



# COMMENCEMENT FINANCIAL PLANNING LLC

Q2

Quarterly Market Review

Second Quarter 2015

# Quarterly Market Review

Second Quarter 2015

This report features world capital market performance and a timeline of events for the past quarter as well as topics of interest.

The world capital market performance discussion begins with a global overview, then features the returns of stock and bond asset classes in the US and international markets.

The report also illustrates the performance of globally diversified portfolios.

## Overview:

Market Summary

World Stock Market Performance

World Asset Classes

US Stocks

International Developed Stocks

Emerging Markets Stocks

Select Country Performance

Real Estate Investment Trusts (REITs)

Fixed Income

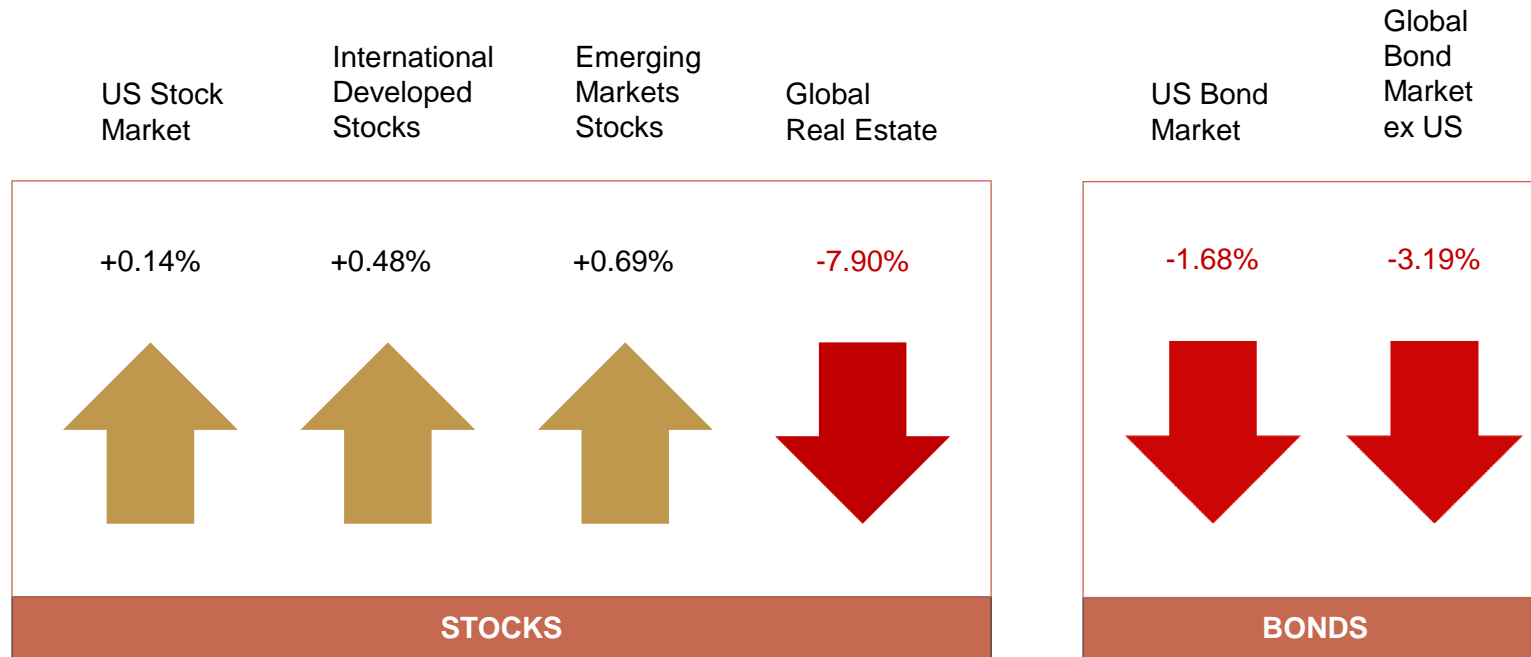
Global Diversification

Quarterly Topics: Yield vs. Total Return

The Seven Roles of an Advisor

# Market Summary

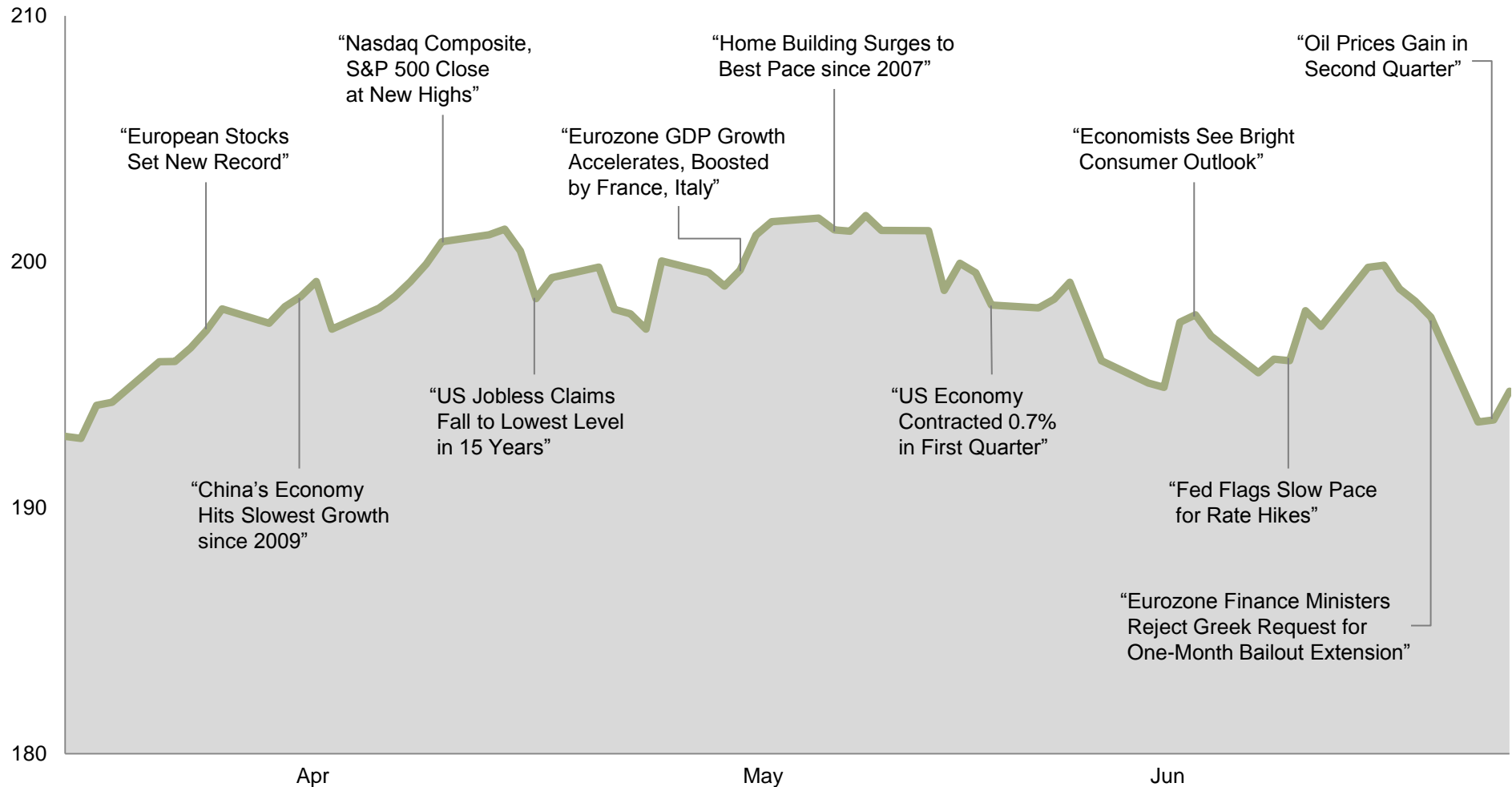
## Second Quarter 2015 Index Returns



**Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.** Market segment (index representation) as follows: US Stock Market (Russell 3000 Index), International Developed Stocks (MSCI World ex USA Index [net div.]), Emerging Markets (MSCI Emerging Markets Index [net div.]), Global Real Estate (S&P Global REIT Index), US Bond Market (Barclays US Aggregate Bond Index), and Global Bond ex US Market (Citigroup WGBI ex USA 1-30 Years [Hedged to USD]). The S&P data are provided by Standard & Poor's Index Services Group. Russell data © Russell Investment Group 1995-2015, all rights reserved. MSCI data © MSCI 2015, all rights reserved. Barclays data provided by Barclays Bank PLC. Citigroup bond indices © 2014 by Citigroup.

# World Stock Market Performance

MSCI All Country World Index with selected headlines from Q2 2015



