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RETIREMENT & WEALTH PLANNING • INVESTMENT MANAGEMENT & DESIGN

**August 2015**

# Summertime Slump in the Stock Markets… Again

***Questions from the Field:***

During the course of teaching seminars, writing articles and newsletters, and meeting with clients we hear lots of questions. We will try to address some of the more timely and relevant questions that investors, executives, and retirees are asking us. Our question(s) for this month are:

Q: *The stock market is dropping – am I still invested in the right places? Should I do anything?*

I was up early Monday morning, reading the global economic news. I have been in the investing and wealth management business professionally for over 20 years, and a stock investor since I was a teenager in college, and have been through many market downturns. After all these years it is still as unnerving and unsettling this morning, to see investments drop in value, as it was each and every time before this.

A natural response, and some of the questions that clients have been asking us are; what is going on? Are we still invested in the right place? What should we do? And I think that underlying all of the uncertainty, our most basic drive and need is whether we are still going to be all right financially – if we will be able to maintain and/or reach our goals of financial security.

Let's try and take our perspective from history and review some facts to help put the last weeks into context.

## Stocks are Important for Retirement Success

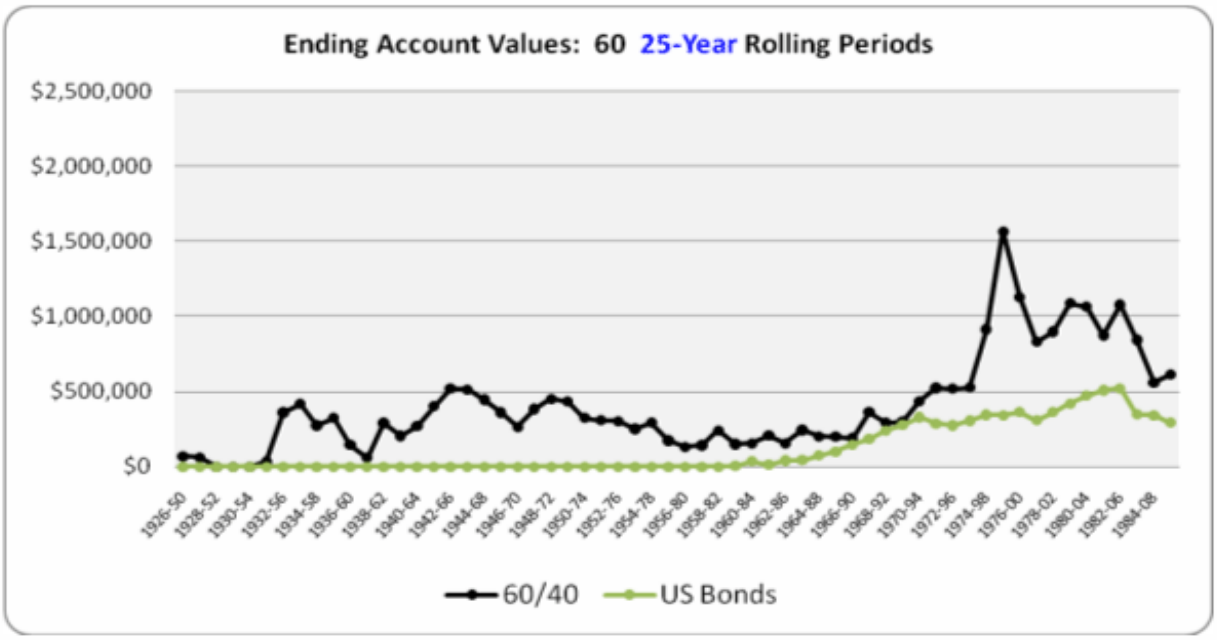
Owning stocks as part of our portfolio is a vital to our retirement success. History has proven time and time again that a retiree is potentially far better off with a healthy allocation of stocks in their portfolio – even though stocks tend to have large drops in value from time to time.

The graph below gives a very clear portrayal of that truth. A study performed by Dr. Craig Isrealsen in 2010 compared two retiree portfolios; 100% government bonds that are essentially principal risk free,

and a mix of 60% stocks and 40% bonds - and asks the question, what will the value of that retiree portfolio be at the end of 25 years if the investor takes 5% of the portfolio per year for income?

