

Summer 2009

MANAGEMENT

"HELPING YOU MAKE SMART CHOICES ABOUT YOUR MONEY"

RECOVERING FROM A MARKET ROUT DOESN'T HAVE TO TAKE DECADES

The U.S. stock market dropped 57 percent from its peak in late 2007 through March 9 of this year, making this the second worst bear market since the Great Depression.

Investors, quite naturally, want to know how long a recovery will take. We are constantly reminded of an ominous precedent: the Dow Jones Industrial Average hit a high in 1929, plunged, and then took 25 years to recover. Will today's market behave in similar fashion?

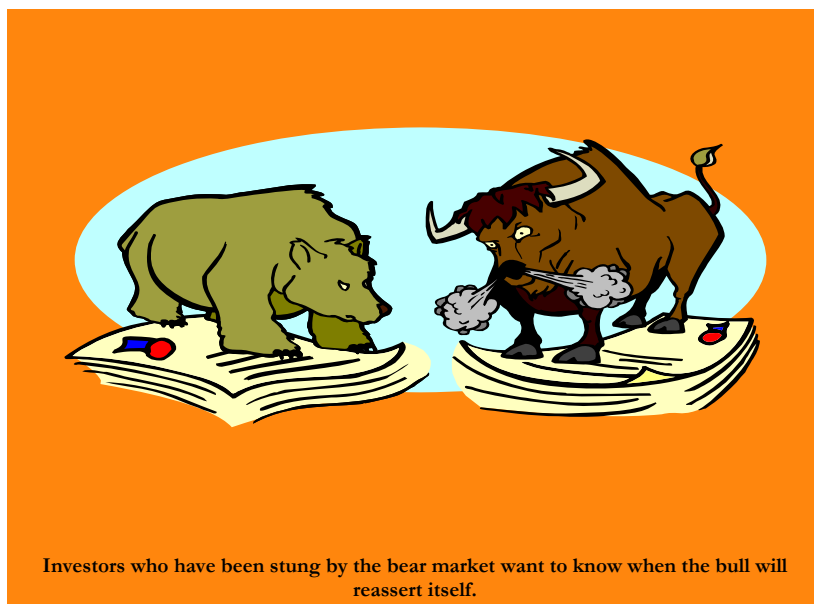
The premise of a long recovery, however, may be a straw man: it really only took the broad stock market about 4½ years to recover from the 1929 crash if dividends and deflation are taken into account, says Mark Hulbert of The Hulbert Financial Digest.

Real vs. nominal

Investors have a bad habit of looking at nominal numbers over time without adjusting for inflation. But that's just wrong: \$1 received in 1975 was worth a lot more than \$1 received today due to inflation over the last 34 years.

In the Great Depression the country suffered from deflation, so that \$1 received in 1936 was worth 18 percent more than \$1 received in 1929. So although the stock market had not hit its former high in nominal terms, even at a lower nominal level it was worth more than in 1929 due to deflation.

Another consideration is dividends: market averages like the Dow merely look at current and historical stock prices and do not take into account all the dividends paid over time, which have a real effect on an investor's wealth.



By the time the Dow hit its Great Depression low in mid-1932, its dividend yield was 14 percent. An investor who reinvested dividends over this period recovered more quickly than did the Dow average.

The IBM effect

The big question is whether the Dow is a good representative for the U.S. stock market, back in 1929 or even today. The index consists of just 30 large stocks. Its makeup changes periodically based on the judgment of a committee at Dow Jones & Co., which publishes *The Wall Street*

Journal.

Up and comer IBM was a member of the Dow average until it was inexplicably deleted by the Dow Jones committee in 1939. It was restored to the index 40 years later.

It has been estimated that if IBM had stayed in the index continuously over that period, the index would have been twice as high in 1979.

IBM was one of the best performers of large stocks in the

(Continued on page 2)

WHAT'S INSIDE

- ◆ Just when the economy is at its low point, stocks begin recovery
- ◆ Inflation, not volatility is the big risk
- ◆ Social Security is still vital to retirees
- ◆ Address issues you can control when doing estate planning
- ◆ Complimentary 2nd Opinion

IT TOOK FOUR YEARS AND FIVE MONTHS TO RECOVER AFTER 1932

(Continued from page 1)

1940s, and its inclusion most likely would have sent the Dow's nominal number well above the levels it actually reached.

1938 recovery

The market hit its Depression low in mid-1932, three years after the 1929 crash. Ibbotson Associates has estimated that in real terms, the market probably had fully recovered just four years and five months after that low.

Other bear markets have

shown similar trends: the average recovery since 1900 is just two years. The big exception was the recovery from the 1973-74 bear market.

The low in that market was December 1974 and U.S. stocks did not fully recover for eight years, when, in 1982, the Dow rose higher than the previous high in 1972.

