

## INSIGHTS

### INVESTMENT OVERVIEW

#### SMALL CAP MALAISE

As many of you know, in a previous life, I was a Portfolio Manager for a small capitalization mutual fund, so analyzing small companies is near and dear to my heart. Unfortunately, 2014 has not been the year to own the companies comprising the lower end of the market capitalization spectrum. The Russell 2000 price index, an equity benchmark designed to track the performance of the investable small cap universe, is down **5.32%** year-to-date (“YTD”) versus a solid **6.70%** increase in the S&P 500.

While the goal of this newsletter is to expose the possible reasons for this extreme underperformance, it is important to provide a rudimentary overview of investing in small cap equities relative to the large and mid cap stocks readily observed in the S&P 500 index. The aforementioned Russell 2000, generally represents companies with a market capitalization below \$2 million headquartered in the United States. Small cap equities are often more difficult to trade, or illiquid, which creates heightened share price volatility, especially during rapid market movements – both higher and lower. Essentially, they represent the opposite of the mighty \$230 billion Alibaba Group Holding Ltd. ADR (“BABA”) that went public last week, setting a global record for an initial public offering (“IPO”).

As BABA soared, small cap stocks continued to sour, with financial markets struggling to interpret a series of conflicting messages. First, with the heightened concerns over Europe slipping back into a recession, the domestic small cap index, composed of companies with minimal international exposure, is underperforming: is this a sign that the US is the next region to resign? Second, investors exhibited extreme exuberance in eagerly bidding up shares of an overhyped IPO, while simultaneously abandoning the high risk-reward inherent in small cap stocks: how do we interpret a market that is speaking out of both sides of its mouth?

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### FINANCIAL ADVISORY OVERVIEW

#### MEDICARE: OPEN ENROLLMENT BASICS

It’s that time of year again: Medicare Open Enrollment Period begins October 15<sup>th</sup>. Therefore, we believe this is an opportune time to review Medicare, what questions you should be asking, and how to evaluate the numerous options for coverage.

Medicare Parts A and B are the foundation upon which additional Medicare policies are built. Medicare Part A is the basic hospital insurance that most individuals receive at age 65. Medicare Part B is the medical insurance that beneficiaries need to sign up for at age 65, with the Initial Enrollment Period (“IEP”) beginning 3 months before your 65<sup>th</sup> birthday. Clients should make every attempt to sign up at the earliest possible date: the sooner you enroll, the sooner coverage begins. The current cost for Part B is \$104.90 for most beneficiaries.

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#### INVESTMENT TEAM

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*President & CIO*

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*Director of Research & Portfolio Manager*

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#### SPECIAL POINTS OF INTEREST

- Stock & Strategy Spotlight
- Monthly Index Review
- Around Rinehart

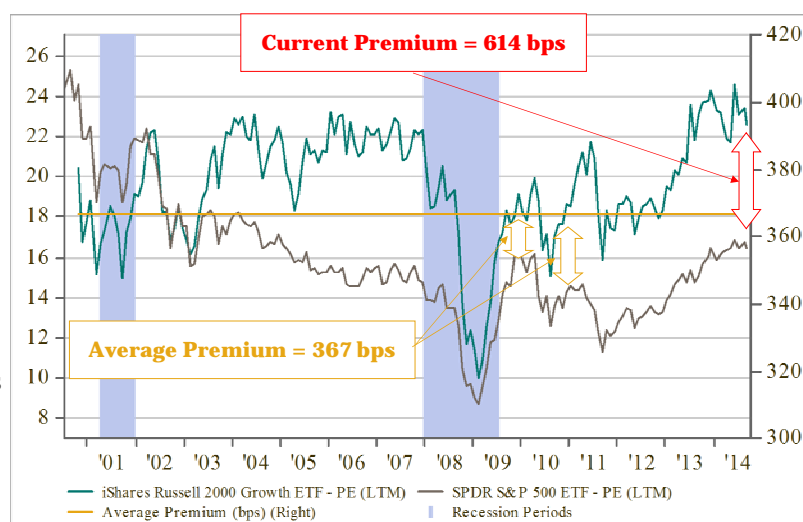
## INVESTMENT OVERVIEW

## SMALL CAP MALAISE

We view the small cap underperformance as a result of two factors: the first factor reflects a cyclical rotation out of small cap during the later stage of a bull market, during which small cap tends to lag. The second factor relates to valuation: after considerable outperformance in 2013, small cap became incredibly expensive. Normally, small cap stocks trade at an average premium to the S&P 500 of 367 basis points (“bps”); however, this premium is currently 614 bps. The chart to the right illustrates this valuation premium relative to the S&P 500. As this valuation premium reached extremes near the end of 2013, we reduced our small cap exposure across portfolios.

