Are We On Track For Dow 20,000?

-J. Kevin Meaders, J.D, CFP®, ChFC, CLU

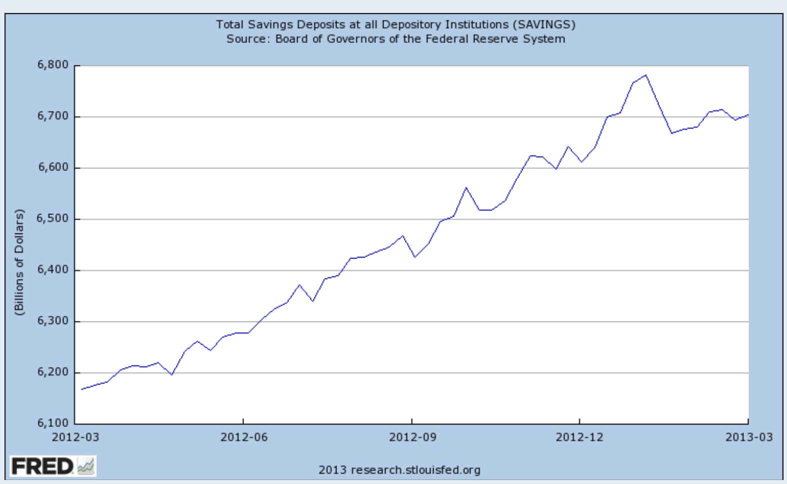
April, 2013—In my article last December, "*The 'Fiscal Cliff' is Just Another Y2K*" I explained that:

> "The economy, through artificial monetary manipulation, essentially goes through two repetitive phases: an expansion phase and a contraction phase. It is during the contraction phase that depressions and recessions occur, and during the expansion phase that money is misallocated into artificial booms.
>
> Through these lenses, we can clearly see that our economy—and indeed the entire world—is in a monetary expansion phase. History has taught that no matter the immediate cause of market pullbacks—Y2K, the U.S. losing its AAA rating, the budget deficit crisis, Libya, Syria, Obama's re-election, the Fiscal Cliff, the Aztec Calendar, the coming Israel-Iran confrontation—the market will continue its general trend of expansion and inflation."[1]

And so it has been. What happened to the Fiscal Cliff countdown clock? The debt ceiling government shut-down clock? America losing her AAA rating?

Oh, and wasn't the government spending sequestration going to crash the economy? Hopefully by now most of us have learned not to trust the media or the talking heads on TV.

In any event, what I've been talking about has finally started to come to fruition: money has started flowing *out* of cash and back *into* stocks. The chart to the right is a close-up of savings accounts in the U.S., focusing on the last twelve months.

