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SENIORS/BOOMERS NEWSLETTER

"THE RETIREMENT EXPERTS"

March 2013

"In Skating Over Thin Ice, Our Safety Is In Our Speed" Ralph Waldo Emerson

So, here we are again, racing towards another self inflicted crisis. By the time you read this we should know if 'sequestration' has been averted or has instead, descended upon us.

Even though speed is not something Washington politicians have been known for, it now appears that they are indeed, in no rush at all to get this taken care of. In fact they were out-of-town the week before the March 1st deadline for the President's Day recess.

Senate minority leader, Mitch McConnell told reporters "it is pretty clear to me that sequester is going to go into effect". A senior congressional aide was asked what happens on March 1st. His response, "Nothing. Nothing happens".

The cuts move forward on a rolling basis. If nothing is done, between March 1 and September 30 (the end of the government fiscal year) their full effect would be felt. But, there is a strong likelihood that Congress is able to use both official and unofficial safeguards that would avoid a head on collision with the economy.

It's also very important to know that certain programs will NOT be touched. Social Security, Medicare, Medicaid, and paying our soldiers; the Defense department will be allowed to move funds around enough to ensure that combat operations are protected.

If you have a couple of minutes, this link to a silent 'keystone cops' clip is both very funny and unfortunately illustrative of our Washington lawmakers.

http://www.youtube.com/watch?v=a8jphxpi1ro

Once we get through this current crisis we still have the excitement of waiting to see what happens with replenishing the federal funding on March 27th as well as the debt ceiling on May 19th .

The stock market is reacting to all these events in quite a ho-hum way. We are in a tight trading range, and if anything, continue to grind higher. Many pundits believe, and expect, that spending cuts are coming in one form or another. Sequestration. So what!

What many investors may not realize is that the $85 billion budget reduction is not all happening on March 1st. Essentially, and luckily for us, much of the budget cost cutting (8% for Defense spending & 5% for Domestic spending) happens over the course of the year. Think of it as being told to reduce your household spending by 5% for 2013. Geez, when you think of it in those terms it kind of makes you wonder what all the fuss is about.

Gross Domestic Product (GDP) is expected to fall…anywhere between 1-2%, depending on whose analysis you're reading. But we have to remember that it's the government that conjures up that figure, and they have lots of magic at their disposal.

For instance: If I shovel my driveway and you shovel yours, there is no addition to GDP. However; if I shovel your drive and you shovel mine and we pay each other the same amount of money, then PRESTO… GDP rises. Kind of magical, isn't it?

Staying with the basics, the economy by most measures is doing well in spite of all the 'goings on' in the world.

- Federal Budgets out of whack
- Tax increases that began January 1st
- Europe basically in recession
- Weak company earnings
- Currency issues with the Euro & Yen.

- Unemployment
- BUT, don't forget we have
- Easy monetary policy with the FED
- Housing recovery
- U.S. manufacturing coming back
- Domestic energy boom
- China and Brazil growing again.

There is an old adage about the stock market that goes like this: 'bull markets are born on pessimism; grow on skepticism; mature on optimism; die on euphoria". Right now, optimism seems to be king. You'll know when we're in the euphoria stage when your taxi driver or hairdresser starts giving you stock and precious metals tips.

So what else is going on in the economy? According to the American Institute of Economic Research, eight of the eleven 'leading' indicators in the United States are showing an expansionary trend. In addition, ALL of the coincident and lagging indicators are trending upward.

Don't get me wrong, I'm not walking around with rose colored glasses; any number of events could cause a market correction. I am cautiously optimistic. I am also still on the constant lookout for stocks that have a lot of intrinsic value (I never overpay for any security). They are, however, becoming harder to find!

There is one particular caution flag that I am watching closely: what is the smart money doing? If you can, always follow those guys. They rarely lose. And, who represents the smartest of the smart money? Why, corporate insiders of course: (officers/directors/managers/board members). No one knows their stock or its value better than them. As of early February, they have been selling their company stock, literally hand over fist, at a ratio of 9 sells for every 1 buy.

