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TO: All clients and interested parties
FROM: Bob Kargenian

In the first newsletter of the year, we always take a look back at the details of the performance of TABR's various portfolios for the prior year, with complete transparency on the positives AND the warts, along with any changes being made.

We'll also have an update on the solar project we mentioned in the last newsletter, along with the latest on a popular stock market valuation tool and its implications for the next 5 to 10 years. Next quarter, we'll include a comment on the increasing frequency of cyber fraud episodes, and what steps we take at TABR to protect your capital.

The Shiller P/E Ratio---A Warning?

There are many methods which attempt to forecast the future returns of the stock market, but as we have outlined before, the vast majority of them do not hold up to statistical scrutiny. And, as you are about to see, for the very few that appear to have some value, there are some major flaws.

One of the few methods that does have value is known as the Shiller P/E ratio, which is the price over the average of the 10-year trailing earnings for the S&P 500 Index. It was developed in the late 1990s by Robert Shiller, who is an American Nobel Laureate, best-selling author, economist and Professor of Economics at Yale University.

His book, "Irrational Exuberance," published in early 2000, warned of a stock market bubble, and was heavily based on the indicator we feature below.

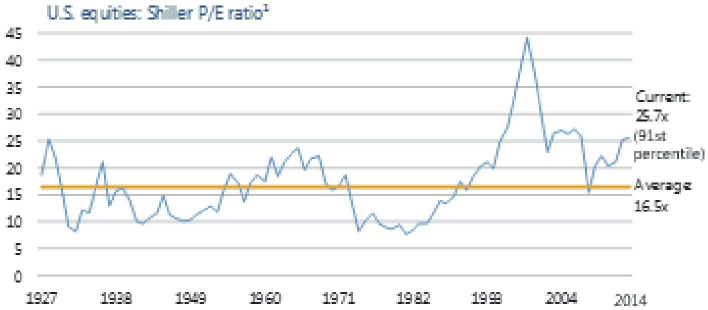
There are numerous indicators or fundamental measures to value companies, and one of the most common is called the price/earnings ratio. This is derived by taking the price of a stock, and dividing it by the most recent 12 months worth of earnings. Over the years, a number of studies (especially research by money manager David Dreman) have concluded that purchasing stocks with low price/earnings ratios will substantially outperform stocks with high price/earnings ratios.

The difference in Shiller's work is that instead of looking at only one year's worth of earnings, he looks at 10 years, and averages them. The reasoning behind this process is to mitigate the effect of the business cycle on company earnings. In a recession, earnings for companies can often temporarily turn negative, which would render a one-year look back period to be useless.

As you can see from the chart and table below, purchasing stocks when the Shiller P/E ratio is low has indeed led to substantially better future returns. But unfortunately, the real world isn't as simple as the median returns imply.

U.S. equity valuation does not support sustained performance

U.S. equities: Shiller P/E ratio[1]



5-Year subsequent nominal returns (annualized)[2]

Starting Shiller P/E	Low	Median	High
<10x	4.5%	15.1%	29.6%
10–15x	-5.4%	9.3%	23.0%
15–20x	-21.2%	6.5%	28.5%
20–25x	-19.6%	4.2%	27.8%
>25x	-22.0%	0.4%	18.3%

10-Year subsequent nominal returns (annualized)[2]

Starting Shiller P/E	Low	Median	High
<10x	0.3%	14.8%	19.1%
10–15x	-0.9%	10.6%	19.4%
15–20x	-7.9%	5.6%	19.4%
20–25x	-9.3%	1.7%	11.8%
>25x	-9.9%	2.9%	9.1%

As of 30 June 2014
SOURCE: Robert Shiller Online Data, PIMCO
1 Shiller P/E is price over average 10-year trailing earnings for the S&P 500 index
2 Median of the annualized subsequent returns calculated at each month end, using Shiller P/E and S&P 500 monthly returns from 31 December 1927 to 31 December 2013

PIMCO | Your Global Investment Authority

This chart and the tables were originally published going back to around 1880, and only showed the median returns going forward. Personally, I don't trust data prior to 1926, and second, median returns do not show the best and worst case outcomes. Thanks to our contact at PIMCO, we were able to have them show the highest and lowest returns in each quintile, as well as begin the study in December 1927.

