



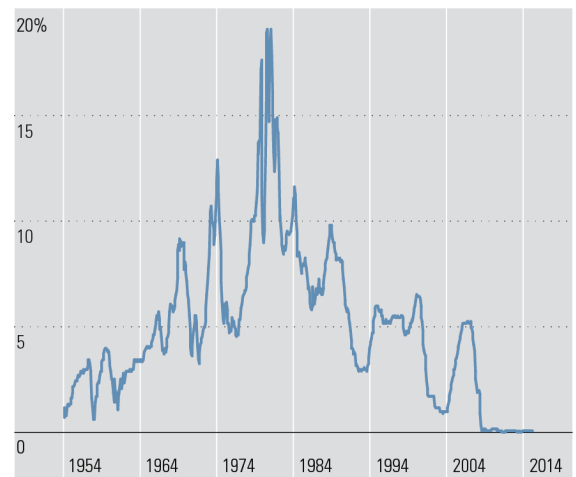
## The Fed Kicks the Can Down the Road

ITI Financial Management/Troy E. Kennedy

- ▶ 4650 S. National, Ste. A-1
- ▶ Springfield, MO 65810
- ▶ 417-889-2550
- ▶ 877-889-2660 toll free
- ▶ 417-889-2559 fax
- ▶ tkennedy@itifinancialmgt.com

The Federal Reserve decided not to raise rates at its September meeting. While admitting that employment and inflation levels were approaching its goals, the Fed worried that slower international economic activity would potentially depress U.S. growth rates (and employment), while a strong dollar was likely to keep inflation lower for longer. Given the uncertainty, it didn't feel an imminent need to raise rates. On the other hand, their longer-range forecasts show rate increases over the next year, albeit at a pace well below normal cyclical patterns. Current Fed governor forecasts have the Fed Funds rate moving up from 0.12% currently to just 1.4% by the end of 2016, slowly working its way to 3.4% by the end of 2018. In total, that is just barely over a 3% increase in more than three years. The relatively slow pace and small size of the total increase are all well below history.

Effective Federal Funds Rate



Source: Federal Reserve. This article contains certain forward-looking statements which involve known and unknown risks, uncertainties, and other factors that may cause the actual results to differ materially from any future results expressed or implied by those projected statements. Past performance does not guarantee future results.



Troy E. Kennedy  
Advisor/Principal

tkennedy@itifinancialmgt.com  
417-889-2550

### Advisor Corner

Mr. Kennedy's investment philosophy is the same that he has practiced over the last decade: securities markets are efficient and advisors primarily add value by coordinating the asset allocation for clients based upon risk tolerance, objectives, and time horizons. The firm has constructed 5 models for clients that vary in risk to meet the goals of each client. The firm primarily uses passive mutual funds in

each model and uses select actively managed funds for bond, commodity, and real estate exposure. ITI uses several research resources, including many that were used over the last 20 years, to assist with the recommended asset allocation and the appropriate funds to utilize in each model. Mr. Kennedy is an Investment Advisor Representative of ITI Financial Management, LLC.

Investment services are offered through ITI Financial Management, LLC, a registered investment adviser with the state of Missouri

# How Will Bond Funds React to Rising Rates?

ITI Financial Management/Troy E. Kennedy

► ITI Financial Management is a fee only, non commissioned registered investment advisory firm headquartered in Springfield, Missouri. We presently manage approximately \$70 million for over 175 accounts. In November 2009, Springfield Trust & Investment Company sold to a large out of town bank holding company. After 17 years as a shareholder/executive vice president with Springfield Trust & Investment Company, Troy Kennedy founded ITI Financial Management to continue to provide the highest level of personalized investment management and financial planning services. There are no fees to hire ITI nor are there any fees to terminate the relationship. It is truly a partnership with each client.

It is difficult to predict how the markets will move once the Fed decides to raise rates. That said, this article explores some ideas about how different types of fixed-income mutual funds are likely to react to an increase in interest rates.

Debt securities and funds that invest in them have varying levels of sensitivity to changes in interest rates. In general, the price of a debt security tends to fall when interest rates rise and rise when interest rates fall. Securities with longer maturities tend to be more sensitive to interest rate changes. Funds holding short-term debt securities are the least sensitive to changes in interest rates, while funds investing in longer-term bonds are the most interest-rate sensitive.

