

## Chicago Blower Corporation Profit Sharing & 401(k) Plans

### Compensation & Capital's Financial Planning Commentary as of June 30, 2013

#### "2013: U.S. Stocks Climb (A Lot). Bonds Drop (A Lot). Time to Change It Up?"

Recurring readers of our *Quarterly Commentary* are well aware of our "focus on the long-term" mantra for retirement plan investing success. The 'noise' of short-term market gyrations can confound even the most seasoned investor or worse yet, push our emotional buttons to trigger destructive changes to our previously well-conceived investing plans. Yet even principled minds can't overlook disparities across investment category returns so far this year. In fact, for some investment categories, spreads in returns this wide haven't been seen since 1999.

Examples abound; a few notables will make the point. For the first six months of 2013 through June 30<sup>th</sup>: U.S. stocks as measured by the S&P500 Index have advanced around 14% while non-U.S. stocks as measured by the MSCI EAFE Index are up only 2% and emerging markets stocks have dropped about 12%. That's a relative 26% spread between emerging markets stocks and U.S. stocks in just six months. Commodities have lost 20+%. Returns across various bond categories are wide-spread as well. Short-term high-quality bond funds lost around 1% of their value over the past six months. U.S. Treasury Inflation Protected (TIP's) government bond funds lost around 8%. With bond investments considered 'safe' from losses in value by many (mostly unsophisticated) investors, *any* loss is notable. These spreads across the various bond categories are stark and a poignant reminder that bond investors can lose money too. *(For a deeper look into what's happening with bonds, check back to Page 2 of our Quarterly Memo of March 31, 2013. We discussed the probable trend towards higher interest rates and its impact on bond fund returns.)*

There is no doubt that the recent breaks from more comfortable comparisons across, as well as within, asset classes (that is, stocks vs. bonds) are signaling shifts in investor sentiment. Worldwide central bank 'easy money' policies as well as investors' perceptions of the various global economies' abilities to heal (or not) from the 2008 capital crisis and resulting recessions have created an unprecedented environment. Clearly, at least for the past year or so, investors have decided that the U.S. economy has the best chance of recovering first and that the U.S. central bank has the best chance of navigating their stimulus reduction without 'wrecking the ship.' There is also no doubt that, at least over future short-term periods, these sentiments will change.

So, without attempting to credit the dog or the tail in creating this current divergence, it's important to remember one important fact. Historically speaking and over long-term (20+ years) time horizons, diversified portfolios of riskier (more volatile) investments have generally produced higher returns than diversified portfolios of less volatile investments. Granted, even for these long term periods, volatility in aggressively positioned portfolios (say 90% stocks and 10% bonds) can be easily twice that of a moderately positioned (65% stocks and 35% bonds) one. That's a lot more swings of much greater magnitude. Accepting that double-up of volatility earns 'only' around 2% extra annually.<sup>(1)</sup> But don't forget – that's 2% *per year*. Over 20 years, an identical account balance earning say 9% vs. 7% annually will result in over 75% more wealth accumulated. So, when confronted with the kind of short-term gyrations and anomalies we are currently experiencing, maintain your resolve by reminding yourself of this mathematically supported relationship between risk and return.

Setting and maintaining an appropriate mix of stocks, bonds and money markets according to your goals, time horizon, and emotional risk tolerance is the most important ingredient in your long-term investing success. Diversification – especially when some investments are looking so stellar and others are losing value – can certainly be frustrating. But the alternative, that is attempting to time your investment switches between various investments, can be devastating.

<sup>(1)</sup> Return and volatility data comparisons are relevant over the period 1926 through 2011.

## Chicago Blower Corporation Profit Sharing & 401(k) Plans

### Compensation & Capital's June 30, 2013

#### Retirement Saving and Investing "Action Points"

##### **Maintaining Diversification in the Face of Bond Market Malaise and U.S. Stock Market Boom:**

The source of this quarter's (opposite page) *Commentary* discussion – that is, the recent widening disparity between 2013 returns from various investment classes (stocks vs. bonds vs. money markets vs. commodities) and investment categories (U.S. stocks vs. foreign stocks) – as well as an overwhelmingly accepted perception that bond funds have an unusually rocky road ahead begs the question: Given these obvious near-term trends, isn't diversifying actually a drag on my Plan account's performance?