These headlines are not offered to explain market returns. Instead, they serve as a reminder that investors should view daily events from a long-term perspective and avoid making investment decisions based solely on the news.

Graph Source: MSCI ACWI Index. MSCI data © MSCI 2015, all rights reserved.

It is not possible to invest directly in an index. Performance does not reflect the expenses associated with management of an actual portfolio. Past performance is not a guarantee of future results.

# World Asset Classes

## Second Quarter 2015 Index Returns

Looking at broad market indices, emerging markets outperformed both the US and developed ex US markets in US dollars during the quarter. REITs recorded the lowest performance in developed markets, including the US.

The value effect was positive in emerging markets but negative in developed markets, including the US. Small caps outperformed large caps in the US, non-US developed markets, and emerging markets. The US dollar had mixed performance during the quarter.



# US Stocks

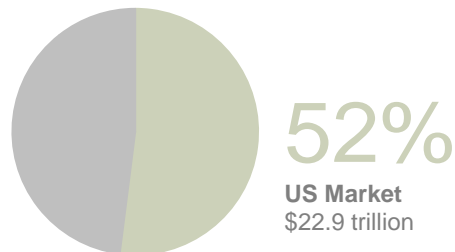
## Second Quarter 2015 Index Returns

The US equity market recorded slightly positive performance for the quarter.

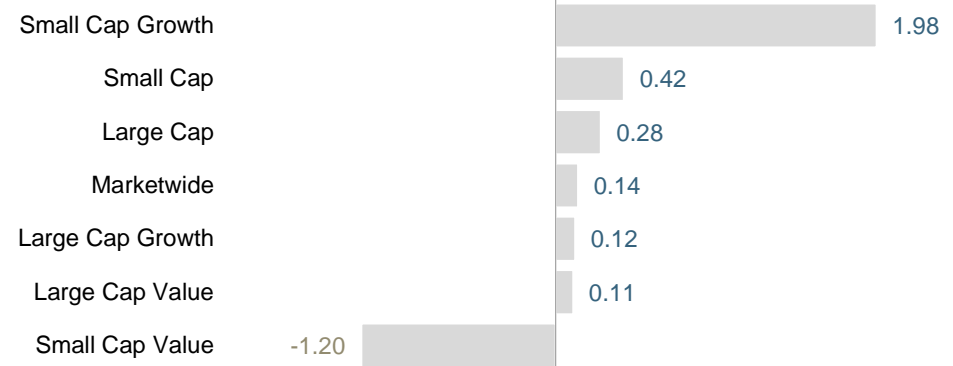
Small caps outperformed large caps, helped by the strong performance of micro cap stocks. Mid caps recorded the lowest return across the size ranges.