While there is no doubt that when looking at median returns, one would want to buy stocks when the ratio is at or below 15, that has only taken place twice in the past 25 years---early in 2009 and back around 1990. Conversely, it is apparent that poor returns going forward are associated with when the P/E is at 20 or higher.

The problem lies with the exceptions. There are cases when the ratio has been 20 or higher, implying 1.7% to 2.9% future 10 year median returns, but in actuality, some of these situations turned into annualized gains of anywhere from 9% to 11%.

In fact, as the chart illustrates, the ratio has been above 20 for several years now, and that has not stopped the S&P 500 from posting gains of over 30% in 2013 and over 13% in 2014.

As Justin Fox recently pointed out in an article on Bloomberg.net, "Shiller's big contribution to academic finance was to point out that speculative markets, while perhaps not "so predictable," are at least a little bit predictable. Stock prices move around a lot more than such corporate fundamentals as dividends, earnings or book value. This means that when prices are markedly higher or lower than normal relative to those fundamentals*, they will eventually revert to the mean*.

"These predictabilities that Shiller has documented, then, really aren't all that useful in figuring out what the market will do next week, next year, or even during the next five years. What they are useful for is understanding that financial markets inevitably overshoot."

The ratio currently stands at about 27.50, and the only time it has been higher was during the late 1990s leading up to the Internet bubble peak in 2000. Historically, therefore, based on median 10-year forward returns, this is a poor time to be buying stocks. But, what if the next 10 years is another outlier on the upside?

That is why we prefer to use technical approaches with some trend-following components that zero in on what the markets are actually doing, and not suggesting what they "should" be doing. At present, the majority of our stock market risk models are positive, suggesting above-average exposure. At some point, this will change, but there is no way to know if that is in four months, or 20 months.

In our view, this is the indicator's biggest flaw. On the opposite spectrum, it can also suggest that stocks are cheap for many years, without them going up. I guess I'd sum up this message by saying. . .Don't Worry. . .Just Yet.

Solar Panels Installation Update

In the last newsletter, I mentioned that we were in the process of installing solar panels on our home, and outlined our experience up to that point. I also mentioned that we have a lot of smart clients who may have superior knowledge in this area, and asked anyone to contact me if I had presented any glaring inaccuracies or if there was important additional information that I'd missed.

There was both. First, CPA Ken Blake who works with several of our clients, reminded me to convey that the 30% Federal solar credit is only available to those who purchase the solar system---those that lease don't get that benefit. Then, another client who is an absolute wizard in the financial analysis area pointed out a couple of things.

I'd erroneously reported that Sun Pro, the company we hired, had the best and most efficient solar panels in the industry. That was incorrect---it is actually SunPower who manufactures these panels, but Sun Pro does in fact use their panels.

Second, and of significant relevance, our client wanted to know if I was aware of AB 327, which is legislation pending before the Public Utilities Commission of the State of California, to consider a rate change proposal of Southern California Edison.

I was not aware of this legislation, so let me briefly summarize it. On July 7 of last year, Edison's Tier 1 energy rate increased 12%, from 13.3 cents per kilowatt-hour to 14.9 cents. The Tier 2 rate rose 17%, from 16.5 to 19.3 cents. Tiers 3 and 4 rose 1.8% and 4.9%, respectively.

Under the currently tiered rate structure, as your usage increases, your energy costs increase. Consumption in the lowest tier is billed at the lowest rate, while the higher tiers are billed at increasingly higher rates.

Should the bill's proposed restructuring get approval from the commission, the Tier 1 electricity rate would increase an additional 8.7%, to 16.2 cents per kilowatt-hour, by 2018. The current tiers 2,3 and 4 would be folded into a single tier, which would billed at 19.5 cents.

In essence, under the plan, below-average energy users will pay substantially more for electricity, while many users who significant amounts would see their costs fall. According to an article published in November in *The Desert Sun*, the law would allow utilities to spread costs more evenly across residential users, and critics of the bill say it could harm the rooftop solar industry and reduce incentives for energy conservation.

In my view, the primary premise for solar panels is to help consumers save money on their electric bills. Any "green" effects are a bonus, but I don't think that is what drives the purchase. If you're a residential or business customer, and anywhere from 60 to 75% of your bill is at 29 or 31 cents per kilowatt-hour, solar power can save one a lot of money over time if you can lock in power at 16 to 19 cents.

