Late Spring 2013

In Context

WEALTH STRATEGY FROM A DIFFERENT PERSPECTIVE

Stock Market Perspective

After the bear markets of 2000–2002 and 2008, we seem to have entered an era in which investors wonder whether a market collapse is right around every corner, even following new market highs. The S&P 500 Index achieved a new high at the end of the first quarter, closing at 1,569 after beginning the year at 1,426, but has experienced considerable volatility surrounding the events in Boston. So, is it reasonable to fear a severe market downturn given this generally good performance in tandem with recent events?

Longer-Term Perspective

Over longer periods of time, we know that the world's stock markets have generally gone up. Over the period of 1900–2012, stocks outperformed inflation by about 5.0 percent per year. From a simple point of view, this means that new stock market highs have been the norm and not the exception. In one way, this reflects the triumph of capitalism and the general improvement in living standards the world has enjoyed as time has marched on.

Specific to the current market, the S&P 500 hit its previous high of 1,565 in October 2007. Prior to that, it had hit 1,527 in the early 2000s. This underscores one other reason why recent market highs do not imply markets are due for a correction. Namely, it is important to realize that the first quarter stock market high was barely higher than levels the stock market reached more than 10 years ago. Said differently, while the stock market did achieve a new high at the end of the first quarter, from a longer-term point of view, the market has barely gone up for more than a decade. In fact from the high of the early 2000s through the end of the first quarter, the S&P 500 returned just 2.1 percent per year. This is hardly indicative of a market that is "clearly" due for a correction.

With respect to recent volatility, virtually every year has a period of time when markets do poorly and volatility increases. For example, during the great stock market performance of the 1990s, the S&P 500 had quarters when it was down by 13.7 percent, 9.9 percent and 6.2 percent. So, periods of higher volatility do not always precede poor performance.

Reasonable Expectations

Investors are wise to factor in their risk tolerance when determining how much to allocate to stocks. They should set reasonable expectations for long-term stock market performance when planning for retirement and other financial goals.

While stocks have outperformed bonds by about 8 percent per year over the long-term history of the U.S. market, the general consensus is that investors should plan for stock returns to be around 4–5 percent higher than bonds on a forward-looking basis. Investors who assume returns will be significantly higher than this will likely be disappointed.

Standard & Poor's 500 Index

Historically, the Dow Jones Industrial Average, which is composed of just 30 stocks, has received more popular media attention than the S&P 500.

Within financial circles, however, the S&P 500 is considered to be a superior gauge of U.S. stock market performance because it includes more stocks and it weights stock by the value of the included companies instead of the stock prices of the constituent companies. The history of the S&P 500 Index traces to 1923 when Standard & Poor's introduced a stock index that covered 233 companies. The index expanded to 500 companies in 1957 and has henceforth been known as the S&P 500 Index. At the end of 2012, the companies included in the S&P 500 represented $12.6 trillion of stock value. As of that same time, Dimensional Fund Advisors placed the total value of world equities at $37.5 trillion in its annual world market capitalization analysis.

Clearing Up Misconceptions About Social Security Benefits

With Tiya Lim

Should people who are receiving Social Security benefits, or who will begin to receive benefits in the next few years, be concerned that benefits will stop?

Since the program began, the precedent has always been if there are any changes to Social Security benefits, it will occur with the benefits of future generations. For example, in 1983, Congress decided to increase the full age of retirement but did so for beneficiaries who had 20 years or more until retirement. The increase did not affect those receiving current benefits.

Something that could change is increasing tax revenues, which affects both current and future recipients. However, current beneficiaries are usually retired, and the majority of tax revenue comes from current and future working populations. There also is a current White House budget proposal that would change the calculation for cost-of-living adjustments for Social Security, which is another possible change.

Are the financial problems with the Social Security program the same as they were a few years ago?

Yes, they are the same. When Social Security was created in 1935, life expectancy was 65–70 years old. They didn't expect to pay out benefits for a very long time. Now you have people living into their 90s and beyond, and Social Security is still paying out benefits at around the same rate as it did when the program started. So, more people are taking money out for a longer period of time while fewer dollars are going into the system due to the recession and smaller workforce. That's causing a lot of the drain on the Social Security system.

The problems are the same as before, and the same earlier predictions still stand — around 26 years from now is when the Social Security Trust will run out of money. But that doesn't mean all benefits would stop. It just means that if nothing is done, such as increasing tax revenues or changing the full retirement age, people receiving benefits at that time would receive reduced benefits, perhaps 75 percent of their promised benefit.

But there's still time to address these issues for future benefit recipients. In principle, these are easy fixes — you could increase the money going into the system through taxation, or you could decrease the money going out by changing benefits or increasing the full retirement age.

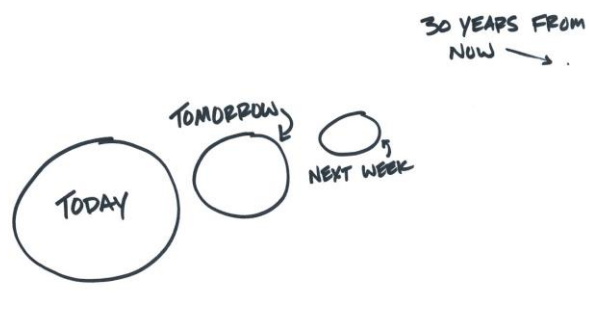
What is the outlook for Social Security?

People fear it's going to go away completely, but there are contingencies in place to keep Social Security functioning fully. Social Security is a revenue-generating system, so it can be self-sustaining if Congress can get serious about fixing some of the flaws. While no one has a clear crystal ball, economists and academics have provided guidance in ongoing discussions about repairing the program. Research has found that Congress has a great deal of flexibility in triggering different levers in the program, all with the intention of creating a more sustainable program.

Tiya Lim is a strategic thought leader for the BAM ALLIANCE. She focuses much of her study on Social Security and other retirement-related strategies. Her work on Social Security has been featured on CBS MoneyWatch.com and cited in the Journal of Financial Planning.

Perspectives

Perspectives features different viewpoints on improving our quality of life. This sketch from Carl Richards, author of The Behavior Gap (2012) and director of investor education for the BAM ALLIANCE, points out how hard it is to see into the future. However, when we concentrate on what we can control, like identifying our goals and creating an Investment Policy Statement that guides our decisions from month to month and year to year, it improves the odds that we'll make a successful transition from today to tomorrow.



An Independent Member of

THE BAM ALLIANCE

11025 RCA Center Drive, Suite 401, Palm Beach Gardens, Florida 33410
Telephone (561) 296-0100 Fax (561) 626-3934
www.poincianagroup.com