CORE Comments

ON PLANNING AND INVESTING FOR THE TWENTY-FIRST CENTURY

December 9, 2012

Recent Investments

During this week just past, Core has undertaken trading in most client accounts as outlined prospectively in the letter we sent on December 3. You will have seen a blizzard of trading confirmations in the last several days and it seems useful to explain. Some trades were for the purpose of realizing capital gains on profitable positions so as to take advantage of the now low tax rates on capital gains. As mentioned in last week's letter, the 'fiscal cliff' negotiations are likely to make changes to the tax code. There is certainly a fair chance that taxes on capital gains will rise in 2013, so realizing gains this year is probably advantageous. The second set of trades we made last week involved changes in investment allocations, motivated by investment considerations, not taxes. First, the tax-driven changes:

In most client accounts with more than $50,000, we made swaps for tax purposes, selling positions with unrealized gains and buying securities with very similar investment characteristics. In these trades, we accomplished our tax job without changing the investment characteristics of portfolios. We sold US high-grade corporate bonds (symbol LQD), US high-yield corporate bonds (HYG), and a REIT holding mortgages (STWD). We replaced these with a Vanguard exchange-traded fund holding high-grade US corporate bonds (VCLT), an iShares ETF for high-yield bonds (JNK), and an ETF holding mortgage-backed securities (REM). The investment holdings and characteristics of our replacement funds are quite similar to those we have held, so these trades merely push forward the realization of the capital gain to this year.

We made these same trades in IRAs and other types of accounts that are not taxed. Of course, there is no tax reason to make swaps in these accounts, but we made the trades in those for what we consider good administrative purposes. Having a similarity in holdings in accounts with similar investment goals and risk characteristics lessens the chance that we will make mistakes in the administration of the accounts we supervise.

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Our other investment activity changed our allocations to different assets and reflect purely investment considerations. We have sold two positions--in both of which there were meaningful profits--in order to make investments in European equity markets. Earlier this year, we made investments in German stocks and Swedish stocks, but had the largest portion of our equity investment in US markets. The crisis in the Eurozone, of which we have written extensively, caused European stocks to underperform US stocks by a long shot. Although the crisis is far from resolved, the risk of serious banking and financial system problems is far lower than last spring and last year, before the commitment by ECB president Mario Draghi, of which we wrote in our letters in July, Septem-

By

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ber and October. Although Europe's economy is likely to be weaker throughout the year ahead than America's, the very low prices of European stocks, when compared to American, make European stocks quite attractive here. To fund these investments, we sold the S&P 500 ETF (SPY) and the ETF for gold bullion (GLD). We think it likely that European stocks will do better than gold and better than the US stock market in the year ahead. Accordingly, for our equity-oriented portfolios, we add to German and Swedish positions with investments in France and the Netherlands.

The matters discussed in the paragraph above do not apply to the accounts that we manage in our Capital Preservation portfolio, which generally avoids equities and invests mostly in bonds. We have retained our gold position for those accounts. Of course, we did not own US stocks in these portfolios, nor did we buy European stocks.

If you have questions about this set of trades, please do not hesitate to get in touch with us. Remember, also, that we can readily prepare reports showing our purchases and sales and the realized capital gains. These will be quite useful in the preparation of tax returns. If you need reports like this, please contact us or have your tax preparer do so.

A word of thanks

As the year draws to an end, we wish you and your families the best for the upcoming holidays and the new year. We are grateful for the opportunity to work on your behalf with your investment capital. The investment work itself endlessly interesting to us, and our work individually with you is rewarding and fascinating. Best wishes to all.

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