You Got To Know When To Hold 'em, Know When To Fold 'em, Know When To Walk Away And Know When To Run

lyrics from The Gambler – Kenny Rogers

Now that I've put the song in your head, the least I can do is give you a link to hear the original version.

http://www.youtube.com/watch?v=Jj4nJ1YEAp4

How To Say "SELL"

This is one of the toughest decisions just about every investor ever has to face. Yet if you don't get this one right, it may easily cause your portfolio, and your retirement, irreparable damage.

William J. O'Neil, Chairman and the Founder of Investor's Business Daily had this to say: "You don't want to take a loss, so you wait and hope, until your loss gets so large it costs you dearly. This is by far the number one mistake most investor's make". As I like to say, you shouldn't beat a donkey because it's not a horse. You must know when to get out.

Now, the time to figure out when to sell a security actually occurs when you first buy the stock. Without going into a very long discussion, I am highlighting some of the when's, why's and wherefore's for you to think about when it comes time to sell:

- Is the reason you bought the stock still valid? If so, keep it. If not, sell it.
- Has something changed for the worse at the company?
- Do you have to re-balance your portfolio?
- Do you need the money?
- Has the stock hit your target price range?
- Do you have a better investment idea to replace one of your existing stocks? I call this portfolio upgrade.
- Mergers typically tend to stagnate the company and its stock price level…certainly anyways until after the actual merger closes. This may be a good time to replace it with a better idea.
- After a bankruptcy. Don't hold on in the hopes that you'll get something out of it. Sell now and book your loss.
- Set a stop-loss for your investment. Depending on the industry it's in, your risk tolerance and its volatility, that could be anywhere from 10-25%.
- In addition to having a stop-loss, you should make it a trailing stop loss. That means, whatever percentage for the loss you are willing to accept, it will follow the stock at the same percentage rate. Therefore the higher the stock price goes the more profits you protect.

- Are there tax considerations? You may need to book a loss to offset a gain.
- Has the stock reached a point where it is completely over-valued? Check its fundamentals to determine this.
- You have reached, and gone past your point of risk tolerance. Don't lose sleep. Sell.
- You have moral or ethical issues with the company.
- The market is rallying, but your stock is not participating. It may be time to do a full analysis.
- The stock value, as a percentage of your portfolio, is heavily over-weighted. This is called concentration. Lighten up.

These are some of the reasons to unload a security from your portfolio. There are many others. But these rules should help you get going.

Components To Figure Out Your Stock Price. (and what to look for to get a 'target price').

IS YOUR STOCK CHEAP…..OR EXPENSIVE?

- COMPONENTS FOR STOCK PRICES
  - Earnings
  - Debt
  - Price/Earnings (P/E)
  - Price /Earnings Growth (PEG)
  - Price/Book (P/B)
  - Book Value (BV)
  - Price/Free Cash Flow (P/FCF)
  - Return on Equity (ROE)

EARNINGS

- **Investopedia explains *Earnings***
  Earnings are perhaps the single most studied number in a company's financial statements because they show a **company's profitability**. A business's quarterly and annual earnings are typically compared to analyst estimates and guidance provided by the business itself. In most situations, when earnings do not meet either of those estimates, a business's stock price will tend to drop. On the other hand, when actual earnings beat estimates by a significant amount, the share price will likely surge.

DEBT

- **Investopedia explains *Debt***
  Bonds, loans and commercial paper are all examples of debt. For example, a company may look to borrow \$1 million so they can buy a certain piece of equipment. In this case, the debt of \$1 million will need to be paid back (with interest owing) to the creditor at a later date.
- An amount of money borrowed by one party from another. Many corporations/individuals use debt as a method for making large purchases that they could not afford under normal circumstances. A debt arrangement gives the borrowing party permission to borrow money under the condition that it is to be paid back at a later date, usually with interest

Price to Earnings

- **Investopedia explains *Price-Earnings Ratio - P/E Ratio***
  In general, a high P/E suggests that investors are expecting higher earnings growth in the future compared to companies with a lower P/E. However, the P/E ratio doesn't tell us the whole story by itself. It's usually more useful to **compare the P/E ratios of one company to other companies in the same industry,** to the market in general or against the company's own historical P/E. It would not be useful for investors using the P/E ratio as a basis for their investment to compare the P/E of a technology company (high P/E) to a utility company (low P/E) as each industry has much different growth prospects.