As with what often seems true with too many investing questions, the answer to this one is both "Yes" and "No". More specifically: At this time, diversifying retirement portfolios with foreign stocks and most bonds will most likely degrade *raw* performance in the short term – say, through the next 3 years or so. That said, appropriate and genuine diversification will probably enhance *risk-adjusted* performance over medium and long term time horizons just as it has done throughout modern-day economic and market cycles. To get a better understanding of why the benefits of diversification offset its current near-term lack of appeal, let's break the issue into its two most important parts:

***The problem with bonds funds now:*** Over the past 30 years bonds have generated returns from not only interest income but also capital gains as a result of declining interest rates since inflation's 1982 peak. And recently bond values have been further enhanced by worldwide central banks' unprecedented levels of bond purchases. Today, with yields on shorter-term bonds near historic lows and prospects of economic growth re-emerging worldwide, interest rates will most likely be trending up. That will reverse at least some of the past capital gains to losses. That said, bonds will continue to pay interest and that interest rate will increase over time from its current low levels. Then, once interest rates stabilize, bonds returns will trend to that new, higher level of interest and significant risks of capital losses will recede. Question is, when and at what interest levels. No one knows.

***The perception that diversification always enhances raw performance:*** The goal of diversification is not the enhancement of *raw* returns. In fact, diversification will not ensure gains or guarantee against losses. It's a tool to set the appropriate level of sensitivity to swings in account value. It customizes our portfolios to our personal financial goals, time horizons and emotional sensitivity to shorter-term losses. But it's not just a tool. For the vast majority of investors it's a necessity to generate long-term *risk-adjusted* returns.

A look back to our most recent market cycle (2007 top -to- 2013 top) sharpens this point. Consider the performance of three hypothetical portfolios: (A) a 100% money market portfolio; (B) a diversified one of 70% stocks, 25% bonds and 5% money markets; and (C) a 100% stock portfolio. Returns?

Risk Level	Portfolio Composition	High to Low Dec'07 thru Feb'09	Low to Recent High Mar'09 thru Jun'13	Entire Cycle Dec'07 thru Jun'13
Very Conservative	100% Money Markets	1.6%	0.3%	1.9%
Moderate	Diversified	-32.4%	94.2%	17.8%
Very Aggressive	100% Stocks	-50.1%	127.5%	13.9%

The table demonstrates how different portfolio structures respond in a crisis, in a recovery, and over an entire market cycle. (It's not meant to be predictive, just instructive.) And, how a diversified portfolio can help an investor maintain their will power by holding true to their appropriate acceptance of market risk in the face of either doom or boom. Diversified portfolios will not out-perform focused portfolios in every economic cycle. Our illustration's cycle unfolded in the face of very unusual forces upon bond markets. But long-term horizons, by definition, aggregate at least two economic cycles. No two cycles are the same. Diversification can help keep the odds on your side.

# Chicago Blower Corporation Profit Sharing & 401(k) Plans' Vanguard Funds Performance Specifics and Comparatives

(All for periods ended June 30, 2013)

(1) A fund with a 15<sup>th</sup> Ranking outperformed 85% of its peers.

**Remember: Past performance is absolutely NOT a guarantee of future performance!**

(2) "OER" or Operating Expense Ratio: Annual % of fund assets paid for fund operations and mgmt.