The Russell 2000 price indexes were positive YTD heading into September, with the Russell 2000 Growth lagging. Last month, however, the Russell 2000 Value experienced a dramatic decline of **9.02%** resulting from its large exposure to underperforming sectors, such as banks and REITS. Although a rotation away from small cap is

CHART I: RUSSELL 2000 GROWTH VS. S&amp;P 500 – P/E RATIO



Source: FactSet Research Systems

normal in the later stages of a bull market, the recent dramatic downturn more closely resembles a decided bet against risk and higher-yielding, interest rate-sensitive small cap names: yet another contradictory condition indicative of a confused, directionless market.

## STOCK &amp; STRATEGY SPOTLIGHT

## Company Name:

Kinder Morgan Energy Partners, L.P.

## Symbol:

KMP

## 2014 (YTD)

**+20.77%**

## Company Description – Investment Thesis:

On August 11<sup>th</sup>, Kinder Morgan, Inc. (“KMI”) announced that it would consolidate its three related entities by acquiring the outstanding equity of El Paso Pipeline Partners, L.P. (“EPB”), Kinder Morgan Management, LLC. (“KMR”), and Kinder Morgan Energy Partners, L.P. (“KMP”). By abandoning the master limited partnership (“MLP”) structure, KMI noted that the resulting consolidated corporate structure will effectively eliminate the incentive distribution rights burden, thereby reducing the cost of capital and increasing the company’s flexibility in deploying capital expenditures on infrastructure projects. Shares of EPB, KMR, and KMP jumped upwards of **17%** following the announcement. Holders of any of the three related securities should expect to receive a combination of cash and KMI shares in exchange for their holdings. Of particular import are the tax implications for holders of EPB and KMP, which are both currently structured as MLPs. According to the *Wall Street Journal*, an average investor in KMP could be expected to owe between \$12.39 and \$18.16 in taxes-due per share, depending on the shareholder’s individual tax rate, as a result of the restructuring, while they could be expected to receive only \$10.77 in cash per share, in addition to shares in KMI. While KMP has been a long-term holding across the firm, we are currently evaluating the tax implications for each client portfolio in order to minimize potential tax liabilities and maximize after-tax returns given the attractive transaction premium still reflected in KMP’s share price.

## MONTHLY INDEX REVIEW

Data as of September 30 <sup>th</sup> , 2014	September 2014	2014 (YTD)	2013
S&P 500	-1.40%	8.34%	32.39%
Dow Jones Industrials	-0.23%	4.60%	29.65%
NASDAQ Composite	-1.82%	8.56%	40.12%
Russell 2000	-6.05%	-4.41%	38.82%
MSCI Emerging Markets	-7.39%	2.75%	-2.27%
MSCI EAFE	-3.81%	-0.99%	23.29%
Barclays US Aggregate	-0.68%	4.10%	-2.02%

## FINANCIAL ADVISORY OVERVIEW

## ABOUT RINEHART

## MEDICARE: OPEN ENROLLMENT BASICS

In addition to Medicare Part A and B, most beneficiaries choose to purchase additional coordinating coverage through a private insurance company. This type of coverage is Medicare supplemental insurance, which is commonly referred to as Medigap, and covers some or all of the additional health care costs not covered by either Medicare Parts A or B. Each Medigap plan has different deductibles, copays, and coinsurance. Choosing the best plan will depend on each person's unique situation and anticipated health care costs. Below are questions to consider when purchasing or changing your Medigap plan:

- What are my current health care costs?
- Do I anticipate any costly procedures or health care treatment in the next year?

Part D prescription drug plans.

Medicare Part D is the prescription drug coverage. Most individuals choose to purchase prescription drug coverage through either Part D or their Medigap policy. It is important to note that you cannot have a Medigap policy with prescription drug coverage and a Medicare Part D drug plan, you must choose one or the other.

