finally, when constructing a portfolio, it is critical to clearly define an investor's long-term investment goals along with her tolerance for risk. The portfolio's performance should, correspondingly, be evaluated over long periods. Focusing on short-term results relative to a benchmark all too often distracts us from achieving our long-term objectives.

A BALANCING ACT: 5 STEPS FOR CREATING A SOUND PORTFOLIO

JOSEPH A. CAPUTO
CHIEF INFORMATION OFFICER
& ASSOCIATE PORTFOLIO MANAGER
jcaputo@bwfa.com

Creating a well-balanced, diverse portfolio of securities can be tricky. It requires time, discipline, and research. There are many factors to consider when developing an investment portfolio appropriate for your individual situation and circumstances.

FIRST, you will want to determine your investment risk tolerance. Are you comfortable with an aggressive portfolio with 100% of the portfolio in the stock market? Or would you feel more at ease with a less-risky blend of 65% stocks and 35% income securities? Whatever investment blend may be best for you, it is advisable to stick with your chosen model until something significant changes that alters your tolerance for risk.

SECOND, review the investment time horizon for your assets. Are the assets going to be used to buy a home in 3 years, fund a child's college in 15 years, or supplement your income when you retire in 25 years? These are extremely important parameters to set and understand. This will help you maintain a portfolio that matches your time-horizon. More importantly, it will help you rest assured that short-term market corrections, or intermediate-term market drops, will not prevent achievement of your long-term goals.

THIRD, you will want to set a reasonable schedule on which to rebalance your portfolio. Depending on your mix of investments, it may make sense to rebalance the first of the year, or semiannually. What is important here is that you avoid attempting to rebalance specifically at times you believe the market is going to change. At one time or another, some of us—even the smartest of investors—have attempted to "time the market." On the surface, it sounds like a solid strategy: sell certain sectors when the market reaches its peak, and "buy back in" when the market has bottomed out. But what strategies do you use to anticipate these events? Do you look at a chart of the S&P 500, retail sales figures, unemployment rate, or do you just go with a gut feeling? Market timing can be a dangerous game, and we do not believe it should play a part in your overall investment strategy. It's best to stay on track with your scheduled rebalance dates and not try to time the market.

FOURTH, you will want to make sure you construct a well-diversified portfolio of securities. You should aim to gain exposure to several areas of the market and invest across multiple asset classes. This may include foreign and domestic stocks, as well as foreign and domestic income securities. Perhaps you will want a portion invested in cash for liquidity as well. You should consider holding small, medium, and large companies in your portfolio. Additionally, it is important to identify, short-, medium-, and long-term fixed income, while remembering to consider the credit risk of all of these securities.

FIFTH, it makes sense to identify funds with below average expense ratios so that the fund fees do not eat away at your performance over time. However, "cheaper" does not always mean better. In certain cases, a managed mutual fund with higher expenses could be a better fit in a portfolio than a low cost index exchange-traded fund.

As you can see, many factors go into the construction of an investment portfolio. Understanding the delicate blend of the many moving parts is important to long –term investment success. If you wish to hear more about how BWFA can help you manage your investments, please contact us at **410-461-3900**.

Tax Services

BEING PREPARED: THE BEST KEPT SECRET TO LOW-STRESS TAX RETURN FILING

BENJAMIN DORSEY
CPA, CFP®, CDFA™, MST
DIRECTOR OF TAX SERVICES
bdorsey@bwfa.com

"IN THIS WORLD NOTHING CAN BE SAID TO BE CERTAIN, EXCEPT DEATH AND TAXES"

— famous words from Benjamin Franklin that have stood the test of time (and likely will continue do so).

Another year is behind us, and April 15 approaches. Congress, meanwhile, continues to lurk in the background, with the potential for last-minute tax legislation that could retroactively impact 2014. Forms such as your W-2 and consolidated investment statements have Jan. 31 and Feb. 28 release deadlines, respectively. Oh, and the issuers reserve the right to amend them in the future. It is easy to see how the dreaded filing deadline becomes more and more of a last minute rush each year.

