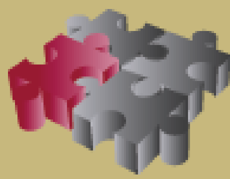

Andrew Brief Retirement Strategies, Inc.

"Dynamic Planning for Lifelong Relationships"

Brief Notes May 30, 2013

Market Psychology

Much of the endless amount of "information" inundating us from the media and other sources can certainly be emotionally compelling. What actions we take (or not take) after processing these emotions can make the difference between success and failure regarding almost everything we do. Retirement planning and investing are certainly no exceptions. This is what makes "market psychology" so interesting and relevant regarding our client/advisor relationship.

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The Ups & Downs of Market Psychology

Given all the uncertainty that has existed in the world throughout our investment lifetimes, I would argue that there has never been a time when any of us have been truly comfortable and at ease regarding our investments. The present day is certainly no exception. However, as Markowitz and the fathers of modern portfolio theory have clearly stated, it is this uncertainty or "perceived risk" that allows equity and bond markets to provide potential returns that are in excess of other "risk free" choices.

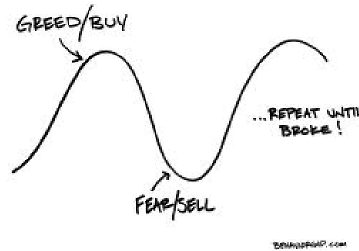
As we know, investment risk is not the only risk we face. Inflation and purchasing power risk must also

be considered if it is our goal to avoid outliving our assets in retirement or face the undesirable choice of reducing the standard of living we have become accustomed to enjoying. If achieving returns greater than what "risk free" investments (Treasury Bills for example) provide is necessary to accomplish this goal, than we must accept some level of investment risk and the uncertainty that comes along with it.

Where does that leave us? With an uncertain financial future subject completely to the whims of the financial markets and an economic environment we cannot control? No doubt there are many investors that feel this way. Every now and then, it is no surprise when some of our clients show signs of being affected by the doubt that this uncertainty creates.

The fear that stock or bond market prices may fall continually exists. When we are in bear markets, the extremely negative sentiment that exists in the media helps heighten the fear that prices could fall lower. In bulls markets we are "happier" about our growing net worth, but the fear of the tenuous nature of the market and our good fortune doesn't go away. In most cases, how we react (or don't react)to that fear is the determining factor in our financial success and of course the greater the level of fear, the greater the chance that our emotional reaction will negatively effect our outcome.

March 9, 2009-The start of the latest bull market!



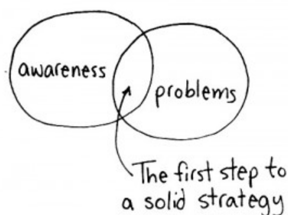
Having a Game Plan is the Only Real Solution

This is where we see our role as your trusted advisor. Our goal is not to eliminate your concerns as some level of uncertainty will always exist. However, if we can help enhance your level of confidence regarding the accomplishment of your financial goals, the level of fear that may exist in these uncertain times, when markets are both good and bad, should be greatly reduced; thus, we enhance the likelihood of avoiding the emotional decisions that may hurt our prospects of financial independence.

Having a well thought out game plan is the key to this approach. If we view bear markets as normal and expected occurrences that cannot be predicted, and we base our game plan on succeeding even in light of these facts, fear should be reduced, and the focus on the uncertainty of market volatility is replaced with a longer term, goals based evaluation of one's financial well-being.

How do we accomplish this?

1) Communicate a clear and accurate understanding of what your money must do for you to be successful in quantifiable terms. Helping define what success means by identifying your current lifestyle through a careful cash flow analysis is the first step. Then, we must be realistic regarding the available resources at and through retirement to produce the necessary income to help maintain this identified standard of living (inflation adjusted).



2) The identification of and the adherence to an appropriate withdrawal rate. This is the key factor regarding portfolio longevity. Tolerance regarding portfolio volatility, age (potential longevity) and desired lifestyle are the considerations that go into understanding how this can affect your financial well-being over time. For those with excessive withdrawal rates, this has been communicated to you and could be the largest contributing factor for not withstanding poor market

performance and the possibility of exhausting assets prematurely.

3) Having a clear understanding that a significant and appropriate amount of your portfolio is invested outside of the stock market. For those approaching or are in retirement, your portfolio is designed to produce the income necessary to maintain your desired standard of living for a considerable period (generally 8 years or more) without having to liquidate stock funds that have temporarily declined in value (as we know however, positive returns are not guaranteed).

4) Develop and maintain an appropriate asset allocation[1] to address your ongoing income need while also addressing the need to grow your income over time to combat inflation and longevity risk. Balancing market risk (portfolio volatility) with purchasing power risk is the goal while adapting your asset allocation with changes to your personal circumstances.

5) Extensive portfolio diversification[1] to enhance income flexibility. Your fund oriented portfolio is diversified among many asset classes to enhance the likelihood that we can always avoid producing income from the portion of your portfolio that might decline in value during difficult markets. This way prices should have time to recover before that portion of the portfolio might be used to produce future income.