So, think about this. If this bill passes, and the top rate is reduced to 19.5 cents, no matter how much electricity one uses each month, where is the edge in going solar? Whatever edge there currently is, it would seem it would be significantly reduced. Though Solar City's stock is just one example, maybe its price action in the last year is foretelling of future problems (TABR does not have any investment in this firm).

From late 2012, the stock of Solar City soared from about $11 per share to over $80, but in the past 12 months, has retreated to $51. Sales are increasing significantly, but the company has yet to turn a profit. So, what are the probabilities of this legislation passing in its proposed form? I have no idea, but our client who made us aware of this feels it absolutely will pass.

We'll just have to see what effect this has on the solar industry. In the meantime, our panels were finally installed in January, and permission to operate was granted by Southern California Edison a week ago, and our system is now up and running. It will be many months before we have any meaningful data, but we'll do an update late in the year when we have at least 9 months under our belt.

Also, I should pass along that I had email communication with a Senior Attorney from Edison who informed me that the Commission expects to issue a decision this Spring, and this would affect customers from not only SCE, but also San Diego Gas & Electric and Pacific Gas & Electric. Bottom line, installing solar, even for those who have high monthly electric bills, may not be the slam dunk decision that the solar industry would have you believe (at least not in California).

Note---should any of you actually want to read the proposed legislation in AB-327, just send me an email note and I will be happy to forward the information.

2014 Performance---All of it

In the first edition of this letter each year, we've made it a practice to review the prior year, how our various accounts did, along with the components of those accounts. It is an on-going, fully transparent report card. Some of you have an interest in the details, since it helps you understand what we are doing and our thinking, and some of you could care less. This section is for the former. For the rest of you, skip to our conclusion.

It will be broken down into categories---real estate, bonds, stocks and alternatives, with the overall numbers at the end of each type of account and several benchmarks.

Real Estate

Dow Jones Real Estate Index (IYR)	17.96%

Our trend following model for this sector entered the year in cash, having sold in August of 2013. A BUY signal was generated on February 24, which remains in effect at this writing. A second model we had been using for several years (since 2007) which uses relative strength versus the broad market has remained in cash, thus limiting our exposure to half of normal. We've eliminated this model, as it held us back from being fully invested in a strong trend. Allocations within portfolios range from about 3% in Conservative accounts to 7% in Aggressive accounts. The gain shown above represents the change in the IYR from February 24 to December 31, including reinvested dividends.

Bond Funds

Sierra Strategic Income Fund	6.98% (bot on June 26)
PIMCO GNMA	6.00
Sierra Core Retirement Fund	5.04 (sold on June 26)
Loomis Sayles Bond	4.76
Blackrock High Yield	3.30
PIMCO High Yield	3.29
Prudential High Yield	2.84
MFS High Income	2.74
JP Morgan High Yield	2.67
Principal High Yield	2.10
Loomis Sayles Limited Term	1.81
Blackrock Low Duration	1.43
PIMCO Short Term	0.96
Fidelity Short Term Bond	0.93
MFS Limited Maturity	0.73
JP Morgan Short Duration	0.62

As a refresher, our bond strategies are broken down into a conservative bucket, consisting of PIMCO GNMA and the Sierra Strategic Income Fund, which represent about 30% of the overall bond allocation. The other 70% is devoted to a combination of the Loomis Sayles Bond Fund and typically a pairing of a high yield corporate bond fund with a short term bond fund (i.e. PIMCO High Yield with PIMCO Short Term Fund, Blackrock High Yield with Blackrock Low Duration, etc.).

Risk models are applied to all funds to preserve capital during negative price environments, except for the Sierra fund, which employs its own stop loss disciplines. The returns noted above represent buy and hold gains for the full year, but we did not own any of the funds for the entire year.

Portfolios began the year with Sierra Core Retirement Fund, but we swapped out of this on June 26 to the Sierra Strategic Income Fund, moving to a different share class with much lower expenses. Our allocation to these funds gained 5.77% for the year.

