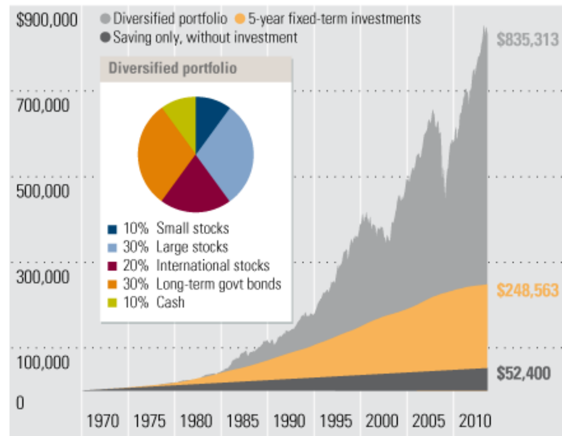
October 2013 | Vol. No. 19 | Newsletter

# Saving Is Not Enough

After two financial crises occurring almost back to back during the "lost decade," investors have every right to be risk-averse, hesitant, angry, or distrustful. The problem with not investing at all, however, is that you may not have sufficient money to achieve your financial goals. An individual saving $100 per month, without investing, would have put away only $52,400 since 1970. By placing that money in five-year fixed-term investments, the investor would have been able to end up with almost five times that amount. And if invested in a diversified portfolio, our investor's savings would have grown to $835,313. It's true that any investment involves varying levels of risk. But, as the image illustrates, even if you have low risk tolerance, you can find a suitable investment for your needs that may still be much better than no investment at all.

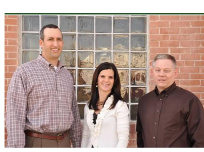
## Two Types of Investments Versus Saving Without Investment, Jan 1970–Aug 2013




Past performance is no guarantee of future results. This hypothetical example is for illustrative purposes only and not indicative of any investment. An investment cannot be made directly in an index. Holding a portfolio of securities for the long term does not ensure a profitable outcome and investing in securities always involves risk of loss. The diversified portfolio was created for illustrative purposes only; it is neither a recommendation, nor an actual portfolio. Government bonds are guaranteed by the full faith and credit of the United States government as to the timely payment of principal and interest, while stocks are not guaranteed and have been more volatile than bonds. International investments involve special risks such as fluctuations in currency, foreign taxation, economic and political risks, and differences in accounting and financial standards. Diversification does not eliminate the risk of experiencing investment losses. The data assumes reinvestment of income and does not account for taxes or transaction costs.

Source: Small stocks—Ibbotson® Small Company Stock Index. Large stocks—Standard & Poor's 500®, an unmanaged group of securities considered to be representative of the U.S. stock market. International stocks—Morgan Stanley Capital International Europe, Australasia, and Far East (EAFE®) index. Long-term government bonds—20-year U.S. government bond. 5-year fixed-term investments—yield on a 5-year U.S. government bond. Cash—30-day U.S. Treasury bill.

## What's Happening at SWA



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Do people spend more money making purchases with a credit card or cash? A recent Dunn & Bradstreet study states that we tend to spend up to 18% more using a credit card. Even McDonald's weighed in on this phenomenon reporting an average transaction increase from $4.50 using cash to $7.00 when using a credit card.
Here are three of the many factors behind these results. First, using credit cards makes us feel like we aren't using real money. Second, using cash provides us with immediate feedback…when the paper money is gone, it is gone. With credit cards we have little reference as to how much we are spending. Third, impulse purchases are easier with credit cards whereas with cash it may require us to visit an ATM machine to first make a withdrawal.

This isn't to say that everyone should only use cash, but we believe credit card balances should be paid off each month. Our behavior around money is very complicated and worth thinking about.