Another aspect of Part D that has been getting a lot of coverage is the closing of the "donut hole" that was a result of the Affordable Care Act in 2010. The "donut hole" describes the current prescription drug coverage gap between the co-insurance limit of \$2,850 and the out of pocket maximum of \$4,550 in which the insured is responsible for 47.5% (for 2014) of the cost for brand-

*"Investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas." - Paul Samuelson*

- If I change plans, will my existing doctors and providers stay "in-network?"
- Do I anticipate any international travel in the next year? Some Medigap plans offer limited coverage options for international health care.
- Is my prescription medication covered by the plan?

Another option for additional coverage above basic Medicare A and B is through a Medicare Advantage Plan, which comprises a variety of private health plans that Medicare offers as an alternative to the traditional program. There are several Medicare Advantage plans available that cover different levels of cost above the traditional Medicare A and B. The Open Enrollment Period (OEP) is from October 15<sup>th</sup> – December 7<sup>th</sup> each year, during which time beneficiaries can change their Medicare Advantage Plan, enroll in Medicare Advantage for the first time, or change their

name drugs. Each year the percentage of cost the insured is responsible for decreases by 5% until 2020 when the "donut hole" will be officially closed and the insured will only pay a 25% coinsurance after meeting the deductible of \$310 until the out-of-pocket maximum of \$4,550 is reached. The closing of the "donut hole" will result in significant savings for Medicare beneficiaries that spend significantly on prescription drugs.

At Rinehart, we realize that each client's situation is unique, and the Medicare program can be very confusing when faced with so many options to elect health care coverage. Please contact your Financial Advisor with any questions, and let us know how we can help.

Rinehart Wealth Management is an experienced, boutique Registered Investment Advisor dedicated to independent, comprehensive wealth management. Founded in 1985 by Mary Rinehart, the firm, from its inception, has had a singular focus: to provide highly customized investment management and financial planning solutions to clients.

**Boutique Firm:**

Being a boutique wealth management firm allows us the flexibility to provide more personalized service and offer unique investment solutions to clients in a Fee-Only environment.

**Team Approach:**

Because each client's situation is different, the team of advisors is hand-selected to ensure areas of expertise are appropriately aligned with the client's specific needs and interests.

**Proprietary Investment Research:**

The differentiating factor of our portfolio management process is the proprietary investment research driving the portfolio construction. All investment research and analysis is done entirely in-house by our Investment Team.



## AROUND RINEHART

### CELEBRATION

Marilyn and Jake Spencer threw a fabulous party to celebrate, simultaneously, their 40<sup>th</sup> birthdays and their ten-year anniversary. Many of the Rinehart team members and their significant others came to celebrate the happy couple and these milestones. Below, Sandy Carlson, her husband Justin, Elliott Van Ness and his fiancée Alana Linn, enjoyed a delicious dinner with friends and coworkers.



### HEARD ON THE STREET

Daniele Donahoe, CFA was quoted in a recent article featured in the Wall Street Journal: “Advisors Sour on Small Caps.” Given Daniele’s prior experience managing small cap equities for over eight years, she is a valuable resource when discussing small cap trends. This initial query received by the article’s author inspired us to revisit small cap equity underperformance, despite being very vocal on the topic over the past year.

### IN THE COMMUNITY

The Rinehart team showed up with friends and family to support and play in the Tossin’ for Tykes cornhole tournament, hosted by the Charlotte Rotary Clubs in support of the Council for Children’s Rights.



### TRULY AMAZING

Last week, Neal Deaton’s wife, Carey, received a lung transplant. Carey has been battling cystic fibrosis since her youth, and her condition had become so severe that a lung transplant was required. Although the family rejoiced when a set of lungs became available, Carey’s body has had a difficult time assimilating the lungs. That being said, she has made significant progress, but there is still a long road ahead. Our love and support go out to Neal, Carey, and their son, Parker, during this difficult time.

### REMINDER: QUARTERLY REPORTS

Over the next few days, we will be assembling and mailing quarterly reports: keep your eyes peeled for our traditional brown envelope over the next couple of weeks!

### Rinehart Wealth Management

Wealth management is our only business;  
therefore, our attention is undivided and our  
intentions are transparent.

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