Value underperformed growth marketwide. Large value and large growth recorded similar performance, while the mid cap value and small cap value indices underperformed their growth counterparts.

### World Market Capitalization—US



### Ranked Returns for the Quarter (%)



### Period Returns (%)

Asset Class	* Annualized				
	YTD	1 Year	3 Years*	5 Years*	10 Years*
Marketwide	1.94	7.29	17.73	17.54	8.15
Large Cap	1.23	7.42	17.31	17.34	7.89
Large Cap Value	-0.61	4.13	17.34	16.50	7.05
Large Cap Growth	3.96	10.56	17.99	18.59	9.10
Small Cap	4.75	6.49	17.81	17.08	8.40
Small Cap Value	0.76	0.78	15.50	14.81	6.87
Small Cap Growth	8.74	12.34	20.11	19.33	9.86

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# International Developed Stocks

## Second Quarter 2015 Index Returns

Developed markets outside the US outperformed the US equity market but underperformed emerging markets indices in US dollar terms.

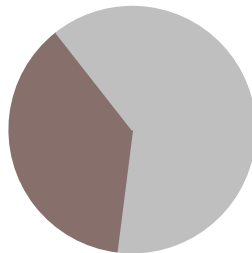
Small caps significantly outperformed large caps.

Value underperformed growth indices across all size ranges, and particularly in small caps.

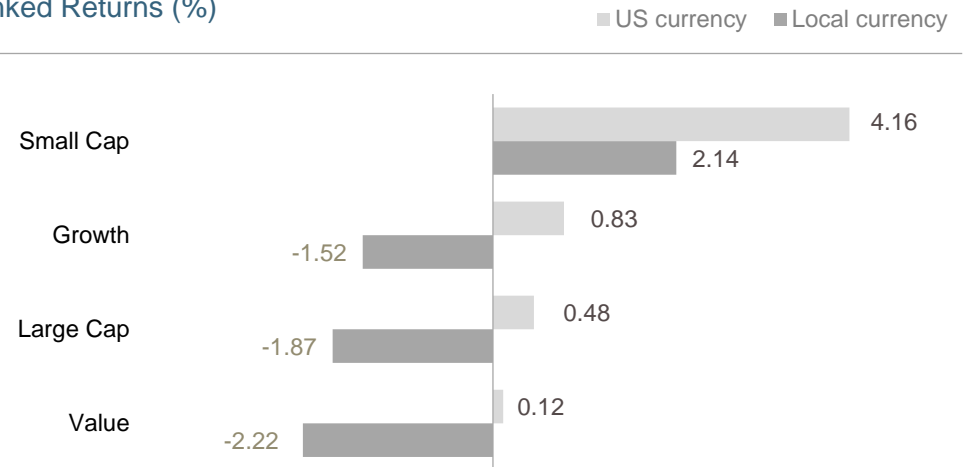
### World Market Capitalization—International Developed

**37%**

International  
Developed  
Market  
\$16.5 trillion



### Ranked Returns (%)



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
Large Cap	4.34	-5.28	11.15	8.97	5.16
Small Cap	8.36	-3.96	13.60	11.10	6.30
Value	2.74	-8.66	10.82	8.42	4.49
Growth	5.90	-1.87	11.43	9.47	5.76

\* Annualized

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Large Cap (MSCI World ex USA Index), Small Cap (MSCI World ex USA Small Cap Index), Value (MSCI World ex USA Value Index), and Growth (MSCI World ex USA Growth). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI World ex USA IMI Index used as the proxy for the International Developed market. MSCI data © MSCI 2015, all rights reserved.

# Emerging Markets Stocks

## Second Quarter 2015 Index Returns

Emerging markets indices outperformed developed markets indices, including the US, in US dollar terms during the quarter.

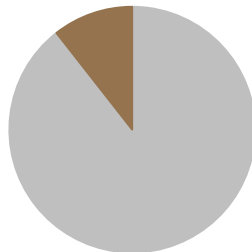
Small cap indices significantly outperformed large cap indices for the quarter.

Value outperformed growth marketwide, influenced by the strong performance of large caps. Value indices underperformed growth indices in both mid caps and small caps.

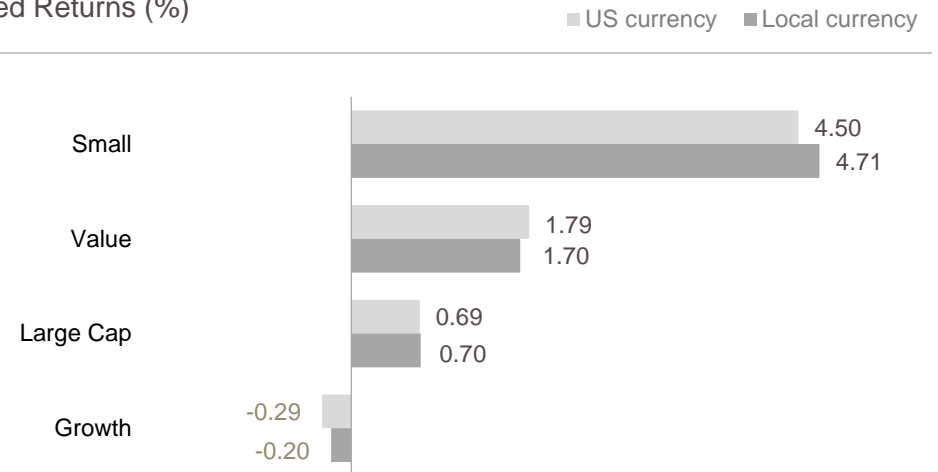
### World Market Capitalization—Emerging Markets