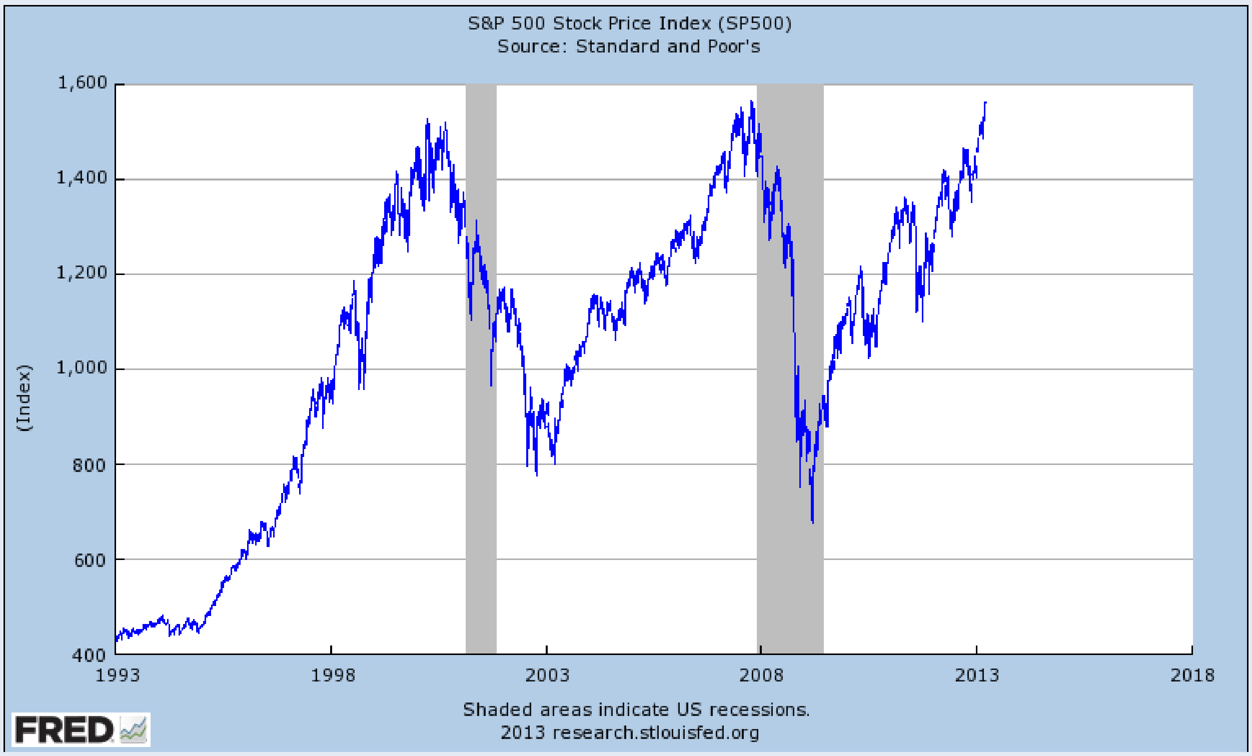


You can see the recent reduction of cash. Checking accounts and money market funds also show a similar decrease.

[1] J. Kevin Meaders, *The Fiscal Cliff is Just Another Y2K*, Dec. 2, 2012.

The recent stock market advance that is occurring simultaneously to these reductions is no coincidence: as I've been saying *ad nauseum*—just follow the money.

And here it is. The chart below shows the S&P 500 for the last 20 years. You can see that we are very close to the S&P 500's all time high. The Dow Jones Industrials Index has already surpassed its all-time high. It would seem the growth run we've all been waiting for has finally arrived—or has it already occurred? Perhaps both.



What are the chances, do you think, that the market will crash again in the future? We believe it is 100%. The next two questions then become critical:

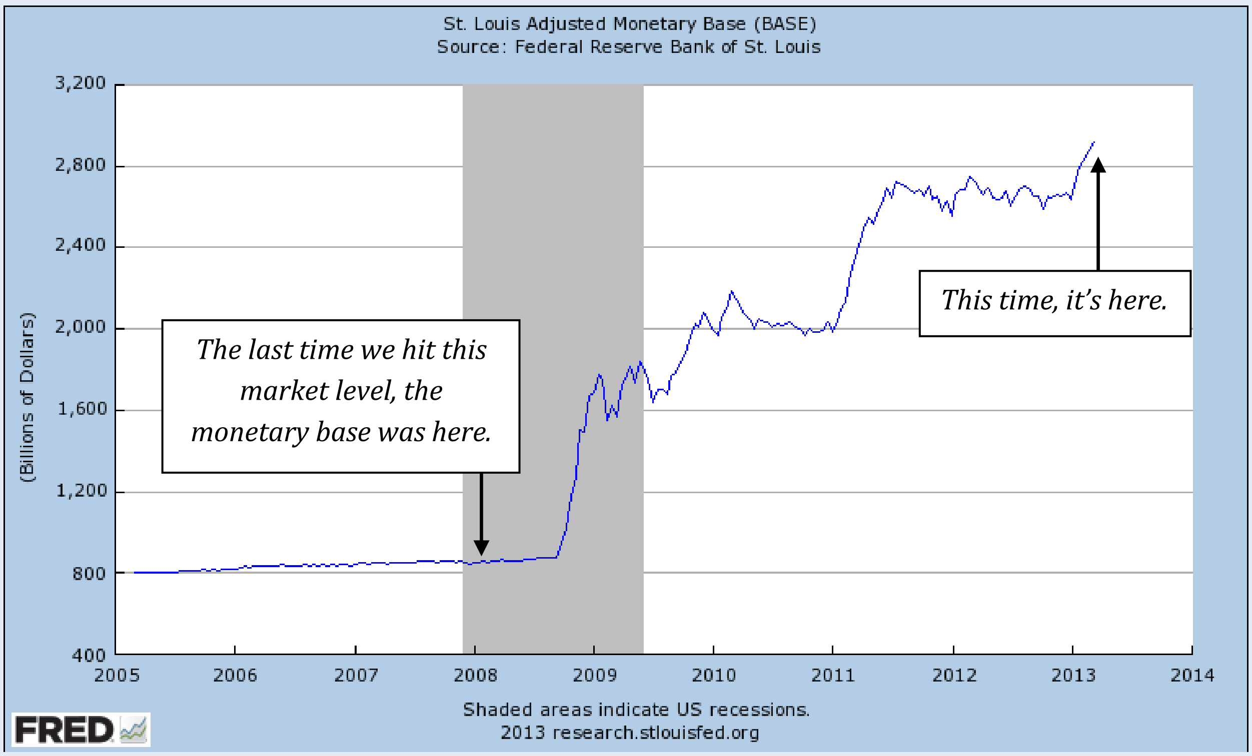
1. How much higher can/will it go before crashing?
2. When will the next crash occur?