Like many professional tax-preparation organizations, BWFA provides its tax clients with a tax organizer to assist in organizing receipts, information, and pertinent documents that will be utilized to prepare annual tax filings. That being said, we try to assist all clients, regardless of service type, in preparing for and filing their tax returns. To that end, we wanted to bring some special items to your attention.

AFFORDABLE CARE ACT

All Americans will be affected in some manner by the Affordable Care Act. As a result of this act, the IRS released new tax forms for 2014. One of the most common forms will be **Form 1095**, which depicts the health-insurance coverage available to you from your employer. Please be sure to provide this form with your tax documents to your tax professional. If you do not receive a 1095, your tax professional will need to ask you additional questions regarding your and your family's health insurance coverage for 2014.

MEDICAL DEDUCTIONS

Under current law, most taxpayers can only deduct medical expenses to the extent they represent more than 10% of their adjusted gross income (taxpayers 65 and older still have a threshold of 7.5% until tax year 2016). Before going through the hassle of organizing and adding up your medical expenses for your tax professional, determine whether it is likely that you will meet the 10% threshold needed to receive any benefit. If you are self-employed, your tax professional will also need to know how much you paid for health insurance.

CHARITABLE CONTRIBUTIONS

All deductions of any amount must be supported by a receipt. Any individual contribution greater than $250 must also have an acknowledgement letter from the charity, and the letter must be dated by the date your tax return is filed.

The letter must show the date and amount of any individual contribution greater than $250, and it should specify whether any goods or services were received as part of the contribution.

ROTH IRA CONVERSIONS

Taxpayers and tax professionals have continued to evaluate the benefit of converting traditional IRA accounts to Roth IRAs. Since these conversions are not a common annual occurrence for most taxpayers, it is imperative that you provide your tax professional with information related to any conversion completed in 2014. Additionally, if you expect lower income in 2015, it can be worthwhile to evaluate future conversions with your tax professional.

CHILDREN/STUDENT TAX RETURNS

Because of the Affordable Care Act, it is imperative that students and dependent children who file their own return not claim their own dependency exemption. Allowing a child to claim their own dependency exemption, particularly a student, can cost the child and parent thousands of dollars in healthcare penalties and/or credits.

PLANNING FOR 2015

Effective January 1, 2013, the amount you can give to one person in a given year without needing to file a gift tax return was increased to $14,000. That amount was not adjusted and will be the same in 2015. IRA contribution limits for taxpayers with taxable compensation will also stay the same for 2015: $5,500 for taxpayers younger than 50, $6,500 for taxpayers 50 and over. Annual 401(k) deferral limits to employer-sponsored retirement plans increased to $18,000, with a catch-up provision for taxpayers 50 and over of an additional $6,000.

Even without the assistance of a tax professional, an organized and informed taxpayer can stay ahead of the curve and file their tax return before April 15. If you do not use a tax organizer, try creating a checklist of items that are commonly used to prepare your return (W-2s, 1099s, K-1s, etc.). Many organizations make their forms available on the Internet as opposed to sending them to clients by mail. Keep on top of email notifications from the banks and brokerages with which you have accounts about the release of tax data and forms. Finally, whether you use your own software or employ the services of a tax professional, it is better to start your return early or send your documents to your tax professional sooner rather than later. This will lead to a calmer pace as you approach the filing deadline.

Business Services

SELLING AN SBA 8(A) GOVERNMENT CONTRACTOR

BRIAN MACMILLAN
MANAGING DIRECTOR
MERGERS & ACQUISITIONS
bmacmillan@bwfa.com

While the Small Business Administration 8(a) Program can provide business owners with numerous benefits, selling an 8(a) contractor can be difficult. However, the notion that an 8(a) contractor cannot be sold is false. Working with advisors with experience selling 8(a) contractors can allow owners of 8(a) contractors to successfully sell their business.

An 8(a) contractor is a business that has been certified to do business with the government or other government contractors under the US. Small Business Administration 8(a) Business Development Program.

