



Matthew S. Clement, CFP[®], AIF[®]
CERTIFIED FINANCIAL PLANNER[™]
ACCREDITED INVESTMENT FIDUCIARY[®]

October 30, 2008

Mr. and Mrs. Family Client
1 Main Street
Stony Point, NY 10980

Dear Mr. and Mrs. Client,

In light of the significant disruption this month within our financial system, I thought it important to reach out to my clients with a bit more reflection than would be possible during any one phone conversation or face-to-face meeting. My challenge in addressing all clients at once, however, is that no client is the same. In fact, each of you has a unique set of circumstances, history, and goals, and hence each of you has a different financial plan or solution.

Despite this challenge, and while not every area I discuss will serve each client's situation, I'm hopeful that you are able to extract something of value from this letter and enclosed materials.

My intention, generally speaking, will be to arm you with your very own "Volatility Defense Kit." If we have been working together for a while, then we've had the opportunity to prepare, both technically and psychologically, for disruptions of this kind. If we have only been working together for a few months to a year, then there's a possibility we've not yet fully worked through all the fundamentals that impact your ability to meet your financial goals. In either case, please allow this to serve as an additional opportunity to build upon your understanding and perspective.

As of today's close, the market (which I define only for tracking purposes as the S&P 500) is down 37% from the same day one year ago. Interestingly enough, if I look to the previous high of March 24, 2000, the Index is also down 37%. I could, with a little research, give you a dozen other equally disturbing statistics, but I suspect if you've opened a newspaper or watched the evening news at all in the last month, you've already been exposed to more than you care for.

What I find far more interesting, however, is that the most dramatic statistics (and therefore the ones that all the media outlets use) are always measured from absolute peak to absolute bottom. When you stop for a moment to contemplate the reality of such benchmarks, one may quickly conclude that these stats are, practically speaking, quite useless, and possibly quite damaging. In using absolutes, **they are referencing a peak where you did not buy and where you would not have sold, and a bottom which can be known only later because it failed to stay there!** If there exists a *less* accurate a way in which to frame the long-term behavior of equity, I've yet to find it.

Statistics now placed in proper perspective, I readily admit that even objectively, the markets are volatile in that even a diversified global equity portfolio (made up of multiple segments, sectors, and countries) still declines about 20% every 4 years or so (though never in any predictable way), and that about one out of every three of those declines is greater than 30%. **Knowing this, why is it that anyone would readily subject themselves to such apparent turmoil?**

There really is only one prudent response to the question, and it's this: **There is simply no other way to protect one's purchasing power throughout a lifetime.** For those unfamiliar with the concept of purchasing power, my definition is, "the change in *value* of dollars, rather than in *number* of dollars, through time, as a result of *your* change in cost of living." So, if you start the year with \$100 in a glass jar and over the course of the year your cost of living increases 4%, then at the end of the year, while you still have the same number of dollars, the value of those dollars has *decreased* by 4%, such that the same \$100 will now only buy what \$96.15 bought the year before. When used in the context of lifestyle, 4% inflation would mean that everything you buy on a regular basis would more than triple in cost over the span of a thirty-year retirement.

Emerald Retirement Planning Group, Inc.
18 Liberty Square Mall, Stony Point, NY 10980
matthew@emeraldretirement.com
Phone (845) 942-8578



Investment Advisor Representative offering advisory service and securities through Cetera Advisors LLC, a Broker-Dealer and Registered Investment Advisor, Member FINRA/SIPC. Cetera is under separate ownership from any other named entity.



Matthew S. Clement, CFP[®], AIF[®]
CERTIFIED FINANCIAL PLANNER[™]
ACCREDITED INVESTMENT FIDUCIARY[®]

The use of a diversified global equity portfolio is the only way for most individuals and families to maintain their lifestyle, keep pace with change in cost of living, and assure that their money lasts a lifetime.