That being said, markets have responded very differently in past rounds of rate hikes. For example, during the rate hikes from March 2004 to June 2006, yields on the 30-year bond actually fell as the yield curve flattened; during the September 1993 to December 1994 hikes, yields rose across the yield curve. If the yield curve steepens (the long-end rises faster than the short-end) or shifts upward in a more or less parallel fashion, long-term bond funds could take a significant hit. But if the yield curve flattens, which is not out of the question given the troubles abroad that may continue to push investors toward the safe haven of U.S. Treasury bonds of all maturities, longer-term funds may fare better. For example, during the 2004–06 rate hikes, the 10-year Treasury bond lost 1.7% while the 30-year bond gained 2.2%.

Globally, it's expected that the eurozone and Japan (the two main non-U.S. developed markets for bond investors) will be relying on quantitative easing much longer than the United States, thus delaying their own rate hikes. But the market for high-quality non-U.S. government bonds, including German bunds and Japanese government bonds, can track U.S. Treasuries when investors seek safe-haven assets. If the Fed continues to delay the rate hike, it could be seen as a signal that it's concerned about economic growth and may stoke fears of slowing global growth, and German and Japanese government bonds could strengthen. Under the same scenario, the dollar is likely to weaken, which would boost issues denominated in

euros or yen.

What does this mean for an investor's portfolio? Predicting the timing and magnitude of interest-rate movements is difficult, and many bond portfolio managers believe it's folly to significantly change a fund's position based on interest-rate predictions. Investors may be better off sticking with an allocation that suits their long-term investment goals, and understanding how different bond funds might perform during various rate environments can help.

The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Mutual funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses. Investors should read the prospectus and consider this information carefully before investing or sending money.

Government bonds and Treasury bills are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest. With government bonds, the investor is a creditor of the government. With corporate bonds, an investor is a creditor of the corporation and the bond is subject to default risk. Corporate bonds are not guaranteed.

With international bonds, the investor is a creditor of a foreign government or corporation. International bonds are not guaranteed. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, liquidity risks, and differences in accounting and financial standards.

# Investors Are Driving Expense Ratios Down

ITI Financial Management/Troy E. Kennedy

► The firm's investment philosophy is the same that Mr. Kennedy practiced at Springfield Trust & Investment Company, that the securities markets are efficient and that advisors primarily add value by coordinating the asset allocation for clients based upon risk tolerance, objectives, and time horizons. The firm has constructed 5 models for clients that vary in risk to meet the goals of each client. The firm primarily uses passive mutual funds in each model and uses select actively managed funds for bond, commodity, and real estate exposure. ITI uses several research resources, including many that were used over the last 18 years, to assist with the recommended asset allocation and the appropriate funds to utilize in each model.

Morningstar's 2015 fee study examined expense-ratio trends in the asset-management industry. The main takeaway was that expense ratios are falling, and investors are paying less for fund management.

The asset-weighted expense ratio across all funds analyzed (which include mutual funds and exchange-traded funds, or ETFs) was 0.64% in 2014, down from 0.65% in 2013 and 0.76% five years ago. The trend is being driven more by investors seeking low-cost funds than it is by fund companies cutting fees. Fund investors are increasingly buying passive funds and investing in lower-cost actively managed funds.

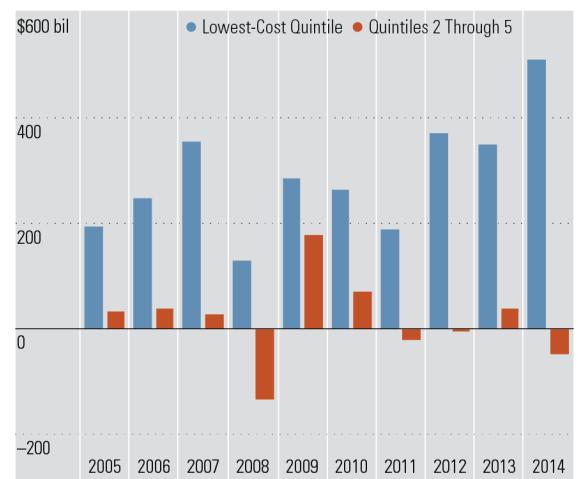
During the past decade, low-cost funds have been attracting far more inflows than their more-expensive peers. This has helped to reduce the industry's average asset-weighted expense ratio over time. Mutual funds and ETFs with expense ratios ranking in the least-expensive quintile of all funds attracted an aggregate \$3.03 trillion of estimated net inflows during the past 10 years, compared with just \$160 billion for funds in the remaining four quintiles. That is to say that 95% of all flows have gone into funds in the lowest-cost quintile. Passive funds (mutual funds and ETFs) have been prominent recipients of the capital flowing into low-cost funds. Compared with funds falling in cost quintiles 2 through 5, funds in the lowest-cost quintile are more likely to be passive/index funds.