# Monthly Market Commentary

News in recent weeks has been all about the government shutdown and the even more worrisome prospect of violating the debt ceiling sometime later this month. A debt-ceiling violation could lead to the deadly combination of higher interest rates and a slower economy. In a world where markets swoon on a 20,000-job miss in monthly employment data (on monthly job growth of about 200,000), losing 800,000 government jobs in one shot is a very big deal. Although the market has been soft lately, it seems to have hardly grasped the potential of a longer-term shutdown. We have reached this crisis point so many times recently with no negative consequences that the market seems almost numbed to the potential pain. Relatively inflexible wage rates and the propensity of most consumers to keep spending despite short-term adversity all contribute to the economy's overall stability and slow growth rate. But a month-long government shutdown would likely cut GDP growth by at least 0.5% in a world of 2.0% growth.

Employment: Another negative consequence of the shutdown is that government agencies have stopped releasing statistics; the Bureau of Labor Statistics' official employment report is missing. The ADP employment report showed more of the slow, unsatisfying growth rates seen for the last several months, with private sector jobs growing by 166,000, up from the 159,000 jobs added in August. The report was a bit of a disappointment, as the consensus estimate was for 180,000 jobs to be added.

Housing: New home sales and housing starts slowed down in the face of higher rates, while existing home sales jumped ahead as homebuyers raced to close quickly before rates moved even higher. Even before the higher rates, housing data had begun to top out as land and labor shortages slowed home construction. This has caused many analysts to scale back their housing growth rate and GDP contribution for both 2013 and 2014.

Consumer spending: Month-to-month consumption data has shown improvement, but the much more reliable year-over-year data suggests more of the same for consumption and the United States economy. Year-over-year three-month averaged consumption growth remained stuck in its slow and unsatisfying rut of 1.9% when adjusted for inflation. That remains well ahead of income growth of just 1.1%, with the higher payroll and income tax rates subtracting close to a full percentage point off of income growth. Income data is beginning to show some improvements that might help fourth-quarter spending data, but initial reports seem to suggest a softer holiday shopping season than last year.

Quarter-end insights: While the overall U.S. economy has been quite stable, the third quarter did bring a number of real surprises, some positive and some negative. In the positive camp, Europe appeared to move from recession into recovery. The U.S., Chinese, and European manufacturing economies appeared to pick up steam in the quarter. Better auto sales and production helped the data, as did some inventory rebuilding and general improvements in consumption from more confident European consumers.

On the negative side, U.S. interest rates continued to climb throughout most of the quarter. The U.S. 10-year Treasury bond approached 3% in the middle of September before settling back a little after the Federal Reserve decided not to taper bond purchases. However, despite this decision, rates are still substantially higher than they were a quarter ago and are unlikely to approach old lows. Although tapering is off the table for another month, it will happen at some point, and the market knows it. Morningstar economists expect the 10-year Treasury bond to reach the 3% to 4% range over the next year or so, and a tapering program of some type to begin in the next three or four months. Projections for the remainder of the year include GDP growth in the 2.00% to 2.25% range, inflation at 1.60% to 1.80%, and the unemployment rate at 7.10%.

# Measuring Fear in the Markets

Fear is a basic emotion that all human beings experience when feeling threatened or uncertain. Fear can be caused by many things, from being afraid of losing a loved one, to being fearful of the ancient Mayan prophecies that predict the end of the world. Interestingly, an investor can also experience (and measure) fear in the stock market.