$100,000 starting balance
**5% initial annual withdraw ($5,000)**
3% annual cost-of-living adjustment

100% bond portfolio: 45% success ratio
60% large US stock/40% bond portfolio: 95% success ratio




("*Death by Withdrawal Rate*" Dr. Craig Israelsen, PhD)

The answer from history? Going back to before the Great Depression, a portfolio of at least 60% stocks had a 95% success ratio and usually had a higher balance at the end of 25 years than when the investor started. The "risk-free" bond portfolio fared miserably by contrast – failing over half the time, and often falling to a zero balance before the 25 year periods ended.

*(Past performance is not indicative of future results. Investing involves risk, including loss of principal.)*

## Ten Percent drops are Common (and so are larger drops)

As I am writing this the US Stock market has dropped about 10 percent from its high of a few months ago. While uncomfortable it is hardly new – as we have had similar drops **123 times since 1900.** In other words, a ten percent drop has occurred regularly and like clockwork about once per year since our grandparents time. Larger drops of twenty percent or more happen a little less often, but still commonly occur about every three years.

Market history also tells us that the market tends to recover fully from a ten percent drop in about a year or sometimes less, and tends to recover fully from a twenty percent drop in about 3 years.

| Declines in the Dow Jones Industrial Average (Dow) | | | |
|---|---|---|---|
| | Dip (5% or more) | Correction (10% or more) | Bear (20% or more) |
| Number | 388 | 123 | 32 |
| Per Year | 3.4 | About 1 | About 1 every 3.5 years |

Source: Ned Davis Research, 1/2/1900–12/31/2013.

The application to us as investors – stock market drops happen all the time, and they usually recover with a little patience.

*(Investors cannot invest directly in an index.)*

## History Rewards Risk Taking

Is it worth it to own an investment like stocks that drop so much and so often? The answer from history is a resounding yes.

*US Stock Market (Dow Jones Average) 1900 - Now*

(www.stockcharts.com)

Value of One Dollar Invested by Asset Class: 1928-2004

- **Large Value Stocks: $5,642**
- **Large Growth Stocks: $859**
- **Small Value Stocks: $43,604**
- **Small Growth Stocks: $1,164**

*(Source: Eugene Fama, Kenneth French, University of Chicago)*

An investor may have more money and, as we just saw, might potentially have a better retirement if they own stocks for the long term.

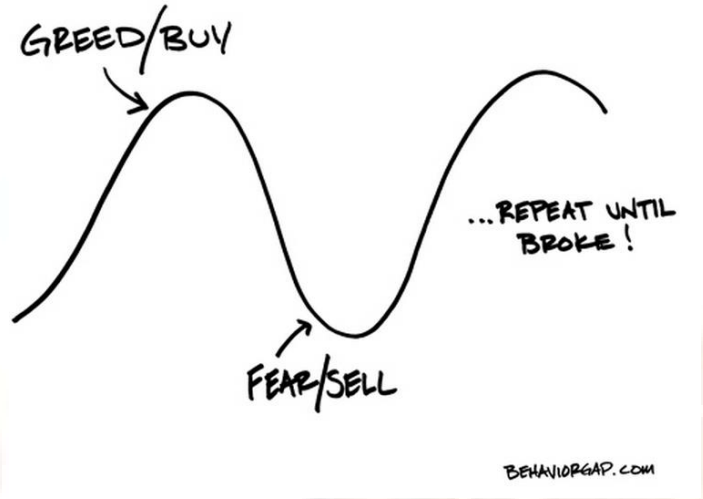
## Diversification Helps

A diversified mix of investments can often help mitigate risk. 2015 gives us evidence of this in our portfolios as overseas stocks as a whole are down less YTD than US stocks. Furthermore, during the last month, bonds in general, gold and gold stocks are actually up in value while most stocks have been declining.


Another important part of our diversification plan is dividends. Dividend stock investments in general tend to be down less this year than the overall US stock market, and we have the optional benefit of reinvesting our dividends at the current lower price also. We significantly increased weightings to dividends several years ago in most client portfolios.

A proper diversification plan is taking a little of the sting off this current downturn, and can be an effective long term part of our investing strategy.