Disclosure: The investment return and principal value of mutual funds will fluctuate and shares, when sold, may be worth more or less than their original cost. Mutual funds are sold by prospectus, which can be obtained from your financial professional or the company and which contains complete information, including investment objectives, risks, charges and expenses. Investors should be read the prospectus and consider this information carefully before investing or sending money.

Holding an exchange-traded fund (ETF) does not ensure a profitable outcome and all investing involves risk, including the loss of the entire principal. Since each ETF is different, investors should read the prospectus and consider this information carefully before investing. The prospectus can be obtained from

your financial professional or the ETF provider and contains complete information, including investment objectives, risks, charges and expenses. ETF risks include, but are not limited to, market risk, market trading risk, liquidity risk, imperfect benchmark correlation, leverage, and any other risk associated with the underlying securities. There is no guarantee that any fund will achieve its investment objective. In addition to ETF expenses, brokerage costs apply. Fees are charged regardless of profitability and may result in depletion of assets.

## Estimated Net Flows by Expense Ratio Quintile



Source: "2015 Fee Study: Investors Are Driving Expense Ratios Down," Morningstar, Inc.

# Risk, Not Volatility, Is the Real Enemy

ITI Financial Management/Troy  
E. Kennedy

- ▶ 4650 S. National, Ste. A-1
- ▶ Springfield, MO 65810
- ▶ 417-889-2550
- ▶ 877-889-2660 toll free
- ▶ 417-889-2559 fax
- ▶ tkennedy@itifinancialmgt.com

What would you do if your investments lost 10% in a single day? A) Add more money to my account. B) Hold steady with what I've got. C) Yank my money; I wouldn't be able to stand any more losses.

If investors buy the right investments but sell them at the wrong time because they can't handle the price fluctuations, they may have been better off avoiding those investments in the first place. Most investors are poor judges of their own risk tolerance, feeling more risk-resilient in up markets and more risk-averse after market losses. However, focusing on an investor's response to short-term losses inappropriately confuses risk and volatility. Understanding the difference between the two and focusing on the former is a potential way to make sure you reach your financial goals.

Volatility encompasses the changes in the price of a

security, a portfolio, or a market segment, both on the upside and downside, during a short time period like a day, a month, or a year. Risk, by contrast, is the chance that you won't be able to meet your financial goals or that you'll have to recalibrate your goals because your investment comes up short. So how can investors focus on risk while putting volatility in its place? The first step is to know that volatility is inevitable, and if you have a long enough time horizon, you may be able to harness it for your own benefit. Diversifying your portfolio among different asset classes can also help mute the volatility. It helps to articulate your real risks: your financial goals and the possibility of falling short of them. Finally, plan to keep money you need for near-term expenses out of the volatility mix altogether.

Investing in securities always involves risk of loss. Diversification does not eliminate the risk of experiencing investment losses.

©2013 Morningstar, Inc. All Rights Reserved. The information contained herein (1) is intended solely for informational purposes; (2) is proprietary to Morningstar and/or the content providers; (3) is not warranted to be accurate, complete, or timely; and (4) does not constitute investment advice of any kind. Neither Morningstar nor the content providers are responsible for any damages or losses arising from any use of this information. Past performance is no guarantee of future results. "Morningstar" and the Morningstar logo are registered trademarks of Morningstar, Inc. Morningstar Market Commentary originally published by Robert Johnson, CFA, Director of Economic Analysis with Morningstar and has been modified for Morningstar Newsletter Builder.



Troy E. Kennedy  
Advisor/Principal

ITI Financial Management  
4650 S. National suite A-1  
Springfield, Missouri 65810

tkennedy@itifinancialmgt.com

Tel: 417-889-2550  
Fax: 417-889-2559