To learn more about how companies qualify for certification under the SBA 8(a) Business Development Program, please visit www.sba.gov/content/about-8a-business-development-program

SOLVING THE CHALLENGES FACED WHEN SELLING AN 8(A) CONTRACTOR:

Limited Number of Buyers: The main reason 8(a) contractors are not sold as frequently or for as much money as their private sector counterparts is the limited pool of buyers that can purchase an 8(a) contractor. It is important to keep in mind that the limited pool of buyers only applies if an 8(a) contractor receives a significant portion of its revenue from 8(a) set-aside contracts rather than "free and open" contracts. The buying pool for 8(a) contractors working on multiple 8(a) set-aside contracts is smaller because 8(a) set-aside contracts can only be transferred to other 8(a) contractors, making other 8(a) contractors the only willing and able buyers. Given the nature of the 8(a) Program, most 8(a) contractors are small and less likely to be in a buying mode, which limits the buying pool even further. Due to the limited buying pool, valuing an 8(a) contractor can be tricky, so it is important to speak with a certified valuation analyst with experience valuing 8(a) contractors. Finding potential buyers can be difficult, but there are buyers out there. Working with advisors who know how to find and attract potential buyers is crucial.

The Waiver Process: Another key complication in the sale of 8(a) contractors working mostly on 8(a) set-aside contracts is the actual process of transferring the 8(a) contracts. When any contractor dealing with SBA-designated contracts is being sold, the SBA contracts have to be novated to the new business through the government entity that awarded the contract. This can be a complicated process itself, but the novation is fairly straight-forward and is typically done shortly after the closing of the sale of the business. However, 8(a) contracts are automatically terminated upon the transfer of ownership of a contractor unless a "waiver" of the automatic termination is obtained prior to the closing of the sale of the contractor.

This SBA waiver process adds complexity and time to the transaction which needs to be anticipated by both the buyer and the seller. In order to make the SBA waiver process as smooth as possible, advisors should have a solid understanding of what the process entails.

The rules and regulations related to the SBA waiver can be found in Section 13CFR124.515 in the Code of Federal Regulations. This Section states that the SBA Administrator may waive the automatic termination if requested to do so by the 8(a) contractor when ownership and control of the concern that is performing the 8(a) contract will pass to another 8(a) participant, but only if the acquiring firm would otherwise be eligible to receive the award directly as an 8(a) contractor.

It is the selling entity's responsibility to submit the waiver request to their SBA Administrator (Contracting Officer) and to manage all communication with the government regarding the waiver. However, the selling entity must include in the waiver request, among other items, evidence that the buyer's 8(a) status is in good standing and that the buyer has the capability to assume and perform all requirements of the 8(a) contracts whose termination is being waived.

The specific government entity (DoD, DoL, DoT, NASA, etc.) that initially awarded the 8(a) contract will have to sign off on the waiver as well. As such, it is important to make sure the specific government entity is aware that the seller is submitting the waiver and, if possible, can provide the seller with a verbal understanding that they will approve the waiver.

The amount of time the waiver process takes can vary dramatically from a few weeks to a few months and can heavily depend on the selling entity's relationship with their Contracting Officer and the experience of said Contracting Officer with the waiver process.

Choosing Experienced Advisors: Complex rules regarding the sale of 8(a) contractors and, more specifically, the transfer of 8(a) contracts means that there are fewer advisors familiar with the sale of 8(a) contractors. The lack of advisors (merger and acquisition advisors, certified valuation analysts, CPAs, attorneys) with knowledge of the subject and experience working with 8(a) contractors creates a void of information for owners of 8(a) contractors; they frequently do not know with whom to speak regarding the sale of their 8(a) contractor.

Selling any business can be a daunting task and is one of the most important decisions in the life of a business owner. Understanding the added complexities of selling an 8(a) contractor can mean the difference between a successful sale and an unsuccessful one. In order to successfully sell an 8(a) contractor, it is important that the owner of an 8(a) contractor with 8(a) set-aside contracts consults with experienced advisors, such as the Mergers & Acquisitions team at BWFA, who have dealt with the challenges outlined above.

