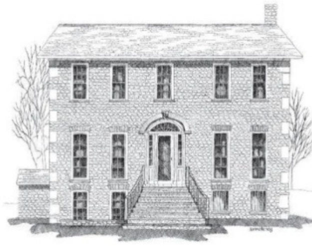

ON THE HORIZON...
NEWS, NOTES, AND COMMENTARY
FOR CLIENTS AND FRIENDS OF THE HORIZON GROUP

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FISCAL FOLLIES

There are a number of issues weighing on clients these days. Almost every interaction I have lately ends with the question, "So, are we going over the fiscal cliff?" Others are sending copies of a recent Time magazine article "Why Stocks are Dead and Bonds are Deader", looking for my opinion. The article has caused a few clients sleepless nights because it's based on the opinions of PIMCO's Bill Gross and Mohamed El-Arian, two men in whom I have great confidence. Throw the election results into the mix, and the average person is feeling unsettled at best.

Let's start with politics and the fiscal cliff. It would be an understatement to say I'm disappointed with the election results. The people have spoken and have chosen what they believe will be higher taxes on the wealthy and an expansive national healthcare plan. But it is merely an illusion. We're saddled with $16,000,000,000,000 in national debt and trillion dollar deficits as far as the eye can see. Higher taxes on the rich won't make a dent in either number. In fact, if every tax increase President Obama has proposed were in effect last year, the deficit would have been 1.22 trillion instead of 1.3 trillion. Even if you throw in every spending cut Mr. Boehner has proposed, last year's deficit would still exceed a trillion dollars. Higher taxes and benefit cuts are coming for ***everyone***. Political dysfunction is hardly a surprise and has been priced into the stock market for years. In spite of the politicians, markets have doubled from the lows of 2009, are within striking distance of all-time highs, and up more than 10% for the year.

One of the biggest crimes is how this story has been packaged and reported. The average person has little understanding of the expiring tax cuts or the scope and context of our fiscal issues. Although it makes for dramatic headlines, the fiscal cliff issue is closer to a severe head cold than a terminal illness. Keep in mind the headlines bombarding you on the hourly news cycle have been carefully crafted to keep you concerned and tuning in at best. At their worst they're intend to manipulate political views or even cause a market response. My personal belief is that we should rev up the engine and barrel off the cliff like Thelma and Louise. We can consider it the first dose of fairly strong medicine we'll all have to swallow. Let's start the treatment.

Now for the article "Stocks are Dead". Although the headline is shocking, it's really what the pair has been saying since they coined the phrase "the new normal" over three years ago. They believe the United States – as well as the rest of the developed world – is in a slow growth environment caused by consumers and governments being hampered by record levels of debt. Although families are in the fourth year of "deleveraging", or paying down excess debt, they still have a long way to go. At the same time governments have been adding debt, increasing spending to offset the slowing consumer with fiscal stimulus programs. The housing meltdown forced individuals to abandon the debt fueled spending spree. Unfortunately, the resulting recession has given cover for politicians to heap more debt on an already unsustainable situation.

So how does all this affect stocks and bonds? It's time for a Macro Economics 100 review. As I've said for years, stock prices follow earnings. Although certain companies can increase profits on an individual basis regardless of economic conditions, the market as a whole can only increase earnings by the rate of economic growth (GDP), plus productivity increases. With productivity gains stalled - corporations have cut to the bone and are running lean - all eyes are on economic growth to fuel corporate earnings increases. But this is the same economy being hindered by a deleveraging consumer with a long way to go. Politicians who would usually charge in and cut taxes or spend more to stimulate growth are being restrained by the backlash to a never-ending mountain of public debt. The result is an economy designed to run at an annual 4% growth rate is mired at 2% for the foreseeable future. That's exactly the new normal described by PIMCO's dynamic duo in the Time article.

This slow growth, high debt scenario lowers the expected return for both stocks and bonds. This is because the total return for stocks is comprised of dividends + GDP growth + inflation. With bonds, you have to remember that they are pieces of debt. At some point lenders (bondholders) will demand higher interest rates from governments with dangerous levels of debt. As we've seen in Europe, it's not an issue until the market decides it is one morning – then it's a crisis. And there's the mathematical issue of higher rates translating to lower bond prices. Remember the teeter-totter - the longer the term of the bond, the larger the price decline when rates rise.

What does all this mean for you? If the folks from PIMCO are correct, it's probable that we're entering a period of time where returns will trail historical ranges by several percent for quite some time. That means the 4% to 6% returns bond owners have enjoyed for the past twenty years will likely trend toward 2% to 4%. Stocks may return 6% to 8%, rather than the historical 10% most experts quote. Keep in mind those percentages are long term averages and in any given year, either stocks or bonds could post big gains or big losses. And not everyone agrees with PIMCO's analysis. Today Blackrock, one of the world's largest asset managers, issued their 2013 market forecast that called for the S&P 500 to close next year at 1600. That represents a 12% gain from today. The truth is that nobody knows what's in store for the market in any given year. But even if returns come in at the low end of PIMCO's ranges, stocks should still outperform most other investment alternatives.