# 11%

Emerging Markets  
\$4.7 trillion



### Ranked Returns (%)



### Period Returns (%)

Asset Class	YTD	1 Year	* Annualized		
			3 Years*	5 Years*	10 Years*
Large Cap	2.95	-5.12	3.71	3.68	8.11
Small Cap	8.25	0.34	7.98	5.04	9.96
Value	2.18	-7.67	1.44	2.14	8.16
Growth	3.66	-2.64	5.92	5.17	8.01

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Market segment (index representation) as follows: Large Cap (MSCI Emerging Markets Index), Small Cap (MSCI Emerging Markets Small Cap Index), Value (MSCI Emerging Markets Value Index), and Growth (MSCI Emerging Markets Growth Index). All index returns are net of withholding tax on dividends. World Market Cap represented by Russell 3000 Index, MSCI World ex USA IMI Index, and MSCI Emerging Markets IMI Index. MSCI Emerging Markets IMI Index used as the proxy for the emerging market portion of the market. MSCI data © MSCI 2015, all rights reserved.

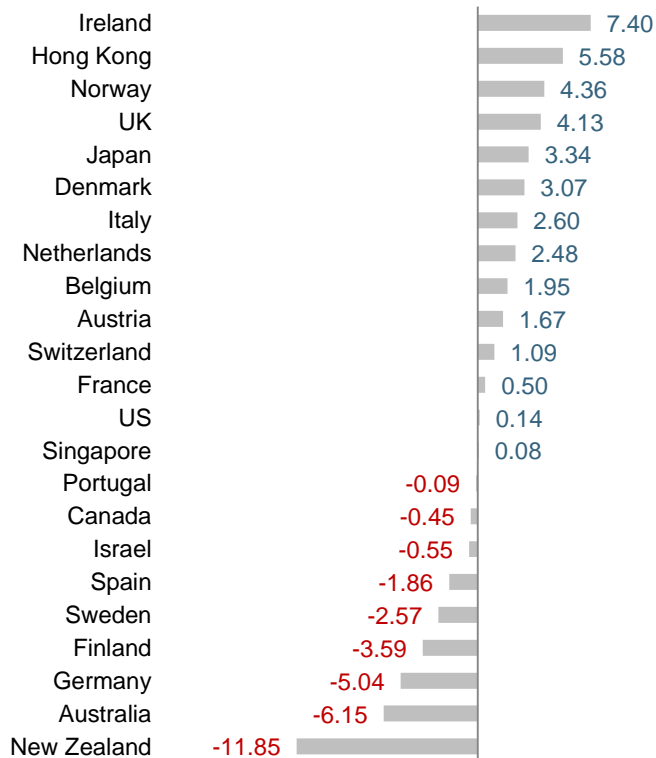


# Select Country Performance

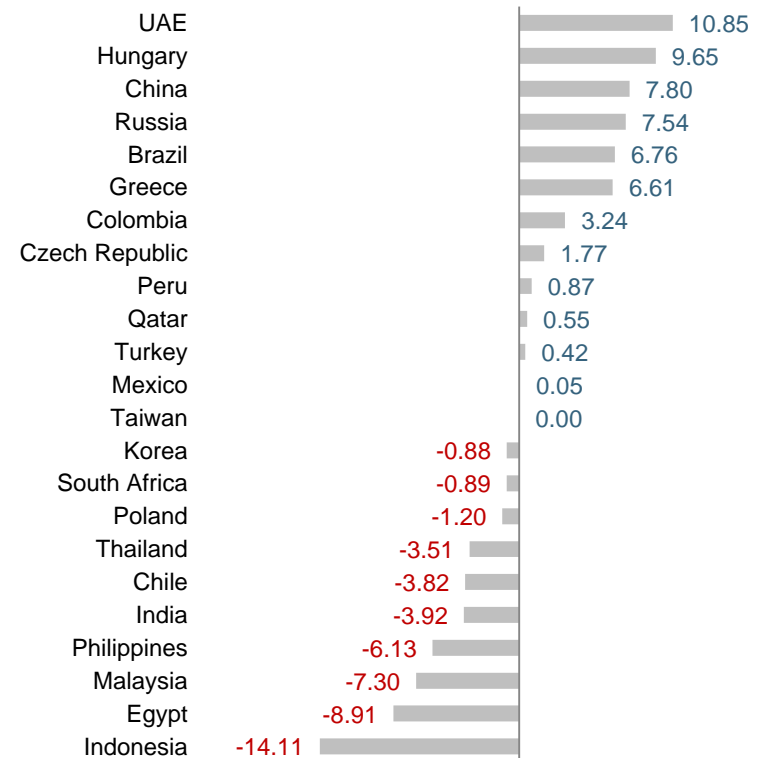
## Second Quarter 2015 Index Returns

Smaller countries recorded the highest performance for the quarter, with Ireland and Hong Kong leading the way in developed markets and the UAE and Hungary in emerging markets. Currency played a role for each of the countries that recorded the lowest performance in developed and emerging markets, as the New Zealand dollar and the Indonesian rupiah depreciated vs. the US dollar.