NAME OF VANGUARD SELECT VENUE FUND <i>Morningstar Category Name</i>	Securities Type(s)	Morningstar™ Category Percentile <sup>(1)</sup> Ranking Past		OER <sup>(2)</sup>	Total Return Performance for		Average Annualized Total Return for:			
		3 Years	10 Years		Past Qtr	12 Mos	3 Yrs	5 Yrs	10 Yrs	15 Yrs
PRIME MONEY MARKET - VMMXX	Money Market	15th	15th	0.16%	0.0%	0.0%	0.0%	0.4%	1.8%	2.5%
<i>Money Market Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		0.17%	0.0%	0.0%	0.0%	0.2%	1.5%	2.3%
INTERMEDIATE TERM BOND INDEX SIGNAL - VIBSX	Bonds	23rd	19th	0.10%	-3.9%	-0.8%	5.1%	6.8%	5.3%	6.3%
<i>Intermediate Bond Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		0.89%	-2.6%	0.9%	4.3%	5.6%	4.4%	5.1%
INFLATION PROTECTED SECURITIES ADM - VAIPX	Bonds	10th	22nd	0.10%	-7.4%	-5.1%	4.5%	4.1%	5.0%	N/A
<i>Inflation-Protected Bond Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		0.82%	-6.6%	-4.5%	3.7%	3.5%	4.6%	6.2%
WELLINGTON ADMIRAL - VWENX	Bonds & Stocks	12th	3rd	0.17%	1.6%	15.0%	13.5%	7.3%	8.3%	7.1%
<i>Moderate Allocation Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		0.99%	0.1%	12.2%	11.1%	5.1%	6.1%	4.8%
EQUITY INCOME ADMIRAL - VEIRX	Stocks	4th	8th	0.21%	3.6%	21.8%	20.7%	9.3%	8.9%	6.5%
<i>Large-Cap U.S. Value Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.21%	3.3%	23.0%	16.9%	6.0%	7.1%	5.0%
500 INDEX SIGNAL - VIFSX	Stocks	18th	33rd	0.05%	2.9%	20.6%	18.4%	7.0%	7.3%	4.2%
<i>Large-Cap U.S. Blend Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.12%	2.6%	20.8%	16.7%	5.8%	6.9%	4.4%
SELECTED VALUE - VASVX	Stocks	31st	20th	0.38%	4.7%	28.3%	18.8%	10.9%	10.7%	7.9%
<i>Mid-Cap U.S. Value Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.30%	2.7%	26.7%	17.6%	8.3%	9.4%	7.6%
GROWTH INDEX SIGNAL - VIGSX	Stocks	14th	34th	0.10%	1.2%	16.8%	18.8%	7.2%	7.5%	3.8%
<i>Large-Cap U.S. Growth Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.26%	2.0%	17.2%	16.5%	5.6%	7.0%	4.1%
MID-CAP GROWTH INVESTOR - VMGRX	Stocks	14th	33rd	0.54%	2.5%	19.6%	20.0%	8.6%	9.8%	8.7%
<i>Mid-Cap U.S. Growth Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.36%	2.1%	19.8%	17.0%	6.1%	8.8%	6.9%
SMALL-CAP INDEX SIGNAL - VSISX	Stocks	20th	16th	0.10%	2.8%	25.7%	20.0%	10.2%	10.9%	7.6%
<i>Small-Cap U.S. Blend Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.33%	2.6%	24.6%	18.0%	8.0%	9.3%	7.6%
INTERNATIONAL GROWTH ADMIRAL - VWILX	Foreign Stocks	47th	34th	0.36%	-2.2%	15.4%	10.4%	1.2%	9.0%	4.9%
<i>Foreign Large Blend Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.29%	-1.2%	16.3%	9.3%	-0.9%	7.3%	3.8%
EMERGING MARKETS INDEX SIGNAL - VERSX	Foreign Stocks	61st	38th	0.18%	-8.4%	1.5%	3.3%	-0.7%	13.3%	10.0%
<i>Diversified Emerging Markets Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.63%	-7.5%	4.5%	3.4%	-1.4%	12.9%	9.4%
ENERGY ADMIRAL - VGELX	Energy Stocks	55th	6th	0.26%	-2.3%	11.1%	11.4%	-3.9%	13.7%	11.7%
<i>Energy Sector Stock Funds &gt;&gt;</i>		<i>Category Average &gt;&gt;</i>		1.58%	-0.1%	19.0%	10.7%	-7.2%	12.0%	9.9%

# Chicago Blower Corporation Profit Sharing & 401(k) Plans' Vanguard Funds Performance Specifics and Comparatives

(All for periods ended June 30, 2012)

(1) A fund with a 14<sup>th</sup> Ranking outperformed 86% of its peers.

**Remember: Past performance is absolutely NOT a guarantee of future performance!**

(2) "OER" or Operating Expense Ratio: Annual % of fund assets paid for fund operations and mgmt.