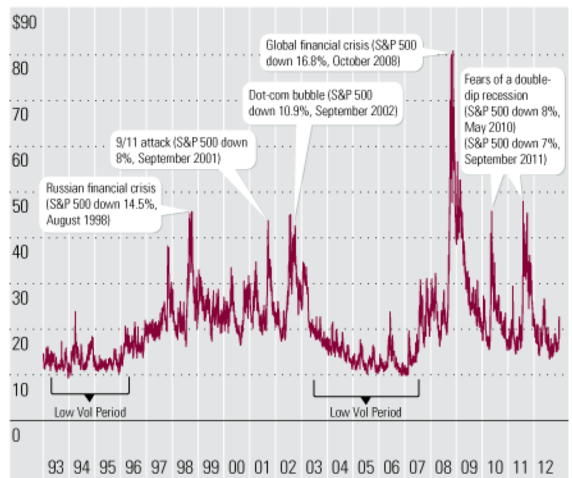
Fear in the market can be measured by the Volatility Index (VIX), also commonly known as the "fear index." The VIX measures the uncertainty that investors feel about short-term market prospects. A period of high fear is characterized by higher uncertainty, higher volatility (stock prices swinging widely), and a higher VIX reading. On the other hand, a lower VIX reading occurs during less stressful periods because of lower uncertainty and lower volatility.

The image highlights the daily closing price of the VIX over the last 15 years. When there were sudden downturns that resulted in steep declines in the market, the VIX spiked sharply to reflect the uncertainties in the market. Examples can be seen during the Russian financial crisis in 1998, the 9/11 attack in 2001, and the dot-com bubble in 2002. More recently, the global financial crisis saw the S&P 500 decline by 16.8% in October 2008, causing the VIX to spike to an all-time high of $80. Concerns regarding a potential double dip recession in 2010 and 2011 also caused the VIX to rise. When times were good and the market grew complacent, the VIX was not as volatile. Instances of this can be seen throughout the 1990s, as well as during the period leading up to the global financial crisis from 2003–2007.

Why is fear so rampant in times of great uncertainty? It's one thing to be afraid of what's happening next in a stable market, but it's a completely different story when you've just seen your portfolio shed 40% of its value and wonder what's next. Investors understand that fundamentals advocate investing for the long haul, and avoiding market-timing pitfalls in the short-term. Yet they can't help but be afraid, thinking about what would happen if they lost another 10% of their savings over the next month, next quarter, or next year. What if markets never recover and they never see that money again?

Investors who are faced with situations where they are fearful of market performance in the near future should take a step back and avoid making irrational investment decisions that may adversely impact their financial goals. Similarly, during calmer times, investors should not be lulled into a false sense of security and expect markets to only continue to rise forever. And for those investors saving for retirement, it is important to remember that short-term fear and volatility should not impact their decisions for the long term.

### Daily Closing Price for the VIX

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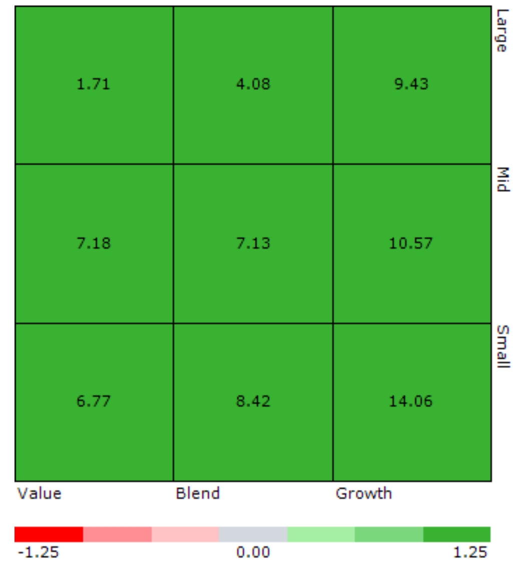
# Quarterly Market Barometer




3 Month, ending September 30, 2013. The U.S. Market returned 6.05% (YTD 20.93%).

The Morningstar Market Barometer provides a visualization of the performance of various stock market indexes. The color scale (red for losses and green for gains) allows you to assess which areas of the market performed strongly and which areas showed weakness for the time period analyzed. The nine-square grid represents stocks classified by size (vertical axis) and style (horizontal axis). There are three investment styles for each size category: small, mid and large. Two of the three style categories are “value” and “growth” while the central column represents the core style (neither value nor growth characteristics dominate). Large-caps account for the top 70% of the capitalization; mid-caps represent the next 20%; and small-caps represent the balance.

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