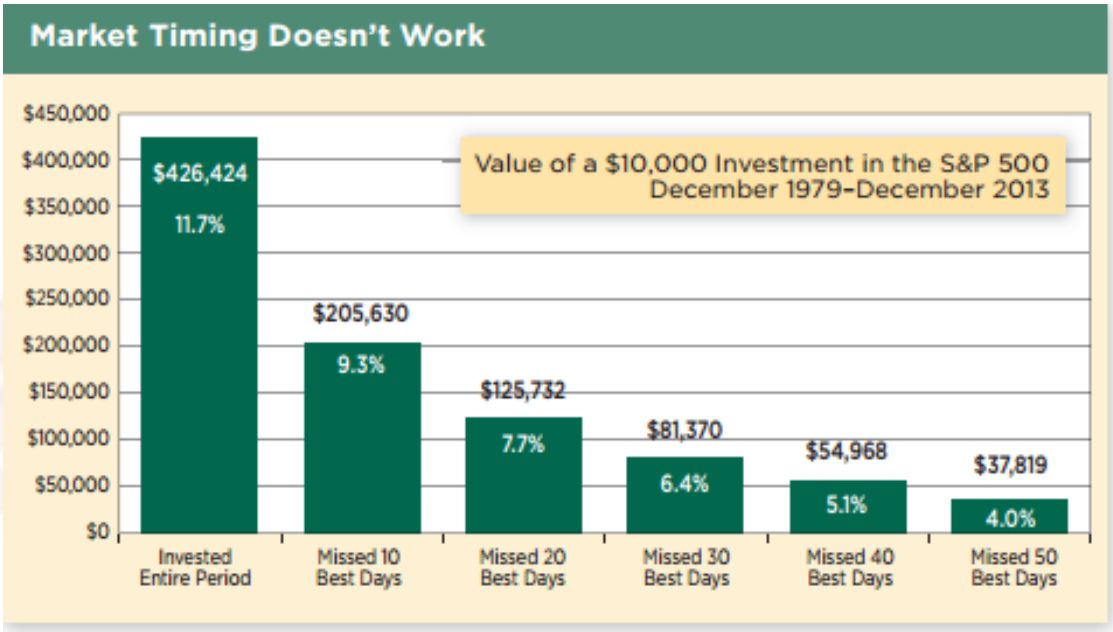
## Market Timing does not Work




A temptation that all of us as investors have is to try and time the market – that is to make major changes in our allocations in anticipation of the markets going up or down. Unfortunately market timing does not work. The investment markets are random and unpredictable, and subject to so many economic, political, social and other influences that it is impossible to know where the markets will go in the short term.

Said Peter Lynch, Fidelity's famed investment chief and perhaps the most successful mutual fund manager of all time,

***"Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in corrections themselves."***




(*https://www.edwardjones.com/groups/ejw_content/@ejw/@us/@graphics/documents/web_content/web034039.pdf)*

The only sure thing we know about market timing is that avoiding that temptation and staying invested through good times and bad has been very effective throughout history.

## Financial Media is not your Friend

The financial media is not working with investors' best interests in mind. Rather, their motivation is to sell magazines, drive viewers to websites and blogs, and higher ratings for TV shows. They try to create drama, titillate and scare, all in the hopes of increasing readership, views and clicks.

The tried and true principles of diversification and patience make for dull reading and poor headline fodder. Use discernment when you read and remember that the media's goal is to try and upset, captivate and sell to you.

## Still Investing – Take Advantage of Lower Prices

If you are still a net investor, that is you are regularly or periodically adding new money to your portfolio, than a market drop means that stocks are on sale. Many of our clients have liquidity events happening or excess cash flow that allows the opportunity to add to their portfolio, and obviously we would rather make new investments when prices are down.

However, there is an old Wall Street saying, "*Don't try to catch a falling knife.*" It would be appropriate for us to discuss and try and fine tune when and where to add new investment dollars given the current uncertainty. Let's review this topic at our next meeting.

## Review your Cash and Liquidity needs regularly

A significant number of clients read our May newsletter (***Dow 18,000 – What Should I do About Risk?***) and took withdrawals from their portfolios for cars, vacations and other spending, paid down debt, raised cash, and made gifts to family and charity.

No matter what level the markets are at, it is important to review our cash and liquidity needs regularly and make sure we have a long term income plan in place. If we have those retirement basics thought through and implemented, a downturn might have a lesser impact on us.

