Kehoe Investment Services, Inc.
Registered Investment Advisor

April 17, 2014

Dear Valued Client:

Enclosed is your portfolio report for the period ended March 31, 2014.

<u>"If Only"</u>

In all sorts of situations, utilizing the wisdom of hindsight, humans convince themselves that they missed an obvious opportunity. Nowhere is this more apparent than in the world of investment strategy. This phenomenon is exasperated by the media who highlights the particular predictor that correctly guessed what a certain stock, commodity or bond was going to do in the short run.

Here are some examples of "if only" (thoughts we did not have Jan. 1) in the first quarter of 2014:

- Everyone enjoys coffee – There has been a drought in Brazil – I will buy coffee – Up 58% this quarter
- U.S. Real estate is sure coming back – I will buy U.S. REITs (**R**eal Estate **I**nvestment **T**rusts) – Up 10.35%
- I have always wanted to go to Italy and Greece – I will buy their currency – Up 15.03% and 18.6%
- Long-term government bonds are definitely the place to be – Up 5.3%

The term for this line of thinking is "hindsight bias". Our ego convinces us to see everything as obvious and predictable.

Warren Buffet suggests that you should think of your properly diversified investment portfolio in a manner similar to the way you think about real estate you own. In short, don't worry about it; the value will go up over time.

Our goal at Kehoe Investment Services is not to pick winners but to overweight asset categories that have outperformed other categories over long periods of time. In the long-run the rationality of this disciplined behavior has always proven successful. As the author Nick Murray states, "You give up the chance of making a killing for the knowledge that you will never get killed."

<u>Taking Advantage of the Magic of Compounding</u>

Our firm's client demographics are similar to the principals of the firm so this portion of the newsletter may be more helpful to children and grandchildren. However, this is often a topic not taught in school and it can be invaluable to learn at a young age.

Albert Einstein said "Compound interest is the eighth wonder of the world. He who understands it, earns it, he who does not, pays it."

There are essentially two elements to compound returns, time and rate of return. It happens that time is just as important, perhaps even more important, than rate of return. As in the previous discussion, hindsight bias comes into play as time is finite.

Following is an illustration of the interaction of time and rates of return:

Rate	6%	8%	10%	12%
Investment Amount	$10,000	$10,000	$10,000	$10,000
5 Years	$13,382	$14,693	$16,105	$17,623
10 Years	$17,908	$21,589	$25,937	$31,058
20 Years	$32,071	$46,610	$67,275	96,463
30 Years	$57,435	$100,627	$174,494	$299,599
40 Years	$102,857	$217,245	$452,593	930,510
50 Years	$184,202	$469,016	$1,173,909	$2,890,022
60 Years	$329,877	$1,012,571	$3,044,816	$8,975,969

Two things leap out from this illustration. First, the large accumulation appears after many years and second, a small increase in the annual rate of return produces a huge increase in long-term accumulated amount. The lesson – Start early, don't spend the accumulating savings in the early years, invest in equities (stocks).

Realistic?
The 60 year return for the S&P 500 (1953 to 2012) is 10.4% (Standard & Poors Index Services)
The 60 year return for small cap value stocks is 16.3% (Fama/French US small value research index)

A necessary caveat here is that small cap stocks are very volatile. While reliable over long periods of time short-term returns can be negative and stay negative for significant periods of time. Investments of this nature belong in your portfolio but only as a component of a well allocated/diversified portfolio.

What could this mean to you? If you are saving for the kids/grandkids college, perhaps you should consider putting something away for **their retirement** in a well diversified and well allocated portfolio.

Tax Day

As fate would have it we are preparing this report on April 15th. The returns depicted in the previous section are without consideration for taxes. Taxes decrease the effective rate of return and/or the buying power of your savings. Consequently, we encourage you to heed the words of Judge Learned Hand:

> "Anyone may arrange his affairs so that his taxes shall be as low as possible; he is not bound to choose that pattern which best pays the treasury. There is not even a patriotic duty to increase one's taxes. Over and over again the Courts have said that there is nothing sinister in so arranging affairs as to keep taxes as low as possible. Everyone does it, rich and poor alike and all do right, for nobody owes any public duty to pay more than the law demands."

We welcome your comments and questions in regard to your quarterly reports.

Sincerely,

Judy Kehoe Bob Kehoe
Amy Morrison