6) Extensive diversification to reduce financial risk. By using funds instead of individual securities for your core holdings, we aim to avoid the financial risk and permanent loss common in bear markets. Those that held virtually any individual tech stocks in the 2000-2002 or GM (stocks or bonds), Wachovia, Lehman and many others in the last bear market may never recover. Your mutual fund portfolio may hold 1-2% at most of any one security with generally thousands that comprise your entire portfolio. You should be confident that the decline you may see in your stock funds in a bear market will be temporary declines vs. permanent losses as long as we avoid

liquidating at market lows (again, there is no guarantee against loss).

Of course there are other benefits to the comprehensive approach that we take with you that go beyond the handling of your investment portfolio; however, understanding the game plan that is in place to get you through expected but unpredictable bear markets is a vital component to your long term success and short term comfort during these uncertain times.

[1]*Using asset allocation and diversification as part of your investment strategy neither assures nor guarantees better performance and cannot protect against loss of principal due to changing market conditions*

"By the Numbers"

1. **UP vs. DOWN** - Friday (5/24/13) was the **100th stock trading day** of 2013. The YTD **split between "up" and "down" days** on the S&P 500 is **62/38**, better than the 50-year **average split of 53/47** (source: BTN Research).

2. **EITHER ONE OR THE OTHER** - Based upon the last 80 years (1933-2012), the S&P 500 is as likely to **gain at least +26% (total return)** in any single calendar year as it is to have a **negative total return** for the year. Both events have occurred 20 times over the 80-year period (source: BTN Research).

3. **THE OLDEST INDEX -** The Dow Jones Industrial Average turned **117-years old** last week. Only 12 stocks were used in the index's original calculation in **May 1896** and only 1 stock in that group **remains in the index** today. The Dow Jones Industrial Average is a popular indicator of the stock market based on the average closing prices of 30 active U.S. stocks representative of the overall economy (source: Dow Jones).

4. **GETTING BETTER -** At the **end of 2011**, 8.2% of mortgages had at least 1-payment past due and another 4.4% of mortgages were in the foreclosure process. At the **end of 2012**, 7.5% of mortgages were late and another 3.7% of mortgages were in foreclosure. At the **end of March 2013**, 6.8% of mortgages were late and another 3.6% of mortgages were in foreclosure (source: Mortgage Bankers Association).

5. **COULD GO UP -** Unless Congress extends current policy, the **interest rate on student loans** will double as of 7/01/13, rising from **3.4% to 6.8%**. The interest rate on student loans was 6.8% **before 2008** (source: Congress).

6. **THE WRONG DIRECTION** - There were **16 American workers** for every **1 Social Security retiree** receiving benefits in 1950. It is estimated that there will be just **2 American workers** for every **1 Social Security retiree** receiving benefits in 2035 (source: Social Security Trustees 2012 Report).

7. **WHAT KEEPS YOU UP AT NIGHT?** - More than **3 out of every 5 Americans** surveyed (61%) between the ages of 44-75 **fear running out of money** during their retirement years more than they **fear death** (source: Allianz).

8. **ALMOST ALL OF IT** - The **top 20% of US households** (as measured by income) **pay 94.1%** of the **federal individual income taxes** collected by the IRS (source: CBO).

9. **DOWN FOR ALL** - The **top 1% of taxpayers** paid an **average tax rate** (i.e., federal income taxes paid as a percentage of adjusted gross income) of 34.5% in 1980, but paid only 23.4% in 2010 (the latest year that data is available). The **bottom 50% of taxpayers** paid an **average tax rate** of 6.1% in 1980, but paid only 2.4% in 2010 (source: Internal Revenue Service).

10. **NO MORE** - An Illinois state employee with just **20 years of service** does not have to pay **health insurance premiums** for their **own insurance coverage** during their retirement years. Illinois passed a bill in 2012 to **remove this benefit retroactively**, a change impacting 80,000 current retirees. The Illinois Supreme Court agreed on 4/11/13 to hear appeals from **4 lawsuits** challenging the premium increase (source: Chicago Sun-Times).

11. **SENIORS** - Medicare enrollment is projected to rise from **52 million** in 2013 to **66 million** in 2021, **an increase of +27%** over the next 8 years. Medicare expenditures over the same 8 years are projected to rise from $598 billion in 2013 to $1 trillion in 2021, **an increase of +67%** (source: Medicare).

12. **NOT TOGETHER** - From 6/30/04 to 6/29/06, the Fed raised **short-term interest rates** from 1% to 5.25%, but over the same period the yield on the 10-year Treasury note **rose only** from 4.62% to 5.22% (source:

Federal Reserve)

13. **NO COLLEGE** - 8 US Presidents **never attended college,** including Abraham Lincoln (source: White House).

14. **TWELVE YEARS LATER**- In the first 6 months of **fiscal year 2013** (i.e., the 6 months ending 3/31/13), the US government spent $1.80 trillion. For the entire **fiscal year 2001**, the US government spent $1.86 trillion, an amount that at the time was **an all-time record** (source: Treasury Department).

15. **SMALL-** President Obama has proposed that **"carried interest"** (e.g., profits of hedge fund managers) be taxed at **ordinary income tax rates** instead of **capital gains rates**. The change would raise **$3.4 billion** in new revenue in fiscal year 2014, **just 0.1%** of the projected $3.034 trillion in tax receipts for the year (source: White House).

Best Wishes,

Andrew Brief, ChFC
Rick Nacius, CFP©

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