Let's answer the second question first. According to our Austrian economists (Mises, Hayek, Hazlitt, and others) a market crash is preceded by monetary contraction (money destruction/rising interest rates), which we can generally follow by watching the Fed Funds rate—the interest rate the Fed artificially manipulates.

We also believe that we are in no real danger of that occurring for another year or two, according to what the Fed Governors are saying. Even then, once they *do* start raising rates and shrinking credit, history has shown that it takes a while to crash the party. Just think, the Fed's been pumping fresh money into the system since 2008, and many would say the economy *still* hasn't fully recovered—and it's been a good five years.

So our best estimation would be that we have another four to six years before experiencing another crash—which could be worse than what happened in 2008—depending on how much money actually ends up in the market. Which brings us back to question number 1. How high can we go?

To answer that, let's look at another chart. This chart represents our monetary base—or the amount of money that has been created and released into the economy. Note that it shows only the *base* amount, not the *actual* amount, which would be far greater.



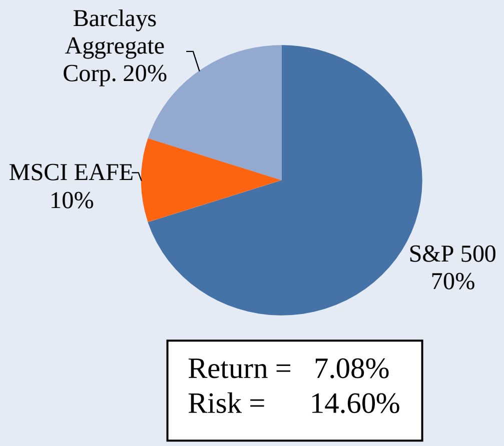
Now consider this: When the S&P 500 was last at its current level—in 2008—the monetary base was (only) a shade over $800 Billion. Today, as you can see above, the base is almost $3 Trillion! If all things hold true and we do some simple math, then the market, *RELATIVE* to the money base, could see the S&P grow to an astonishing 5500 (about Dow 52,000) before toppling. Although we don't really expect to see those levels, it is a mathematical possibility.

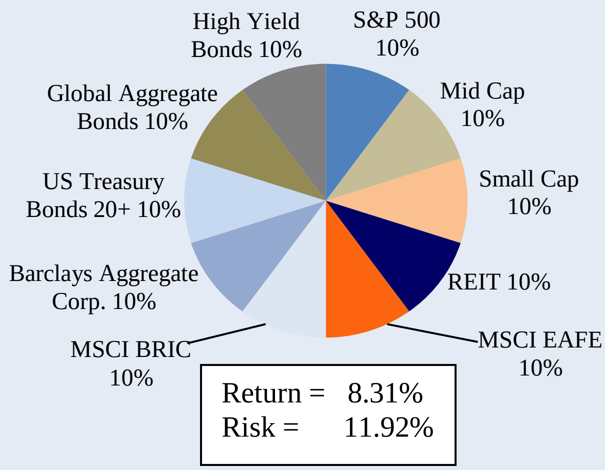
Our average portfolio—consisting of 65% stocks and 35% bonds—has a significantly lower overall risk than the general market, as defined by the S&P 500. The S&P 500's standard deviation (a measurement of risk) is about 17. Our 65/35 portfolio has a standard deviation (risk) of about 10.

In the last three years this same portfolio has returned over 12% per annum, while the S&P 500 has returned about 1% more, according to Morningstar®. Thus, roughly the same return was obtained with about 60% percent of the risk of the S&P 500, which you may remember, was down over 50% during the last market crash (see chart on page 2, *supra*).

So how does one build a better portfolio, properly allocated and diversified?

Please compare the following two graphs. The one on the left illustrates a portfolio concentrated mainly in the S&P 500, while the one on the right illustrates a portfolio equally weighted among ten asset classes. For the period 1995-2011, the equally weighted portfolio on the right produced a higher return, while also providing lower risk.





Index returns for the period 1995-2011 (YTD): S&P 500, S&P400 Midcap, S&P600 Smallcap, MSCI EAFE, MSCI BRIC, Barclays Capital U.S. Corporate Bonds, Barclays Capital U.S. Treasury Bonds, Barclays Capital Global Aggregate Bonds, Barclays Capital U.S. High Yield Bonds., NAREIT REIT. For illustration only. Past performance is not a guarantee of future results. Investors cannot invest directly in an index.
Source: FactSet. Returns data from 9/30/1995-12/30/2011.