I shall therefore spend the remainder of this letter articulating several additional fundamental elements to long-term planning, and wherever possible I will reference them within the context of our current “bear market.” When appropriate I will also reference additional documents that may assist in giving you the fullest understanding possible. Ultimately, if I fall short in conveying any particular point, **please call me for clarification.**

Bear Markets

- Including our present cycle, there have been thirteen bear markets since 1945 (defined here as a significant U.S. market decline approaching or surpassing 20%), each of varied length and degree of decline. See “An Historical Look at Recessions and Stock Market Returns”¹ for nine such examples.
- The particular *causes* of each of these bear markets was as varied as were the results, but ranged from war, to banking, to oil, to inflation, to government itself, but in a majority of cases, it was the general cycle of expansion and contraction, otherwise known as the business cycle, which most influenced the direction of the market.
- Amid these thirteen bear markets, each represented by the news media as the end of the world, the S&P Composite rose to 954 (today’s close) from the January 1, 1945 open of 12. That’s no misprint but let me spell it out for you to be sure—twelve. And all one had to do was sit there for 53 years and 10 months and refuse to be sidetracked by the media or reactionary behavior.
- Such results ignore the fact that if you had reinvested your dividends, you would have done even better.

Long Term Trends – The 3 “Mega-Bears”

- Whereas no single bear market has lasted more than sixteen months, with most lasting eight or ten, there have historically been longer trends of fifteen to eighteen years where multi-cycle market returns have been either higher or lower than their long-term average of 10.4% (again referencing U.S. large companies only). See “2000’s, A Lost Decade.”²
- If the S&P ends 2008 below 975, it will have been the first negative 10-year period in over sixty years. By the chart you can see that 1974 almost accomplished the task, but because the market doesn’t know where “zero” is, what is far more important than crossing that line (as far as our present circumstances are concerned) is that; (1) there has never been two negative decades in a row, and (2) the fifteen to eighteen years following an underperforming 10 years such as 1998-2008 tend to be vastly superior to other periods. This chart therefore explains what will likely occur if we are simply patient enough to let it happen.

Behavior

- Over time, the average investor will underperform his own investments by greater than 50% as the result of nothing more than poor behavior. (This is indeed a proven fact, but should you require the evidence, call me and I’ll send it to you.)
- Timing the market does not work. By the time it is apparent that our economy is moving from contraction to expansion, the market will have already responded in the affirmative. That particular point in time simply cannot be predicted. There is therefore no objective or rational criteria one can use to decide when to re-enter the market, which leaves only an emotional criteria.
- Use of emotional criteria = poor behavior. Hence, #1 is *caused* by #2. Positive long-term behavior, on the other hand, leads to incontrovertible success. But to accomplish the task, we need to ignore the chatter around us (print media, TV

Emerald Retirement Planning Group, Inc.
18 Liberty Square Mall, Stony Point, NY 10980
matthew@emeraldretirement.com
Phone (845) 942-8578



Investment Advisor Representative offering advisory service and securities through Cetera Advisors LLC, a Broker-Dealer and Registered Investment Advisor, Member FINRA/SIPC. Cetera is under separate ownership from any other named entity.



Matthew S. Clement, CFP[®], AIF[®]
CERTIFIED FINANCIAL PLANNER[™]
ACCREDITED INVESTMENT FIDUCIARY[®]

media, and fellow employees) and have faith that the great companies in the U.S. and the world will do what they have always done—grow.

Read “A Tale of Two Fridays”³ for a review of not only the importance of disciplined behavior, but of the danger of the media and the value of equity ownership as the great protector of purchasing power.

Dividends, Small Companies, and the Globe

- I’ve referenced “diversified global equity” several times now but have yet to explain what it looks like. It is, essentially, the act of owning all types of equity in a systematic and balanced way. Because we can never know which segment will outperform all others over a short period of time, we eliminate the possibility of being wrong by owning them all.
- By adding segments such as dividend-paying companies (known as “value”), smaller companies, and international companies, the long-term investor can lower the overall volatility of his portfolio while simultaneously improving his returns over time.
- The reason the media never shows you how a diversified global equity portfolio would have fared in any given bear market is because, most often, such a portfolio is more resilient than a single benchmark such as the S&P 500 Index. And that wouldn’t be as dramatic!
- During environments when the key components of downward movement are global in nature, even a diversified global equity portfolio is not immune to temporary decline. Our recent credit and housing crises is one such example. All companies—large and small, dividend-paying and non-dividend-paying, U.S. and International— have felt the impact of the crisis. And so all portfolios are down.
- A portfolio made of up diversified global equity, systematically rebalanced, is the **only** consistent way to eliminate long-term market risk, i.e. the permanent loss of capital, while at the same time capturing the full long-term value of the growth of companies around the world.