Ranked Developed Markets Returns (%)



Ranked Emerging Markets Returns (%)



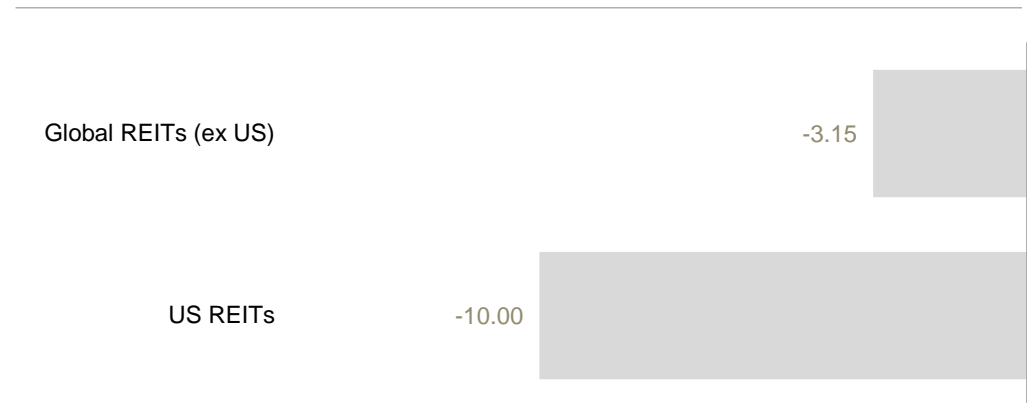
Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Country performance based on respective indices in the MSCI World ex US IMI Index (for developed markets), Russell 3000 Index (for US), and MSCI Emerging Markets IMI Index. All returns in USD and net of withholding tax on dividends. MSCI data © MSCI 2015, all rights reserved. Russell data © Russell Investment Group 1995–2015, all rights reserved. UAE and Qatar have been reclassified as emerging markets by MSCI, effective May 2014.

# Real Estate Investment Trusts (REITs)

## Second Quarter 2015 Index Returns

REITs both in the US and non-US markets significantly underperformed the broad equity markets during the quarter.

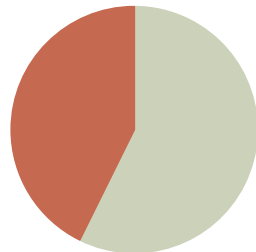
### Ranked Returns (%)



### Total Value of REIT Stocks

**43%**

**World ex US**  
 \$409 billion  
 236 REITs  
 (22 other countries)



**57%**

**US**  
 \$549 billion  
 92 REITs

### Period Returns (%)

*\* Annualized*

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
US REITs	-5.75	5.21	8.67	14.43	6.78
Global REITs (ex US)	-1.05	-3.21	9.24	11.93	4.01

**Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio.**

Number of REIT stocks and total value based on the two indices. All index returns are net of withholding tax on dividends. Total value of REIT stocks represented by Dow Jones US Select REIT Index and the S&P Global ex US REIT Index. Dow Jones US Select REIT Index used as proxy for the US market, and S&P Global ex US REIT Index used as proxy for the World ex US market. Dow Jones US Select REIT Index data provided by Dow Jones ©. S&P Global ex US REIT Index data provided by Standard and Poor's Index Services Group © 2014.

# Fixed Income

## Second Quarter 2015 Index Returns

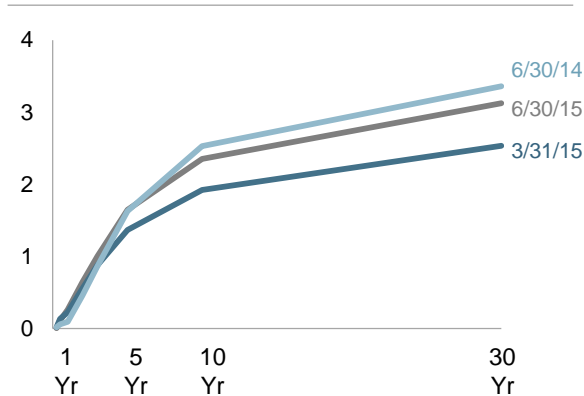
Interest rates across the US fixed income markets generally increased during the second quarter. The 5-year Treasury note added 25 basis points to end the period yielding 1.63%. The 10-year Treasury note increased 42 basis points to end the quarter at 2.35%. The 30-year Treasury bond added 56 basis points to finish with a yield of 3.10%.

On the short end of the curve, the 2-year Treasury note added 8 basis points to finish at 0.64%. Yields on securities within one year to maturity were generally lower by 2 basis points.

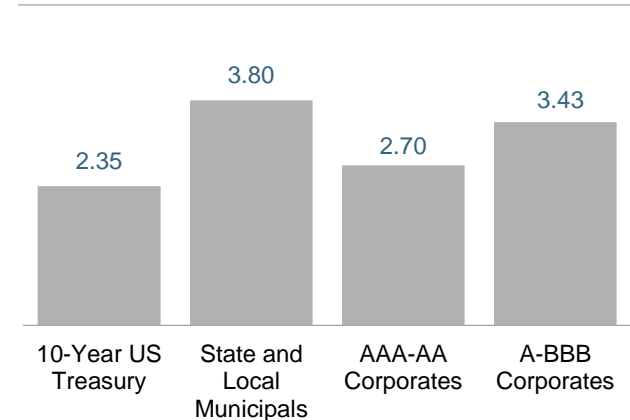
Short-term corporate bonds gained 0.06%, while intermediate-term corporate bonds lost 1.09%.

Short-term municipal bonds were relatively unchanged, but intermediate municipal bonds declined 0.89%. Municipal general obligation and revenue bonds experienced similar returns.

