Advice for Life's Changing Seasons

NH Winter – Karen Lynch

In spite of a flat 4th Quarter, markets significantly outperformed many Wall Street analyst predictions in 2012.

In reviewing my recent newsletters, I realized just how tired I am of writing about fiscal cliffs and political uncertainty. The following is a quote from my newsletter of one year ago: "A slight decrease in the unemployment rate coupled with an increase in consumer spending helped to drive up U.S. stock prices." Not much has changed. We are now entering the fifth year of a bull market. However, the economic recovery has been so painfully slow that many Americans are not convinced that the recession really ended in 2008. In the fourth quarter, the Standard & Poor 500 Index* lost 0.38%, but returned 16% for 2012. According to the Lipper data** published in the WALL STREET JOURNAL, small and midcap value style stock funds led the quarter with returns of about 3.8%. Large cap growth stock funds lost about 1% in the fourth quarter. For all of 2012, large cap stock funds returned about 15%, midcap funds returned 13.5% (growth) to 17.0% (value), and small cap funds returned 13% to 16%. Active large cap fund managers did much better than their passive counterparts last quarter, with 85% to 92% beating their benchmarks. Health/Bio funds were up 21.4% last year, and balance funds were up 11% to 12%. Outside the U.S., stock funds in Europe were up 22.2%, and emerging market funds returned 18.2%.Investment grade bond funds returned about 6.8% and high yield bonds returned about 14.7%. Gold lost 12.5% in the quarter, and finished the year down 9.3%. Now that the bear market returns of 2000 to 2002 are out of the ten year average return figures, even long term stock market performance looks greatly improved. Over the last decade, emerging market and Latin America stock funds have averaged 15% to 24%.The S&P 500 Index was up in nine of the last ten years, with an average annual return of about 6.8%. Not surprisingly, the financial services sector struggled for the last decade, returning only 1% to 3% annually, in spite of a solid showing of 23% in 2012.

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"We need a much more visionary, responsible and functional Congress"
Mohamed El-Erian, CEO PIMCO 1/2/2013

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The ongoing search for yield extended through 2012, as action by the Federal Reserve continues to penalize savers. With inflation at about the 2% level, negative real rates of return extend beyond ten year Treasuries. Our slow growing economy, coupled with our political wall of worry continues to drive individual investors out of the stock market. In 2012, the Dow Jones Industrial Average crossed the 13,000 level 21 times. Bond funds received an additional $131 billion in inflows in 2012, while actively managed stock funds lost over $100 billion in outflows. Among the stock funds that experienced outflows, the most expensive funds lost 12% of assets, while the least expensive funds lost only 4%.

Investors are paying more attention to how much they pay for investment management, and investment advice. As pension plan sponsors and plan participants become comfortable with last year's new fee disclosure regulations, I expect this pattern to continue.
I am more concerned about the bond market than the stock market for the next few years. Dan Fuss of Loomis Sayles recently said "Bonds are priced in general, higher than a kite." (FORTUNE, 12/24/12). The Federal Reserve has indicated they will continue their current policies until the unemployment rate drops to 6.5%, a level we will probably not reach this year. Bonds may only post low single digit returns in 2013. When interest rates rise in 2014 or 2015, keep in mind that a 1% increase in a ten year treasury bond yield from 1.7% to 2.7% will create a 9.2% loss of capital. Chasing yield by investing in longer maturity and/or lower quality bonds right now is not safer than buying high quality dividend paying stocks. Portfolios should remain well designed and well diversified, based upon the objectives, time horizon and risk profile of the investor.

According to Pew Research, 10,000 "baby boomers" will be turning 65 every day for the next 16 years. Unfortunately, less than half of this group has actually calculated how much they need to live comfortably in retirement, much less saved enough. No one enjoys hearing the correct advice: save more, spend less, retire later. Too often, investors look to some "quick fix", such as a reverse mortgage. 83% of baby boomers plan to stay in their current home through retirement. A reverse mortgage can be an effective financial tool for a 70+ year old retiree without enough savings to cover day-to-day expenses. However at ages 62 to 70, especially when a lump sum amount is withdrawn, they can be dangerous. Reverse mortgages are defaulting at a much higher rate than traditional mortgages, and they are expensive. Fees can run up to $12,000 on a $300,000 home. How else can they afford to hire all of the celebrities doing their commercials? Be careful, and do lots of research before you or a loved one commits to a reverse mortgage.

Try working backward toward retirement. Focus on the cash flow you will need to live comfortably in retirement, not the cash pile you are accumulating prior to retirement.

Dennis P. Lynch

The views and opinions expressed are those of Dennis Lynch as of 01/15/2013 and are subject to change based upon market conditions. Investment decisions should be based on an individual's own goals, time horizon, and tolerance for risk. Past performance is not a guarantee of future results.

*The S&P 500 Index is a price weighted index of 500 actively traded stocks. Investments cannot be made directly into an index.

**Lipper, a division of Thompson Reuters, manages a mutual fund performance tracking and rating system. Lipper Indexes allow an investor to compare a particular mutual fund to other funds utilizing a similar investment style. A Lipper index is composed of the 30 largest funds of a given investment style. For more information about Lipper's methodology, visit their web site at www.lipperweb.com/research/IndexComponents.aspx.