The fact is you have to invest your money in search of return. Not participating is not an option. Having all your money in a half-percent CD or a money market making 0.01% is not a realistic approach. The key point I want you to take away is that none of the risks dominating the headlines are unknown, and almost any can be managed. As for bonds, we've been keeping our funds shorter term and of lower credit quality – both less sensitive to interest rate increases. We are also well diversified in global and international bond funds, with great managers picking the appropriate countries and currencies. As far as stocks are concerned, I still believe they are the best investment for growth in the long run. Although prospects for return may be diminished in the new normal, they remain the primary option for inflation beating returns. We mitigate risk by using mutual funds for professional management and security selection. We provide a secondary level of diversification with our asset allocation and bucket approach. A third level of protection is added by monitoring withdrawal rates and making adjustments at regularly scheduled reviews. We are attempting to focus on what we can control.

One thing we can't control is weather. A couple weeks ago I took a long weekend to build a dock at my camp because of the balmy forecast. I was treated to single digit temperatures, driving rain, and wind. It probably saved me some nasty splinters and gave me a chance to catch up on reading and work on a pro-bono planning case I volunteered to look at. To the shock of her family, a woman who wasn't financially prepared submitted her retirement paperwork to take care of her husband with Lou Gehrig's disease. After parsing the numbers and talking to everyone involved, I was confident she understood the financial consequences and the resulting hardship her decision would bring. I made some suggestions that would help close the monthly income gap, but what was most important to her was time. Time with her husband, being there with him through this terrible ordeal. And after 26 years of doing this, I know from far too many experiences that at some point we'll all be brought to a place where we'd gladly trade all of our money for just a little more time. The holiday season gives us a chance to approach life from this unique perspective.

I've never been more delighted at the prospect of flipping the calendar to a new year and a fresh start. If last year was a bad one, this past year was absolutely horrendous for so many of the clients in our Horizon Group family. We said final goodbyes to far too many wonderful people. We helped countless others undergoing dangerous procedures, enduring grueling treatments, and many overwhelmed with sadness and loss. Life is not always fair. But it allows us to experience tremendous joy as well. Many of you experienced it this year with the birth of a grandchild, at a family wedding or reunion, taking special trips, celebrating milestones, and spending time with family. My holiday wish for you this season is that you wring all the joy you can from the time you have with the people you love. Don't waste a minute of it following the fiscal follies; I assure you I'm doing enough of it for all of us. We wish you and your loved ones a Happy Hanukkah and Merry Christmas. May you be blessed with good health this coming New Year!

Mark Congdon, and your friends at The Horizon Group

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Odds and Ends……

It's hard to believe but our 20th annual Financial Fair is just around the corner. We've enclosed an invitation for Saturday, January 26th at the RIT Inn and Conference Center. The theme of the fair is "The Future is Brighter than You Think". This year's event was originally booked at MCC in their 550 seat theater. Unfortunately, they canceled our contract to perform renovations. Since we were cramped last year at RIT, we'll be hosting two sessions of the exact same program to keep seating comfortable and provide plenty of conference tables to sit at (we really do read the comment cards!). The morning session will start at 8:45 a.m. and the afternoon will start at 1:30 p.m. In between the two offerings at noon we'll be hosting a special breakout session. Two dynamic representatives from Apple will show clients with iPads and iPhones how to get the most from their products. Plan to stay if you're choosing the morning show, or come early if you're attending the afternoon session. Make your reservation early, we're limiting attendance to 300 for each session!

Ken Blazick and Mike Silverstein are completing a very successful year with our group. Most of you had a chance to meet the pair. Ken is specializing in helping younger clients still accumulating assets for retirement and protecting young families. Mike is a very successful money manager and is ending his first year with me with over $20 million under management. I'm excited to announce that both are opening their own offices. We're putting the finishing touches on a new 1200 square foot office and conference room for Mike across from my cobblestone in Erie Station Village. Ken will still keep an office with me but is opening a satellite office in his beautiful hometown of Lewiston, near Artpark. The addition of this extremely qualified pair has allowed me to help many of your children and friends in need of advice but without the assets to interest a qualified advisor. Terry and I are still taking new clients at the point of retirement on a limited referral basis. But both Ken and Mike will gladly help anyone you wish to refer to them at any stage of life, and with any amount of assets.

Obamacare is a political lightning rod these days. I'm sure you are well aware of where I stand on this issue. However, this controversial national healthcare program may end up being a godsend for many Kodak retirees whose coverage was cut but are too young to be on Medicare. If New York fully implements the healthcare exchange by 2014, anyone who was laid off or had healthcare eliminated should be able to attain coverage at reasonable rates. I've benefited personally by being able to keep a 22-year-old and 24-year-old child on my coverage. It will also allow many people to leave terrible jobs they're stuck keeping for access to healthcare.

Several weeks ago I had the privilege of having one of Wellington Asset Management's fund managers drop into the office. We had a long talk about the fiscal cliff and the outlook for stocks and bonds. My biggest takeaway was the firms' extremely positive view of foreign bonds.

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