### US Treasury Yield Curve



### Bond Yields across Issuers



### Period Returns (%)

Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*
BofA Merrill Lynch Three-Month US Treasury Bill Index	0.01	0.02	0.06	0.08	1.42
BofA Merrill Lynch 1-Year US Treasury Note Index	0.21	0.24	0.28	0.36	1.92
Citigroup WGBI 1-5 Years (hedged to USD)	0.51	1.27	1.40	1.54	2.93
Barclays Long US Government Bond Index	-4.52	6.20	1.25	6.23	6.12
Barclays US Aggregate Bond Index	-0.10	1.86	1.83	3.35	4.44
Barclays US Corporate High Yield Index	2.53	-0.40	6.81	8.61	7.89
Barclays Municipal Bond Index	0.11	3.00	3.10	4.50	4.45
Barclays US TIPS Index	0.34	-1.73	-0.76	3.29	4.14

\* Annualized

Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect the expenses associated with the management of an actual portfolio. Yield curve data from Federal Reserve. State and local bonds are from the Bond Buyer Index, general obligation, 20 years to maturity, mixed quality. AAA-AA Corporates represent the Bank of America Merrill Lynch US Corporates, AA-AAA rated. A-BBB Corporates represent the Bank of America Merrill Lynch US Corporates, BBB-A rated. Barclays data provided by Barclays Bank PLC. US long-term bonds, bills, inflation, and fixed income factor data © Stocks, Bonds, Bills, and Inflation (SBBBI) Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld). Citigroup bond indices © 2014 by Citigroup. The BofA Merrill Lynch Indices are used with permission; © 2014 Merrill Lynch, Pierce, Fenner & Smith Incorporated; all rights reserved. Merrill Lynch, Pierce, Fenner & Smith Incorporated is a wholly owned subsidiary of Bank of America Corporation.

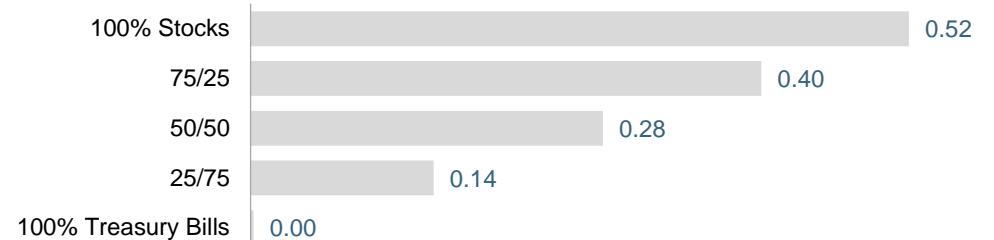
# Global Diversification

## Second Quarter 2015 Index Returns

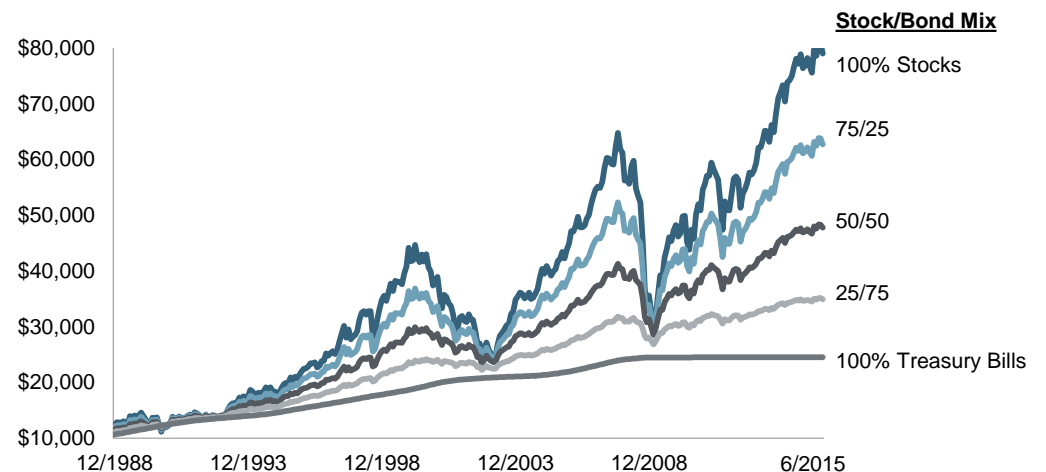
These portfolios illustrate the performance of different global stock/bond mixes and highlight the benefits of diversification. Mixes with larger allocations to stocks are considered riskier but have higher expected returns over time.

Period Returns (%)		* Annualized				
Asset Class	YTD	1 Year	3 Years*	5 Years*	10 Years*	
100% Stocks	2.97	1.23	13.61	12.52	6.97	
75/25	2.27	0.99	10.14	9.46	5.81	
50/50	1.54	0.71	6.72	6.35	4.47	
25/75	0.78	0.38	3.35	3.21	2.96	
100% Treasury Bills	0.01	0.01	0.03	0.04	1.30	

### Ranked Returns (%)



### Growth of Wealth: The Relationship between Risk and Return



Diversification does not eliminate the risk of market loss. **Past performance is not a guarantee of future results. Indices are not available for direct investment. Index performance does not reflect expenses associated with the management of an actual portfolio.** Asset allocations and the hypothetical index portfolio returns are for illustrative purposes only and do not represent actual performance. Global Stocks represented by MSCI All Country World Index (gross div.) and Treasury Bills represented by US One-Month Treasury Bills. Globally diversified allocations rebalanced monthly, no withdrawals. Data © MSCI 2015, all rights reserved. Treasury bills © Stocks, Bonds, Bills, and Inflation Yearbook™, Ibbotson Associates, Chicago (annually updated work by Roger G. Ibbotson and Rex A. Sinquefeld).

# Yield vs. Total Return

Before pursuing a yield bias, investors should understand the potential effect on portfolio diversification and expected returns.