Investors who bet against the market now could be right for several years yet, but they will eventu-



ally be disappointed if the market follows its historic pattern.

JUST WHEN THE ECONOMY IS AT ITS LOW POINT, STOCKS BEGIN RECOVERY

A deep recession coupled with a bear market for stocks usually makes investors more and more pessimistic about the future.

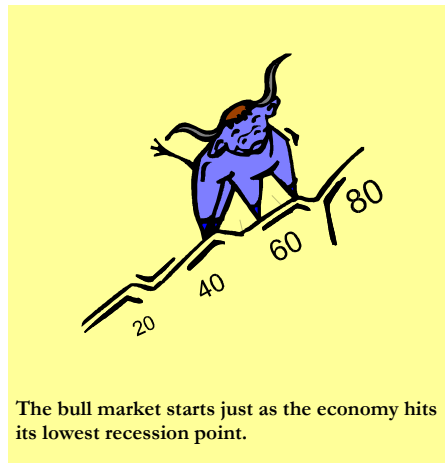
Yet it is often just at that maximum moment of pessimism that the stock market begins to rally. In most cases stocks have produced double-digit returns in the 12 months following the economy's bottom.

A recent study by Mark Riepe, head of the Schwab Center for Financial Research, found that investors profited well after 9 of 10 low points hit during recessions since World War II.

GDP is key

He calculated stock market returns beginning in the calendar quarter when Gross Domestic Product, a measure of all goods and services produced in the United States, hit its lowest point.

The average return for the Standard & Poor's 500 Stocks Index was 22 percent over the next 12 months. The gains



ranged from 15 percent in 1949-50 to 45 percent in 1953-54.

There was one exception: after GDP hit its low point in the last recession during the third quarter of 2001, the market went on to lose 22 percent over the next 12 months as tech stocks continued to suffer.

"It is hard not to be at least a little perturbed by the fact that the one negative result just happens to be the most recent," Riepe said.

Job loss rallies

Another low point in recessions is marked by the point of maximum job loss. Again, Riepe found that in the year following the month with the worst job loss, the market was up by an average of 23 percent.

The exception again came in the last recession. Payrolls hit a trough in Oct. 2001, but the market continued to fall by 16 percent over the next year.

What's the lesson for investors? Unfortunately, as Riepe notes, no one rings a bell when the economy hits bottom. We are not certain that the bottom has been reached until well after the fact, usually too late to get in on the gains.

That means it is hard to use this information to time when to buy stocks.

Instead investors who want to participate in market recoveries should remain invested throughout a recession, he argues.

INFLATION, NOT VOLATILITY, IS THE BIG RISK

Many investors have worried about principal loss recently as the stock market turned sharply lower.

They may be emphasizing the wrong danger: While the risk of loss in stocks declines the longer you own them, the risk of loss of purchasing power due to inflation is a given that only keeps growing steadily throughout an investor's lifetime.

Except in very old age, investors typically have a time horizon of at least 25 to 30 years. Since there has never been a 17-year period in U.S. stock market history with negative returns, they should have confidence that the risk of loss due to day-to-day fluctuations in the market should diminish to near zero.

Energizer bunny

However, inflation just keeps on going. The United States has experienced just a handful of years of declining inflation. There have been none so far this century. There were isolated incidents of lower prices in 1954 and



1949, and a string of years during the deflation of the late 1920s and early 1930s.

Otherwise, consumer prices since 1926 have grown at an average annual rate of about 3 percent.

Someone entering retirement today with a fixed income of \$50,000 would see the purchasing value of that income erode to just \$23,349 in 25 years.

That's why investing in something that seems "safe" today, such as a bank certificate of deposit or a fixed-

rate bond, can be a devastating choice in the long run.

After adjusting for inflation, short-term U.S. Treasury Bills have increased by only 0.7 percent per year since 1926, according to research firm Ibbotson Associates. Long-term government bonds grew by only 2.4 percent per year after inflation.

Income tax wipeout

Once income tax is paid on that interest, a saver would have had a negative return and would have fallen behind inflation.

U.S. stocks, however, have delivered a "real return" after adjusting for inflation of 7.1 percent per year from 1926 through 2007.

This real return was earned despite massive declines in stock prices in the 1930s and bear markets in every decade since then.

So the short-term risks of big price fluctuations did not prevent a long-term investor from earning enough income to ease inflation's bite.

SOCIAL SECURITY IS STILL VITAL TO RETIREES

Some younger workers discount the relative importance of Social Security in their retirement planning, yet it remains a major source of income for most retirees.

Social Security benefits currently represent about 40 percent of all income received by the elderly, says the Social Security Administration.

For some, Social Security represents an even greater source of retirement income. About half of married retirees and three-quarters of single retirees derive 50 percent or more of their income from the government program.