This is a regular topic of our client review meetings, and of course please let us know if something has changed in your cash and income needs before our next meeting, or you would like to review this subject again.

The previous principles are long standing investment maxims that have helped guide investors to success through the years, and are timeless in their application. Let's also look at some specific issues that are timely to our portfolios and financial lives today.

## It's Happening Again - 2011, 2012, 2013, 2014, and now 2015

Five of the last six years have seen significant downturns in late summer/fall. 2011 saw a 2000 point drop in August and then a second drop in October. 2012 also saw a 1000 point drop in early summer, and again a slightly smaller drop in October. 2013 again had an August and October double drop of close to 1000 points each time, and finally 2014 once again had two drops in August and October. In each of those years the stock market fully recovered and ended in the black for the year. *(Please see the graphs for each year at end of this letter.)*

So here we are again and we are once more watching a late summer tumble in the markets in 2015. Will this time be different than the last four times? No one knows, but it does lend some perspective that this has been a somewhat regular occurrence in the recent past. History also tells us that October is the worst month of the year to be invested in stocks, and that November and December are often some of the best months of the year.

## This Could get Worse…

As I am writing this the US stock market has dropped about ten percent since its high of the year in May. Remember we have seen larger late summer drops in recent years, and again even a 20% drop is a regular event in stock market history. A 20% drop would put the Dow Jones Average at a level of about 14,700 – another 1200 points down from Monday's close. The Dow Jones average was last at

that level in October of 2013 – so another way of looking at a 20% drop is a retracement of the last two years' progress.

So will it get worse? I don't know and neither does any other self-proclaimed guru, seer or market prophet. There are some huge unanswered questions about the economy and the markets; What happens to the stock markets and economy when the Fed finally stops printing money? What about the skyrocketing US debt? What about the 3 Trillion plus in new money that the Fed has created since 2008?

If you are a long time reader of our letters you know that I have been writing about Quantitative Easing and money printing, the US Debt, and the US dollar for the last ten years, and that I have a great deal of concern about how all these will play out over time. There is no definitive answer, but a broad diversification plan and a robust income and cash & liquidity plan is perhaps the best response in the face of the economic uncertainty due to the historically unprecedented and egregious actions of the Federal Reserve.

## When will the Fed raise Interest Rates?

When I was a young boy in school I got in a trouble. A lot. Nothing horrible by today's standards, my mischief usually involved talking too much or goofing off in class resulting in a trip to the office and a call to my Mom. We had a patriarchal family; my Mother would make me wait in my room after school, always accompanied by the threat of, "*Just wait until your Dad gets home!*" I had a very strict European father who did not tolerate any misbehavior from his children, and I was scared of him and his punishment.

Several hours alone in my room, waiting in dread for what came next was almost unbearable. The longer I had to wait, the worse my potential punishment grew in my mind. It was somewhat of a relief when he finally did come home, and I received the spanking or other consequence that I probably deserved. Looking back at it, I think that the contemplation of the punishment during those hours confined to my room might have been worse than the punishment itself.

The US Markets are kind of like I was back in my school days. Just like I was dreading and waiting for my Dad to come home and give me a punishment – the markets are dreading the threat of an interest rate increase by the Fed. Just like me they have had to wait a long time, and just like me, the longer the wait, the more uncertainty, and the more upsetting the thought of the event became.

The Fed has been hinting at a rate increase now for almost a year, and as a result there has been a great deal of volatility in the stock market. The more imminent that the pundits and markets believe that rates will increase, the worse stocks behave.

Perhaps just like with my Dad, the actual event will be less traumatic than the anticipation of it. As long as the Fed delay and lingers over the rate increase, it is highly likely that uncertainty will remain high and stock prices may respond accordingly.

## China

The Chinese stock market has dropped recently, worse than US markets. Companies with significant sales in China like Apple and Luis Vuitton (LVMH Group) have seen their share prices drop with worries that demand by Chinese consumers will slow down. Commodities like copper and oil have also fallen as China is the world's largest consumer of basic goods and any slowdown is likely to impact most commodity markets as well.