**Many investors, including retirees, rely on their investment portfolio to fund their cash needs. This need can be approached in one of two ways.**

**The first approach looks primarily to interest and/or dividends from securities to fund cash flow needs. The amount of dividend and interest income generated by a portfolio is largely determined by dividend policies of the firms and prevailing market interest rates—two variables outside an investor’s control. Investors may also allow their preference for yield to influence their asset allocation by focusing on securities with higher yields.**

**An alternative approach, focused on total return, involves selling assets in the portfolio to create cash flow. This method reflects the idea that, from an investment standpoint, it makes little difference whether returns are delivered**

**as dividends or capital gains. Selling assets also allows greater control over the amount of cash flow generated.**

**Traditionally, income-oriented investors have chosen the first approach, resulting in a bias for securities that pay interest and dividends. However, investors should carefully consider the investment tradeoffs in pursuing an income-based strategy, as their income bias may affect diversification and expected returns.**

**In this brief, we explore the yield vs. total return approaches to generating income in a portfolio and address misconceptions about the benefits of emphasizing dividend and interest income at the expense of other portfolio issues.**

## **DIVIDEND APPEAL**

The traditional appeal of dividends stems from a long-held belief that stocks paying high dividends are less risky because they offer a regular stream of payments to investors. But dividend payments are not created out of thin air. They flow from a company’s earnings or assets, which are reflected in the current stock price. As illustrated in **Exhibit 1**, when a company pays a dividend, its stock price is reduced by an amount approximately equal to the dividend (Scenario 1). When accounting for this cash dividend, the portfolio value may be unchanged.<sup>1</sup>

Part of the conventional wisdom about dividends is that a high dividend yield may help a retiree avoid encroaching on capital to generate cash flow. Yet, **Exhibit 1** shows that a dividend distribution does encroach on capital unless it is reinvested rather than spent. Although no stock may have been liquidated, the economic impact is essentially the same.

Another common misconception is that dividends offer downside protection by mitigating the impact of a falling stock price on the portfolio. For example, a stock that yields a 5% dividend can decline by up to 5% before the investor experiences a negative total return. However, since a dividend paid reduces the stock price by the same amount, any additional non-dividend related price decline would result in a negative total return.

1. Certain studies show the price drop on the ex-dividend date is, on average, lower than but close to the amount of the dividend when controlling for market movement.

# Yield vs. Total Return

**Exhibit 1: Ex-Dividend Price Change Illustration**

Scenario 1: Dividends				Scenario 2: No Dividends			
Before Dividend Payment				After Dividend Payment			
Asset	Quantity	Price	Portfolio Value	Asset	Quantity	Price	Portfolio Value
Stock XYZ	100	\$20	\$2,000	Stock XYZ	100	\$19	\$1,900
Total			\$2,000	Cash			\$100
				Total			\$2,000

For illustrative purposes only. Assumes no nondividend-related price movements.

**Exhibit 2** illustrates that a dividend-paying stock may not offer special downside protection. Consider a stock that loses 25% of its value before the dividend payment. After the dividend payment, the share price further drops by the amount of the dividend, but the investor also has cash from the dividend. Overall, the investor has still suffered a 25% loss.

**Exhibit 2: Stock Decline Illustration**

Initial Portfolio			
Asset	Quantity	Price	Portfolio Value
Stock XYZ	100	\$20	\$2,000
Total			\$2,000

Portfolio Value Drops 25% Before Dividend Payment			
Asset	Quantity	Price	Portfolio Value
Stock XYZ	100	\$15	\$1,500
Total			\$1,500

After Dividend Payment			
Asset	Quantity	Price	Portfolio Value
Stock XYZ	100	\$14	\$1,400
Cash			\$100
Total			\$1,500

For illustrative purposes only. Assumes no nondividend-related price movements.

# Yield vs. Total Return

## OTHER TRADEOFFS

Holding a portfolio that emphasizes dividend-paying stocks may also force significant tradeoffs related to diversification and expected returns (Black, 2013).<sup>2</sup> The research concluded that:

- A global portfolio of dividend-paying stocks would have similar average returns to a portfolio of nondividend-paying stocks. However, a dividend-focused portfolio would exclude 35%–40% of stocks globally, resulting in lower diversification. Also, the number of US and international firms that pay dividends is shrinking—from 71% of the market in 1991 to 61% in 2012.
- The proportion of dividend-paying firms varies considerably across countries. For example, 92% of Japanese stocks paid dividends in 2012, compared to only 38% of Australian stocks. Dividend payout levels also have high cross-country variation. For example, an average 31% of corporate earnings were distributed in Switzerland vs. 73% in New Zealand.
- Holding only dividend-paying stocks may impact investors' ability to pursue higher expected returns. The research shows that global portfolios holding only dividend-paying stocks exclude about 47% of

the available small cap stock universe, which historically has offered higher average returns than large cap stocks.

- Dividends are not certain or guaranteed. Although dividends may be less volatile than the capital gains component of stock returns, the aggregate stream of dividend payments is subject to the same broad, macroeconomic risks that affect capital gains. As demonstrated in the 2008–2009 financial crisis, companies have reduced dividends after large market declines.

## TOTAL RETURN: CREATING CASH FLOW

The alternative to meeting a cash flow need through dividend and interest payments is to create cash flow by selling securities in the portfolio. By selling assets, investors have greater control over the level and timing of cash flows. Investors can also reduce their reliance on dividend yields and market interest rates, both of which are variable through time and outside their control.

Investors in taxable accounts should consider any tax implications that may arise from differences in capital gains and dividend tax rates.<sup>3</sup> For example, if capital gains are taxed at lower rates than dividends, a stock sale may be more tax efficient.

Furthermore, the lower tax rate is only applied to the portion of the cash flow that represents the stock's capital gain, whereas the higher tax rate for dividends is applied to the full amount of the dividend. Tax treatment of dividends from domestic companies vs. foreign companies may also play a role in the outcome.