And the benefits provide 90 percent of retirement income for about a third of all retirees.

Average benefits

Those are sobering statistics, especially given that the average benefit paid to a retiree is \$1,153 a month, or just \$13,836 a year.

That means those beneficiaries

who derive half of their income from Social Security are living on \$27,672 a year.

The Social Security Administration also warns that workers who are planning their retirements should be ready to go a longer distance than in the past.

In 1935, when Social Security was founded, the average life expectancy for a 65-year-old was 12½ years. Today that average life expectancy is 18 years. Also, that is only an average expectancy: retirees who never smoked and are generally healthy most likely will be looking at an even longer period in retirement.

Here is another sobering statistic for those who want to relax in retirement: earnings from working account for 28 percent of all retirees' incomes and it is the second largest income source after Social Security.

Savings are important

The third-largest source of retirement income is money earned on



The average retiree relies on Social Security for at least 40 percent of his retirement income and might not survive without it.

assets, i.e., interest from bank accounts and bonds and capital gains from stocks and other investments.

Pensions account for only 8 percent to 10 percent of retirement income, depending on whether you have a private or a public employee pension.

This supports the need for workers to build up the largest retirement accounts possible.

Regular contributions to 401k accounts and other retirement savings accounts are a must, with annual increases in contributions recommended. Some of that savings should be put into high growth assets.

ADDRESS ISSUES YOU CAN CONTROL WHEN DOING ESTATE PLANNING

The future of federal estate taxes remains up in the air. No one is certain whether the Obama administration will offer a new taxation plan when current regulations expire after 2010.

In the meantime, anyone doing their own estate planning should focus on the important issues that are in their control. It also helps to set up a record-keeping system for executors and trustees that will make it easier to turn over your assets and take care of your dependents and beneficiaries.

Consider scenarios

You have to plan for several eventualities, and all should be addressed in your will or trust.

For instance, if both spouses die simultaneously, at what ages should property be available to children? Who should be the guardian of children? Who would succeed that guardian if he or she became unable to serve?

How should property be distributed if you die before your spouse? What if your spouse dies before

you? What if you die before a financially dependent parent or child?

Physical stuff too

Too often personal property is forgotten in estate planning. Simply saying that heirs "will sort things out" is not the best way to handle things. Sometimes this can lead to family feuds over emotionally-loaded items.

Discuss with family members and friends their desires to have items of sentimental and monetary value, and include written instructions to your executor or trustee.

Leave good records

Don't leave your executor, spouse, children, or trustee scrambling to put together the jigsaw puzzle of your financial life.

Provide them with an annually updated list of all assets and liabilities complete with account numbers and custodian names.

Provide information on real estate, boats, cars, and other major physical items, along with deeds and other ownership papers.

Make sure information on em-



You have control over how your estate is passed on.

ployee benefit plans are available. Executors and lawyers also need copies of all gift tax returns ever filed.

Also leave good information on any charitable organizations that are due to receive a bequest upon your death.

This need for good records is why we have been making Life Records books available to our clients. It allows you to organize and have your information in one place. Please contact our office if you would like further information.

Complimentary 2nd Opinion

We know there is a lot of concern now with the current economy and wealth management. Most of our clients have their financial house in order. We applaud you for that and hope you appreciate the wealth management services we offer.

If you are happy with what we have done for you, we would like you to refer us to your family and friends. As a courtesy, we would like to extend a complimentary 2nd opinion of their financial plan. If we find the plan is good, we will let them know that no changes are necessary, or we can offer suggestions to them. If they prefer, they can take those suggestions to their current advisor or we would be happy to work with them as their new advisor if they would be a good fit for both of us.

Our Basic Tenets

Our objective is to design portfolios using passive asset class funds that maximize investors' returns within their tolerance for risk. Here is what sets us apart:

- ◆ Fee-only investment management
- ◆ A disciplined investment strategy
- ◆ Access to institutional no-load passive asset class funds
- ◆ An academic Nobel Prize-winning investment approach

- ◆ Continued access to academic research
- ◆ A tax-efficient focus with valuable tax- and estate-planning ideas
- ◆ Risk tolerance assessment
- ◆ Periodic portfolio rebalancing
- ◆ Regular communications and state-of-the-art reporting
- ◆ No front-end loads, no back-end loads, no surrender fees, not locked in
- ◆ **MOST IMPORTANT ...**
A TRUSTED ADVISOR RELATIONSHIP

CBF

WEALTH MANAGEMENT
A Registered Investment Advisor

McMill Building, 125 So. 4th Street
P.O. Box 1264 Norfolk, NE 68702
(402) 371-1160
www.cbfwealthfirm.com

INTRODUCTIONS -REFERRALS ARE
ALWAYS APPRECIATED.

Visit our website at www.cbfwealthfirm.com to view prior newsletters and other investment information.