Much ado has been made in the media about this, and it certainly a very large drop. But again, to try and put things into some logical perspective, the Chinese stock market has more than doubled since 2013 before this current pullback, and even with worries about the Chinese economy and a slower projected growth rate, China is still expected to growth their economy at roughly triple the rate that the United State is.

Shanghai Composite Index – Jan. 2014 - now


## Oil Prices are Low

Oil prices are hovering in the low $40 to high $30 per barrel range, less than half of what we saw in early 2014. There are two groups that are particularly and adversely impacted by that; Saudi oil sheiks (and other energy exporting countries like Canada and Venezuela and Russia,) and most energy companies.

Outside of that group, low energy prices are a tremendous boon. Airlines are happy, energy intensive industries are happy, manufacturing jobs become more competitive domestically with cheap energy, farmers are happy, and consumers are overjoyed. Economists have estimated that every 1 cent drop in gas prices at the pump translates into about a $1 Billion additional stimulus into the US economy. Some rough math suggests that the US might enjoy an additional $150 Billion annually benefits as gas prices are about 1.50 gal. lower now than they were in early 2014 – a tremendous boost to our economy.

## So what should we do?

Is it uncomfortable to watch our investments go down – heck yeah! Nobody enjoys that feeling. Should we do something now? Warren Buffet famously said,

***"Lethargy bordering on slothfulness is the cornerstone of our investment style."***

The key principles as always are to review your short term needs for cash and liquidity, have a sound income plan in place, know and regularly review your risk level and risk tolerances – all topics that we try and discuss on a regular basis, and implement individually as appropriate.

We look forward to our next review meeting, and as always we are available to answer questions and discuss concerns if you want to contact us before our next scheduled meeting.

We hope you have had a wonderful summer and enjoyed our delightful weather (at least for those of us in Seattle!) with your family.

Warm Regards,

Willy

William R. Gevers
Financial Advisor

PS: *We have been repeatedly asked by clients if they could share these e-mail notes with their friends or neighbors. Please feel free to forward this with the stipulation that it may only be forwarded if done so in its entirety with no portions omitted. We would be delighted to share our comments and opinions with your friends, and welcome your comments and feedback. If you received this and would like to be included on our newsletter list, please email us at info@geverswealth.com*

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2011 DJIA Return:

2012 DJIA Return:

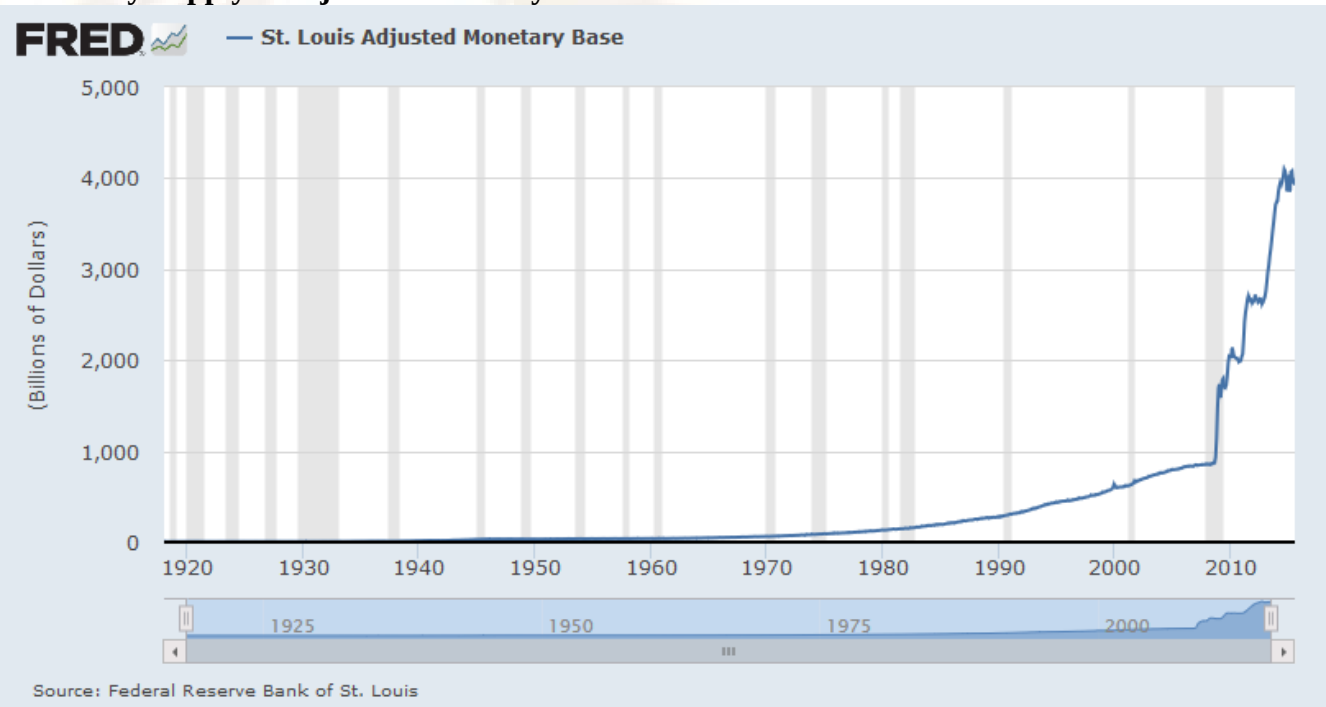

2013 DJIA Return:

2014 DJIA Return:

# US Money Supply, US Dollar, and Inflation/Deflation Watch

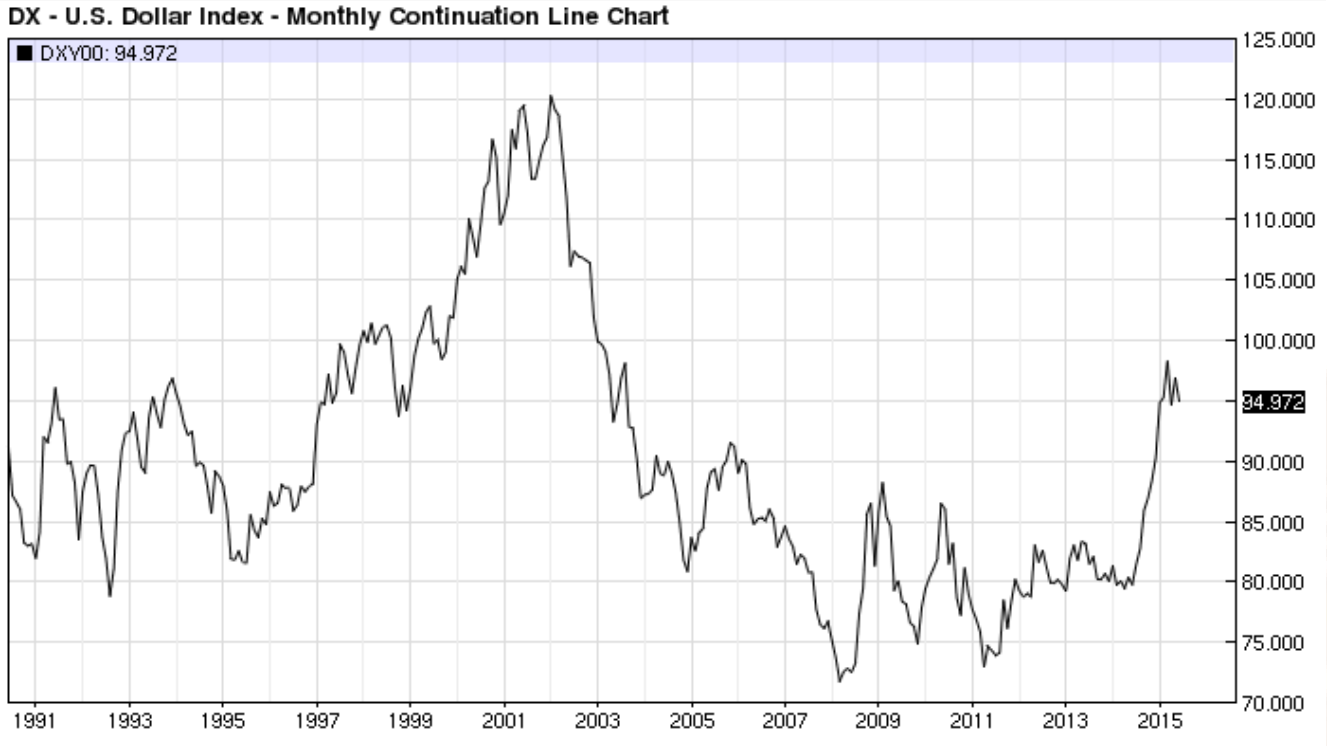
*"Neither a wise man nor a brave man lies down on the tracks of history to wait for the train of the future to run over him." - Dwight D. Eisenhower*