I’ve just stated above, in case you missed it, that diversified global equity *eliminates risk*. But in order for me to be fully accurate in that statement (and move this letter past my compliance department), I need to define the different types of risk that people encounter.

What the Real Risks Are

My job as a financial planner is multi-faceted, but a key component is to help individuals and families eliminate three distinct types of risk.

- Risk #1 is **purchasing power risk**, and I have previously addressed this.
- Risk #2 is **sequence of returns risk**. This risk arises in the years just before and just after a required cash outflow. For most people, that’s retirement. Reducing this risk entails structuring a plan that eliminates the possibility of selling assets at a loss in order to live off them. Having a cash reserve, an annuity, a pension, or some other fixed-income source is often a solution.
- Risk #3 is **long-term market risk**. When a single stock declines in value, there’s always a chance it will never recover. Long-term market risk is therefore present any time you invest in a single stock or a single idea (such as internet in 1999). In doing so, one takes on the possibility of a permanent loss in value.
 - This is a behavioral error in that the investor came to believe that one idea, sector, or segment would outperform the broad market.

Emerald Retirement Planning Group, Inc.
18 Liberty Square Mall, Stony Point, NY 10980
matthew@emeraldretirement.com
Phone (845) 942-8578



Investment Advisor Representative offering advisory service and securities through Cetera Advisors LLC, a Broker-Dealer and Registered Investment Advisor, Member FINRA/SIPC. Cetera is under separate ownership from any other named entity.



Matthew S. Clement, CFP[®], AIF[®]
CERTIFIED FINANCIAL PLANNER[™]
ACCREDITED INVESTMENT FIDUCIARY[®]

- Eliminating long-term market risk entails the use of many segments as defined earlier by “global diversified equity.” In owning no company and no idea in any great quantity, you eliminate the possibility of any company or idea creating a permanent loss in value, as the other segments will make up for that loss.
- The key word is “long term.” What you can never eliminate in the short-term, however, is volatility. In fact, the very volatility that has concerned so many people recently is precisely what’s responsible for the long-term *benefits* of owning companies (equity) over loaning to those companies (bonds). The reward for taking on such volatility is known as the “equity premium.” It is the foundation for the capitalist system that allows companies to function and grow, and it is responsible for inflation- adjusted returns of **two to three times** what is available through bonds.

In an effort to assure the safest and most appropriate course of action for their savings, my clients often confuse market risk with market volatility. In other words, they confuse the *permanent* loss of *value* as a result of *behavior* (market risk) with the *temporary* drop in *prices* as a result of *cycles* (market volatility). The two look very similar in the midst of a “crisis,” but ultimately result in two very different outcomes.

In addition to the actual process of financial planning, helping clients keep separate the concepts of market risk and market volatility is one of my most crucial (and challenging) responsibilities. I’m hoping that this letter serves to assist my effort to do so. Certainly, the topic requires ongoing attention, which is why it should not surprise you if I bring it up again at our next meeting together.

As I work toward helping you with proper planning and proper investment behavior, it is always with the end in mind that I commit my efforts. It is therefore the successful accomplishment of your long-term financial goals which dictates all other issues, and I look forward to continuing that process with you over the next many years.

Very best regards,

A handwritten signature in blue ink that reads 'Matthew Clement'.

Matthew Clement

1. *An Historical Look at Recessions and Stock Market Returns*, May 1, 2008, Prudential Investment Management Services.
2. Hofschire, Dirk, *2000s: A “Lost Decade” for U.S. Stocks?*, July 31, 2008. Market Analysis, Research and Education (MARE) of the Fidelity Management and Research Company.
3. Murray, Nick. *A Tale of Two Fridays*, October 2008. Reprinted and distributed with permission.

Emerald Retirement Planning Group, Inc.
18 Liberty Square Mall, Stony Point, NY 10980
matthew@emeraldretirement.com
Phone (845) 942-8578



Investment Advisor Representative offering advisory service and securities through Cetera Advisors LLC, a Broker-Dealer and Registered Investment Advisor, Member FINRA/SIPC. Cetera is under separate ownership from any other named entity.