VANGUARD INDEXED AUTO-BALANCED FUND <i>Morningstar Category Name</i>	Securities Type(s)	Morningstar™ Category Percentile <sup>(1)</sup> Ranking Past		OER <sup>(2)</sup>	Total Return Performance for		Average Annualized Total Return for:			
		1 Year	5 Years		Past Qtr	12 Mos	3 Yrs	5 Yrs	10 Yrs	15 Yrs
TARGET RETIREMENT INCOME - VTINX	Target Date 2000-2010	65th	14th	0.16%	-1.8%	4.5%	7.4%	5.4%	N/A	N/A
Target Date 2000-2010 Funds >>	Category Average >>			0.53%	-1.5%	6.8%	8.1%	4.1%	5.0%	4.1%
TARGET RETIREMENT 2010 - VTENX	Target Date 2000-2010	48th	14th	0.16%	-1.2%	7.1%	9.4%	5.3%	N/A	N/A
Target Date 2000-2010 Funds >>	Category Average >>			0.53%	-1.5%	6.8%	8.1%	4.1%	5.0%	4.1%
TARGET RETIREMENT 2015 - VTXVX	Target Date 2011-2015	28th	7th	0.16%	-0.7%	9.6%	10.6%	5.5%	N/A	N/A
Target Date 2011-2015 Funds >>	Category Average >>			0.49%	-1.4%	8.0%	9.0%	4.0%	4.2%	3.0%
TARGET RETIREMENT 2020 - VTENX	Target Date 2016-2020	23rd	10th	0.16%	-0.3%	11.5%	11.5%	5.4%	N/A	N/A
Target Date 2016-2020 Funds >>	Category Average >>			0.56%	-1.3%	9.0%	9.8%	4.2%	5.5%	3.8%
TARGET RETIREMENT 2025 - VTXVX	Target Date 2021-2025	34th	13th	0.17%	-0.1%	13.0%	12.3%	5.3%	N/A	N/A
Target Date 2021-2025 Funds >>	Category Average >>			0.49%	-0.8%	11.4%	11.4%	4.2%	N/A	N/A
TARGET RETIREMENT 2030 - VTENX	Target Date 2026-2030	33rd	13th	0.17%	0.2%	14.6%	13.2%	5.2%	N/A	N/A
Target Date 2026-2030 Funds >>	Category Average >>			0.56%	-0.8%	12.2%	11.5%	4.1%	6.0%	3.8%
TARGET RETIREMENT 2035 - VTXVX	Target Date 2031-2035	35th	16th	0.18%	0.4%	16.0%	14.1%	5.3%	N/A	N/A
Target Date 2031-2035 Funds >>	Category Average >>			0.49%	-0.2%	14.4%	12.9%	4.2%	N/A	N/A
TARGET RETIREMENT 2040 - VTENX	Target Date 2036-2040	30th	14th	0.18%	0.6%	16.9%	14.3%	5.5%	N/A	N/A
Target Date 2036-2040 Funds >>	Category Average >>			0.56%	-0.4%	14.3%	12.5%	4.1%	6.2%	3.4%
TARGET RETIREMENT 2045 - VTXVX	Target Date 2041-2045	42nd	16th	0.18%	0.6%	16.8%	14.3%	5.5%	N/A	N/A
Target Date 2041-2045 Funds >>	Category Average >>			0.49%	0.1%	15.6%	13.4%	4.2%	N/A	N/A
TARGET RETIREMENT 2050 - VTENX	Target Date 2046-2050	43rd	18th	0.18%	0.6%	16.8%	14.3%	5.5%	N/A	N/A
Target Date 2046-2050 Funds >>	Category Average >>			0.53%	-0.4%	14.9%	12.7%	4.2%	6.6%	N/A
TARGET RETIREMENT 2055 - VTXVX	Target Date 2051+	53rd	n/a	0.18%	0.6%	16.9%	N/A	N/A	N/A	N/A
Target Date 2051+ Funds >>	Category Average >>			0.48%	0.3%	16.5%	13.4%	3.2%	N/A	N/A
LIFE STRATEGY CONSERVATIVE - VSCGX	Conservative Allocation	48th	58th	0.15%	-1.1%	6.9%	8.1%	4.6%	5.6%	5.0%
Conservative Allocation Funds >>	Category Average >>			0.92%	-1.7%	6.4%	7.7%	4.9%	5.2%	4.6%
LIFE STRATEGY GROWTH - VASGX	Aggressive Allocation	45th	45th	0.17%	0.3%	14.9%	13.0%	4.6%	7.0%	4.7%
Aggressive Allocation Funds >>	Category Average >>			0.94%	0.3%	15.0%	12.1%	4.3%	6.4%	4.5%