Community Spotlight

In the fall of 1977, a handful of local string players in Howard County got together and formed the Columbia Chamber Orchestra. Over the next eleven years this group grew to include winds and percussion as it evolved into a full orchestra. Since then, the Columbia Orchestra (CO) has been providing the community with high-quality musical performances, offering local youth and educators a classical music resource, and giving local musicians an opportunity to explore and perform great orchestral literature and chamber music.

In its 37th season the CO is led by conductor and cellist Jason Love, who is in his sixteenth year as musical director. In 2013, he was the winner of the American Prize for Orchestral Programming. He is also a past winner of the "Howie" award, recognizing achievement in the arts in Howard County, Maryland. Mr. Love sets the tone for the performances by engaging the audience with humor, passion, and an encyclopedic knowledge of the music. The stories of the histories behind the works are almost as engaging as the actual performances.

BWFA IS PROUD TO CONTINUE ITS SUPPORT OF THE COLUMBIA ORCHESTRA THIS SEASON.

THIS SEASON

The orchestra performs a diverse mix of classical masterpieces and contemporary music. This season the CO is playing a repertoire that ranges from classical masterpieces like Brahms & Schumann to Symphonic Pops, a family-friendly concert bringing together hits from Broadway, the cinema, and light classics. No season with the CO would be complete without its Young Peoples Concerts. This spring they will perform *Camille Saint-Saëns – Carnival of the Animals* and *Peter and the Wolf*. Both performances will be accompanied by dance from local artists and will give children a hands-on opportunity to play instruments at the free Musical Instrument Petting Zoo (sponsored by Music Arts).

LOCAL COMPETITIONS

The CO also sponsors two competitions for artists: the American Composer Competition and the Young Artist Competition. The American Composer Competition helps to promote new American works both locally and across the country. The winning artist receives recognition and a cash prize. In addition, his or her work will be performed publicly, providing the potential to build an audience for the new work. The Young Artist Competition is open to Howard County students through the twelfth grade who play string, wind, and percussion instruments. Winners have an opportunity to win a cash prize and to play with the CO. This year's winners will perform on April 11th between performances of Schubert & Stravinsky.

BWFA is proud to continue its support of the CO this season. We invite you, too, to support this Howard County organization by attending one of their performances. The CO is offering BWFA clients $5 OFF per ticket to any concert in its 2014-15 season. To purchase tickets online, please use the discount code BWFA5 on the website, **http://columbiaorchestra.org/tickets/** or call **410-465-8777**.

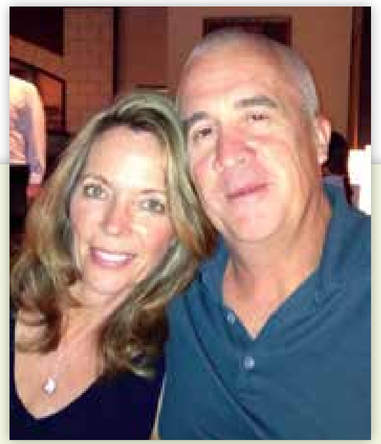
What's Happening at BWFA

TELL ME SOMETHING GOOD

MEGHAN MANAS
OFFICE MANAGER

We are excited to introduce a new feature, **"Tell Me Something Good,"** that we plan to include twice a year in *The Advisor* magazine.

If you know or would like to nominate someone who is doing good or interesting work in our community, please contact Meghan Manas, **mmanas@bwfa.com** or **410-461-3900**.



Cathy Rees earned a master's degree in nursing from Georgetown University and practiced nursing in a variety of settings for 30 years. Two years ago, to help deal with her impending "empty nest," she became certified by the Yoga Alliance as an RYT200 (a registered yoga teacher with 200 hours). Now she's training to become an RYT500 through the Columbia Yoga Center.

Teaching yoga has more than fulfilled Cathy's need to stay busy and active. In early November, she returned from an eight-day training course where she earned her certification in Therapeutic Yoga for Seniors at Duke Integrative Medicine in Durham, North Carolina. The intense and informative program, she said, will truly enhance and refine her teaching.