$$P/E = \frac{\text{Market Value/Share}}{\text{Earnings/Share}}$$

Price to Earnings Growth

- **Investopedia explains *Price/Earnings To Growth - PEG Ratio***
  PEG is a widely used indicator of a stock's potential value. It is **favored by many over the price/earnings ratio because it also accounts for growth.** Similar to the P/E ratio, a lower PEG means that the stock is more undervalued.

$$PEG = \frac{\text{Price/Earnings Ratio}}{\text{Annual Earnings/Share Growth}}$$

Return on Equity

- **Investopedia explains *Return On Equity – ROE***
- The amount of net income returned as a percentage of shareholders equity. **Return on equity measures a corporation's profitability by revealing how much profit a company generates with the money shareholders have invested.** Return on equity measures a company's profit as a percentage of the combined total worth of all ownership interests in the company. For example, **if a company's profit equals \$2 million for a period, and the total value of the shareholders' equity interests in the company equals \$100 million, the return on equity would equal 2% (\$2 million divided by \$100 million).**

Book Value

- **Investopedia explains *Book Value***
  Book value is the accounting value of a firm. It has two main uses:

  1. It is the t**<u>otal value of the company's assets that shareholders would theoretically receive if a company were liquidated.</u>**

  2. By being compared to the company's market value, the book value can indicate whether a stock is under- or overpriced.

N.B. The best way to review this data is to see what the book value per share is vs. the price per share.

Price to Free Cash Flow

- **Investopedia explains *Price to Free Cash Flow***
  In general, **<u>the higher this measure, the more expensive the company is considered.</u>** But it is useful also to compare to the company's past levels of price-to-free-cash flow along with comparing the average within its industry. **For example, if a company generated $200 million in operating cash flow and spent $50 million on capital expenditure, then it generated free cash flow of $150 million. If the company currently has a market cap of $5 billion, the company trades at 33 times free cash flow ($5 billion/$150 million).**

$$P/FCF = \frac{\text{Market Capitalization}}{\text{Free Cash Flow}}$$

How to set a Stock's Target Price?

- **Estimate sales for the coming 12 months**
- **Estimate the profit margin**
- **Convert total earnings into earnings per share**
- **Compute stock price range based on likely price/earnings ratios.**

Compute Earnings/ Share

- Multiply the projected sales by the profit margin to come up with 'estimated earnings'.

EXAMPLE: $1,370 B x 6% = $82M earnings for the year.

- Next, divide the earnings by the number of outstanding shares.

EXAMPLE: Company A had 33 million shares outstanding last year. Divide the earnings by the # shares:

$82 M divided by 33 M shares = $2.49/share

Compute "Target Price"

- Get a 5 year average P/E ratios under the Morningstar "VALUATION" tab.
- Get a current P/E ratio

THESE TWO NUMBERS WILL GIVE YOU A PRICE RANGE

- Multiply the 'Earnings/Share' by these two ranges

EXAMPLE: The 5 year average P/E, & the current P/E ratios were between 25 & 35.

RANGE IS: $2.49 x 25 = $62
$2.49 x 35 = $87

Current Stock price is = $24

THERE'S ROOM FOR PROFIT!!!!

MISCELLANY ☺

☺ Beginning March 1st, Social Security checks will <u>only</u> be issued electronically. If you've been receiving a check in the mail up till now, make sure you go to www.godirect.org or call 800-333-1795 to change this.

☺ You can lookup drugs and their interactions on www.safemedication.com

☺ If you registered your phone number on the DoNotCall list prior to February 2008, there is a good chance it is no longer registered. You can now register up to three numbers forever by going to www.DoNotCall.gov

☺ Anyone interested in a guide to biking, fishing, historical places, local cuisine, whale watching, etc. can find information on www.AdventureFinder.com

☺ New limits have been set for contributions and deductions for 2013:

- **If you turn 66 this year, you will not lose any Social Security benefits if you make $40,080 or less.**
- **Deductions for Long Term care have increased to $4,550 for ages 71 and older; $3,640 if between the ages of 61-70 and $1,360 for those 51-60 year olds.**

☺ Finally, the estate and gift tax exemption increases to $5,250,000 and the annual gift tax exclusion goes up to $14,000.