**Exhibit 3** illustrates the impact of earning dividends vs. selling assets to create cash flow from a portfolio. In Scenario 1, the stock's price per share is reduced by the dividend, whereas in Scenario 2 the share price stays the same but the number of shares is reduced. After the respective dividends are received, the portfolio balance sheets for Scenarios 1 and 2 have the same value and asset composition. Thus, an investor's approach to generating cash flow may not affect total portfolio value on a pretax basis.

A final consideration in structuring portfolio income is the implication for rebalancing. Generating cash flow from securities sales may create an opportunity to strategically rebalance by selling assets that are overweighted relative to the target allocation.

2. Black, Stanley. March 2013. "Global Dividend-Paying Stocks: A Recent History." Dimensional Fund Advisors white paper.

3. As of this writing, tax rates for long-term capital gains and qualified dividends are the same in the US (15% or 20%, based on a taxpayer's income bracket). But tax rate differences have occurred in the past and may occur again in the future.

# Yield vs. Total Return

**Exhibit 3: Creating Cash Flow Illustration**

Scenario 1: Dividends				Scenario 2: No Dividends			
Asset	Quantity	Price	Portfolio Value	Asset	Quantity	Price	Portfolio Value
Stock XYZ	100	\$20	\$2,000	Stock XYZ	100	\$20	\$2,000
Total			\$2,000	Total			\$2,000

Scenario 1: Dividends				Scenario 2: No Dividends (Sell Assets)			
Asset	Quantity	Price	Portfolio Value	Asset	Quantity	Price	Portfolio Value
Stock XYZ	100	\$19	\$1,900	Stock XYZ	95	\$20	\$1,900
Cash			\$100	Cash			\$100
Total			\$2,000	Total			\$2,000

For illustrative purposes only. Does not include transaction costs from asset sale. Assumes no nondividend-related price movements.

## FIXED INCOME AS A CASH SOURCE

Investors must also consider their goals for fixed income when determining an appropriate asset allocation. Investors seeking yield in fixed income may consider incorporating term or credit premiums. However, market interest rates can be volatile, so the cash flows generated by interest income will vary over time. Investors seeking greater control over their cash flows should also consider selling assets rather than relying heavily on interest income.

## CONCLUSION

Investors can have much greater control in generating cash flows by selling securities rather than relying on dividend and interest income. Firms' payout policies evolve over time, as do market interest rates. Rather than letting portfolio yields determine spending rates, investors can develop a sustainable withdrawal strategy with their advisors.

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# The Seven Roles of an Advisor

Second Quarter 2015

What is a financial advisor for? One view is that advisors have unique insights into market direction that give their clients an advantage. But of the many roles a professional advisor should play, soothsayer is not one of them.

The truth is that no one knows what will happen next in investment markets. And if anyone really did have a working crystal ball, it is unlikely they would be plying their trade as an advisor, broker, analyst, or financial journalist.

Some folks may still think an advisor's role is to deliver market-beating returns year after year. Generally, those are the same people who believe good advice equates to making accurate forecasts.

But in reality, the value a professional advisor brings is not dependent on the state of markets. Indeed, their value can be even more evident when volatility and emotions are running high.

The best of this new breed play multiple and nuanced roles with their clients. None of these roles involve making forecasts about markets or economies. Indeed, there are at least seven hats an advisor can wear to help clients without ever once having to look into a crystal ball:

**1. The Expert:** Investors need advisors who can provide client-centered expertise in assessing the state of their finances and developing risk-aware strategies to help them meet their goals.

**2. The Independent Voice:** The global financial turmoil of recent years demonstrated the value of an independent and objective voice in a world full of product pushers and salespeople.

**3. The Listener:** A good advisor will listen to clients' fears, tease out the issues driving those feelings, and provide practical, long-term answers.

**4. The Teacher:** Getting beyond the fear-and-flight phase often is just a matter of teaching investors about risk and return, diversification, the role of asset allocation, and the virtue of discipline.

**5. The Architect:** Once these lessons are understood, the advisor becomes an architect, building a long-term wealth management strategy that matches each person's risk appetites and lifetime goals.

**6. The Coach:** Even when the strategy is in place, doubts and fears inevitably arise. At this point, the advisor becomes a coach, reinforcing first principles and keeping the client on track.

**7. The Guardian:** Beyond these experiences is a long-term role for the advisor as a kind of lighthouse keeper, scanning the horizon for issues that may affect the client and keeping them informed.

These are just seven valuable roles an advisor can play in understanding and responding to clients' whole-of-life needs, which are a world away from the old notions of selling product off the shelf or making forecasts.

Knowing the advisor is independent—and not plugging product—can lead the client to trust the advisor as a listener or sounding board. From this point, the listener can become the teacher, architect, coach, and, ultimately, the guardian. Just as people's needs and circumstances change over time, the nature of the advice service evolves.

However you characterize these various roles, good financial advice ultimately is defined by the patient building of a long-term relationship founded on the values of trust and independence and knowledge of each individual.

# In Closing

Second Quarter 2015

***Remember:*** *Develop a financial plan according to your unique situation and manage your investment portfolio according to a well thought out and documented investment policy. Doing so will greatly increase the probability you will actually meet your financial goals.*

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*This letter is intended to address broadly defined financial planning issues. If you need assistance developing a wealth management program tailored to your unique situation, then seek the assistance of a fee-only NAPFA registered financial advisor who is also a CERTIFIED FINANCIAL PLANNER™ professional having the proper education and experience. Consult with your tax advisor before implementing a particular tax strategy.*