**US Money Supply – Adjusted Monetary Base**



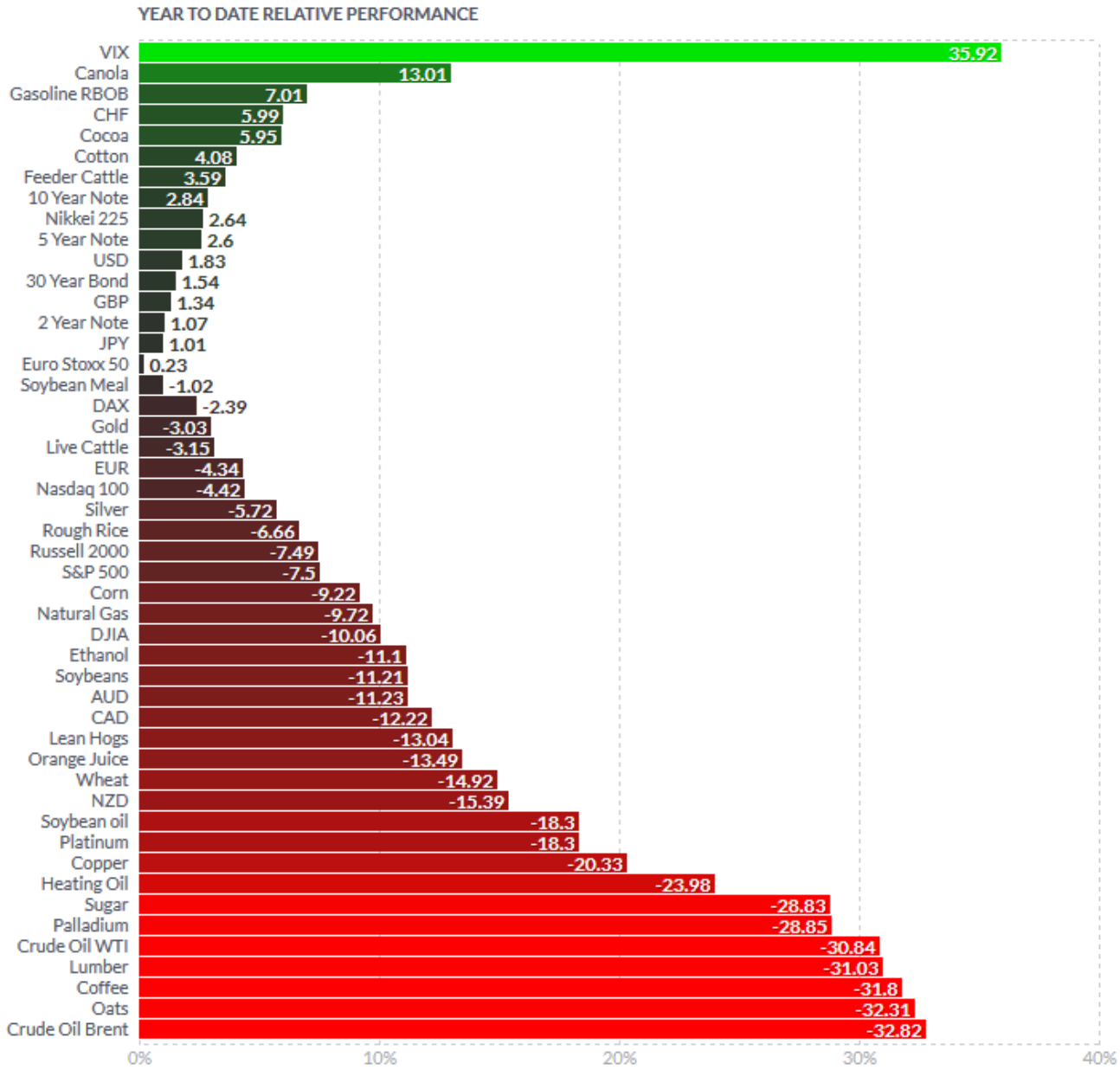

*(http://research.stlouisfed.org/fred2/graph/?s%5B1%5D%5Bid%5D=AMBNS#)*

**US Dollar Price – (DXY) USD Index measured against other currencies**



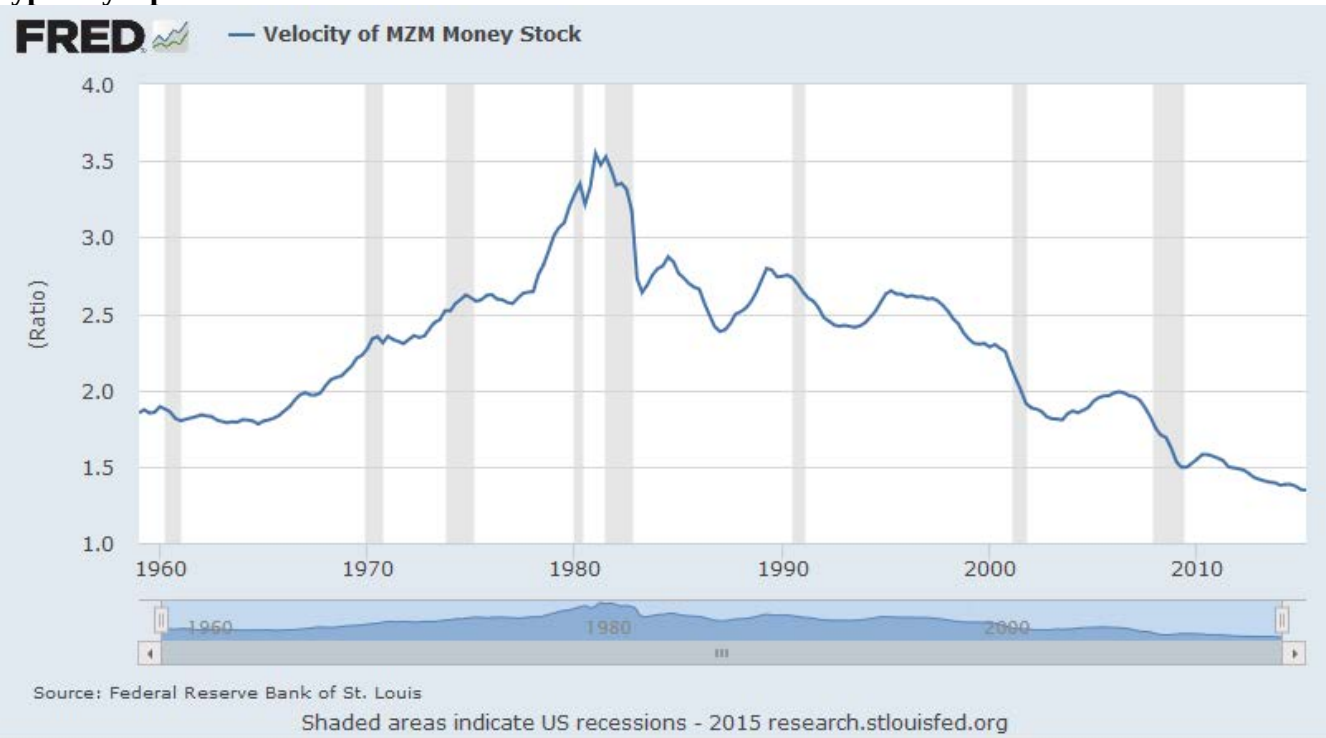

*(http://www.barchart.com/chart.php?sym=DXY00&style=technical&template=&p=MC&d=X&sd=&ed=06%2F11%2F2015&size=M&log=0&t=LINE&v=0&g=1&evnt=1&late=1&o1=&o2=&o3=&sh=100&indicators=&addindicator=&submitted=1&fpage=&txtDate=06%2F11%2F2015#jump)*

**Inflation/Deflation -Year to Date price increase in commodities and basics as measured by futures**




*(http://www.finviz.com/futures_performance.ashx?v=17)*

**Velocity of Money – Velocity is a measure of how quickly money is spent. High velocity is typically a precondition for inflation.**




*(http://research.stlouisfed.org/fred2/series/MZMV)*