For the allocation devoted to PIMCO GNMA, we entered the year in short term bond funds, as our GNMA model had been on a SELL signal since June 10 of 2013. But, as yields began to drop, our model generated a BUY signal on January 27 and remains on that signal at this writing. Our allocation to this fund gained 5.21% for the year.

We had been fully invested in our allocation to Loomis Sayles Bond from October of 2013 until late September of 2014, when our models began to change. At year-end, our allocation was at about 30% in the fund, with the remaining 70% in either Loomis Sayles Limited Term Fund or in cash. Our trading in the funds resulted in an approximate gain of 4.45% for the year, with less risk.

Finally, in the pure high yield corporate area, we had only one change the entire year, a sell signal which took place on August 1, after being nearly fully invested since October of 2013. So, for the final five months of the year, about 90% of the allocation to this area was invested in short term bond funds, such as Fidelity Short Term Bond, PIMCO Short Term Fund, or Blackrock Low Duration, as a few examples.

In TABR's all-bond account, we estimate the high yield allocation gained 2.15% for the year. This number varies by portfolio, depending on what combination of funds is used (Blackrock, PIMCO, Principal, Prudential, etc.). Overall, TABR's Bond Account gained 3.45% for the year, while the Vanguard Total Bond Index was up 5.75%.

Our models in the bond market continue to do well over time, providing absolute return and a reduction in risk, especially in the high yield area. At some point, interest rates will rise and prices will fall and risk management will be much more relevant.

Alternative Funds

Leuthold Core Investment	8.58%
PIMCO All Asset All Authority	-2.76
Hussman Strategic Growth	-8.50
Marketfield Fund	-12.31

As they are known in the industry, alternative funds tend to use investment strategies that are uncorrelated to traditional portfolios of stocks and bonds. As a result, many of them have significant tracking error, as they are attempting to be different, to zig when markets zag.

We have noted in previous communications dating back to the summer of 2013 that this area has been quite problematic for us and we began to gradually reduce our exposure. The four funds above represented just over 10% of the allocations in our Moderate risk accounts entering 2014. Technically, I would not categorize Leuthold in the Alternative area, as they are basically an asset allocation fund that will adjust their exposure to stocks and bonds using their major risk models.

During the third quarter, as we were finishing a re-vamp of several of our stock market timing models to improve up capture going forward, we made the decision to completely eliminate Marketfield and Hussman from all portfolios, which was done in October and December. The PIMCO position was reduced to 2% and may be eliminated in the future.

Bottom line, we are not relying on Alternative funds anymore---it will all be on our own selection work and our various timing models, which we continue to work on to see if there is anything we can make better.

Stock Funds---Core Tactical Holdings

Rydex S&P 500 Pure Growth	12.52%
Hotchkis & Wiley Mid Cap Value	11.90
PIMCO Fundamental Index Plus AR	11.68(bot February 4)
Ariel Fund	10.95 (bot December 8)
Rydex S&P 500 Pure Value	10.86
Hennessey Focus Fund	10.20 (sold February 4)
Hotchkis & Wiley Value Opportunity	9.80 (bot October 3)
Touchstone Sands Capital Growth	7.90
Hodges Small Cap	6.05 (bot June 4)
Pro Funds Mid Cap Growth	5.58
Brown Small Company	2.19 (sold June 4)
Pro Funds Small Cap Growth	1.91
Southern Sun Small Company	-4.46 (sold October 3)
Huber Small Cap Value	-9.46 (sold December 8)

Since the inception of the relative strength methodology we developed and began to use in 2008 and 2009 for our core tactical equity funds, there has been an edge in performance in comparison to the benchmark we've been using, which is a 75% blend of the Vanguard Total Stock Index Fund with a 25% weighting in Vanguard Total International Fund.

But, unlike in 2013 when our 5 core funds beat the benchmark by nearly 10 percentage points, last year our five core funds, accounting for the changes noted above, averaged gains of 4.96% versus the blended Vanguard benchmark of 8.26%. During the last three years when stocks did not decline by more than 10% from any peak, our challenge has not been fund selection, but rather not having more equity exposure, as a result of our various stock market risk models. Average exposure in our equity allocations for 2014 was just over 50%.

That flaw has been rectified going forward with the introduction of several more intermediate to longer term trend following models. Yet, please know we'll never relinquish our risk management approach with our tactical portfolios---this is one of our key differentiators.