These portfolios above have been constructed using indices. Our Investment Committee process uses indices only when we can find no superior alternative, such as an ETF or fund manager that provides the potential for an even greater return for an even lower level of risk

The good news is that the next phase of the investment/business cycle seems to have finally arrived, and the next few years should prove profitable. We see this recent market run as a sign that investors are finally getting their appetite for stocks back, and though we should see interim market pullbacks, the overall trend should be growth-oriented. As you know, investing is always subject to risk and no one can predict the future. While economic/market cycles and trends may be useful knowledge, past performance does not guarantee future results.

While we believe that our outlook is getting rosier, remember that after a period of time—perhaps one to two years—inflation will force the Fed to begin raising rates. We believe this will herald the beginning of the end of this bull run. For us, it will signal the need to begin reversing our allocation—just as we did in 1999, and just as we did in 2007.

Please enjoy the following required disclosures, with my compliments…

The views and opinions herein are those of J. Kevin Meaders, J.D., CF®P, ChFC, CLU and should not be construed as investment advice. All information is believed to be from reliable sources; however, we make no representation as to its completeness or accuracy. Additional risks are associated with international investing such as, currency fluctuation, political and economic stability, and differences in accounting standards. Investors cannot directly invest in indices. Past performance does not guarantee future results.

All indexes are unmanaged and an individual cannot invest directly in an index.
Index returns do not include fees or expenses.

Index Disclosures

Barclays Capital Global Aggregate Bond Index measures a wide spectrum of global government, government-related, agencies, corporate and securitized fixed-income investments, all with maturities greater than one year.

Barclays Capital U.S. Aggregate Bond Index is composed of U.S. securities in Treasury, Government-Related, Corporate, and Securitized sectors that are of investment-grade quality or better, have at least one year to maturity, and have an outstanding par value of at least $250 million.

Barclays Capital U.S. Corporate Bond Index is a component of the Barclays Capital U.S. Aggregate Index.

Barclays Capital U.S. Corporate High-Yield Bond Index tracks the performance of non-investment grade U.S. dollar-denominated, fixed rate, taxable corporate bonds including those for which the middle rating of Moody's, Fitch, and S&P is Ba1/BB+/BB+ or below, and excluding Emerging Markets debt.

Barclays Capital U.S. Treasury Bond Index is a component of the Barclays Capital U.S. Aggregate Index.

MSCI BRIC Equity Index is a market capitalization weighted index of about 320 companies located in Brazil, Russia, India and China.

MSCI EAFE Index is a free float-adjusted market capitalization weighted index designed to measure the developed markets' equity performance, excluding the U.S. & Canada, for 21 countries.

S&P MidCap 400 Index is a benchmark for mid-sized companies, which covers over 7% of the U.S. equity market and reflects the risk and return characteristics of the broad mid-cap universe.

S&P SmallCap 600 Index covers approximately 3% of the domestic equities market and is designed to represent a portfolio of small companies that are investable and financially viable.

S&P 500 Index is a gauge of the U.S. stock market which includes 500 leading companies in major industries of the U.S. economy.

Past performance is no guarantee of future results.

About J. Kevin Meaders

kevin@magellanplanning.com

Kevin Meaders graduated from Oglethorpe University in Atlanta with a double B.A. in Philosophy and Political Science, and then obtained a law degree from Georgia State University College of Law, focusing on estate planning and trust law. He has earned the designations of Certified Financial Planner (CFP®), Chartered Financial Consultant (ChFC) and Chartered Life Underwriter (CLU). He holds a General Securities Principal and Registered Representative registration and Investment Advisor Representative registration through ING Financial Partners (member SIPC).

About Magellan Planning Group

www.magellanplanning.com

Magellan Planning Group was established in 2000 to provide a service uniquely tailored to the needs of our affluent Atlanta community. We concentrate on *personalized* retirement planning through tri-disciplinary coordination:

- Financial planning with our Certified Financial Planner™ to prepare a retirement plan that takes into account your needs and expectations. We are a fee only asset management firm.
- Estate planning with our in-house Attorney-at-Law to determine and prepare the documents needed to minimize family liability and maximize privacy. (www.magellanlegal.com)
- Tax planning through a relationship with our in-house CPA to manage tax obligations throughout the year and prepare a tax return that takes into account current tax laws. (www.magellantax.com)

Our relationship doesn't begin and end with the preparation of a plan and the appropriate documents. We establish close personal relationships with our clients and their families and maintain those relationships through regular 'check-ups', market commentaries and educational Lunch & Learns.

4170 Ashford Dunwoody Rd. NE, Suite 480
Atlanta, GA 30319
404-257-8811