Cathy started teaching yoga at Copper Ridge and Fairhaven last February. At Fairhaven she teaches gentle chair yoga and gentle mat yoga for the independent living residents twice per week, as well as classes for the assisted-living and nursing-home residents. At Copper Ridge she teaches three levels of dementia yoga to the assisted-living residents who have moderate to severe dementia and who are somewhat ambulatory, as well as those who are confined to wheelchairs and have more severe dementia—including Alzheimer's disease, Parkinson's disease, frontotemporal dementia, and many others.

Cathy is working with the Director of Health and Wellness at Copper Ridge as well as the neuropsychiatrist to develop a "Yoga for Dementia" program that can be taught to other yoga teachers who serve a similar demographic.

TEACHING YOGA HAS MORE THAN FULFILLED CATHY'S NEED TO STAY BUSY AND ACTIVE.

"The dementia population tends to be an underserved population," she said, "perhaps because it is considerably more challenging to teach yoga to this group as compared to a level-one yoga class where everyone can follow your instructions and remain alert throughout the class."

To Cathy, the work they do at Copper Ridge is incredibly rewarding. "If I get a smile or eyes following me or small movements of fingers or toes, I am successful," she said. "I have learned to detach from expectations and let the energy create its own sense of balance in the space."

A physician who specializes in dementia care once asked Cathy, "What is your goal for teaching this population?" She replied with confidence: "Merely to facilitate present-moment joy in the student." If the research could be funded, she said, she would love to prove what she knows to be true – that smiling and laughing and feeling loved by another human being can soothe the nervous system and perhaps lower the amount of anxiety medication that people need.

"If I could help to reduce even one dose of medication per day, I would feel measurable success," she said. "However, knowing in my heart and seeing in their eyes that we have connected as two loving human beings is reward enough and keeps me going back day after day."

NEW SERVICE FOR DIVORCING COUPLES OFFERED BY BWFA

We are pleased to announce that our Director of Tax Services, Benjamin Dorsey, CPA, CFP®, MST, recently completed a specialized education program in professional divorce analysis and is now a Certified Divorce Financial Analyst™ (CDFA™).

Ben is trained to provide financial information and assistance to people going through a divorce. He evaluates the tax implications of dividing property, and the financial implications of various settlement options for dividing marital property (including pensions), and of child and spousal support payments.

Be on the lookout for Ben's articles in future editions of *The Advisor* magazine.

ORIOLES MAGIC

BWFA staff took part in supporting the Baltimore Orioles during their exciting playoff run. Each day that the O's played was dubbed "Orioles Day" at the office, and staff were encouraged to show their support by wearing orange. A few members of the team even got to go to a couple playoff games!

BWFA'S GREAT PUMPKIN CONTEST

BWFA staff spent an afternoon in teams of three carving pumpkins for the first annual BWFA Great Pumpkin Contest. It got competitive, as the prize was an extra vacation day and lunch on BWFA! The carved pumpkins were on display during the week of Halloween, and guests who visited the office that week voted for their favorite pumpkin. Team #1—which included Allison Gowallis, Meghan Manas, and Rob Williams—was crowned the winner!

BWFA STAFF BONDING

For the first annual BWFA Staff Autobahn Classic, the staff of BWFA spent an afternoon at the Autobahn Indoor Speedway in Jessup, Maryland. Jake Birdsong was the racer who took the trophy that day! As Mario Andretti once said, "If everything seems under control, you're not going fast enough."

Congratulations

BWFA FAMILY NEWS!

BWFA's Financial Planner Thad Ismart and his wife Sara welcomed future planner **EMMA**, on Oct. 20, 2014!

CONGRATS TO THE NEW PARENTS!

B|W|F|A

Baltimore-Washington

FINANCIAL ADVISORS

RETIREMENT & ESTATE PLANNING | INVESTMENT MANAGEMENT | TAX SERVICES | BUSINESS SERVICES

5950 SYMPHONY WOODS ROAD | SUITE 600 | COLUMBIA, MD 21044 | P:410.461.3900 | TF: 888.461.3900 | F: 443.539.0330 | BWFA.COM