TABR Fully Invested PBA (Passive But Active)

For those clients who want to be more aggressive with a portion of their portfolios, along with being a bit more balanced between strategies (tactical/active vs passive), we introduced this approach in the fall of 2013 with a research report and began to open several accounts. We now have a full year under our belt.

Here, we are allocating 60% to stock funds and 40% to bond funds, but instead of owning index funds, we own actively managed funds with strong track records, and we re-balance the portfolio in early January of each year. Last month, when re-balancing, we also replaced four of the eight funds in the portfolio. The overall gain in 2014 was 4.92%, in comparison to the benchmark at 7.26%. The entire lag was due to a selection issue within the international equity allocation, but that has been fixed. Below were the individual holdings.

PIMCO Real Estate Real Return	37.98%
Yacktman Fund	1.33
Ashton Fairpointe Mid Cap	9.73
Hennessey Cornerstone Value	8.86
Loomis Sayles Core Bond	6.18
PIMCO Small Cap Stocks Plus	5.86
Alliance Bernstein Hi Income	3.22
PIMCO Int'l Stocks Plus AR UH	-5.21
Huber Small Cap Value	-9.46

TABR Dividend Stock Account

Research on this new strategy was introduced during the 3rd quarter and client accounts were established at various points in the 4th quarter, and continue on that path. I established TABR's real-time account with $102,000 on September 29 and went fully invested on October 15, with really good timing catching the low.

For the final 3 months of the year, the account gained 8.38% compared to a 4.9% gain for the S&P 500. We do not necessarily move new client accounts to a fully invested position immediately---that depends on conditions at that time. At this writing, almost all client accounts are 75% invested, and we are looking for some weakness in the next few months to put that final amount of cash to work. Our next quarterly re-balancing will be either the last day of March or the first day of April.

Below is the performance, net of management fees, of TABR's five different portfolios at present. These represent a majority of the strategies we are using in client accounts, but not all. The differences are mainly attributed to risk (example—moderate allocation versus conservative allocation or aggressive) and account size. The numbers are for the calendar year ending December 31, 2014 as well as the peak-to-peak cycle from September 2007 to December 2014.

Type of Account/Strategy	**YTD**	**Benchmark**	**09/07 to 12/14^**	**MaxDD**
TABR Tactical Moderate	+1.87%	+ 6.92%*	+ 0.88%	-25.06%
TABR Tactical Conservative	+1.45	+ 4.48**	n/a	
TABR Tactical Bond	+3.45	+ 5.75***	+5.97	-19.73
TABR Dividend Stock	+8.38	+ 4.90****	n/a	
TABR Fully Invested PBA	+4.92	+ 7.26	n/a	
Vanguard Total Stock	+12.43		+6.80	-55.38
Vanguard Total IntlStock	-4.24		- 0.90	-60.60
Vanguard Total Bond	+5.75		+4.90	-5.36

*consists of 40% Vanguard Total Stock Index, 15% Vanguard Total International Stock Index and 45% Vanguard Total Bond Index

**consists of 30% Vanguard Total Stock Index, 10% Vanguard Total International Stock Index and 60% Vanguard Total Bond Index

***Vanguard Total Bond Index

****Vanguard S&P 500 Index Fund from 9/30/2014 to 12/31/2014

^ denotes annualized returns and actual period is 9/30/2007 to 12/31/2014

MaxDD stands for maximum drawdown, the worst loss from peak to trough in the period noted

Returns shown are net of management fees, and include reinvested dividends

In Closing

During the past three years, any strategy with less than a fully invested portfolio, especially in the stock allocation, has under-performed. Playing defense, and being cautious has hurt, rather than helped portfolios. We know. We've been there.

We've addressed a variety of areas to close the gap, but please know we're not about to cancel our auto insurance because we've not been in an accident, nor our homeowner's insurance because there's been no fire. We always remember our mission at TABR---to help you meet your goals with much less risk following a structured, disciplined approach.

The importance of us "sticking to our knitting" will become quite relevant in the next 12 to 24 months, in our view. All of us at TABR are grateful for the trust and confidence you express in us daily.

Sincerely,

Bob Kargenian

Bob Kargenian, CMT
President