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SENIORS/BOOMERS NEWSLETTER

'the retirement experts'

JULY 2014

Q: Mr. (Yogi) Berra. Would you like your pizza cut in 4 or 8 slices?
A: Please cut it in 4. I'm not very hungry.

Many investors today are wondering when the market is going to take the 'inevitable' tumble. As a result, many investors have been risk-adverse for a very long time.

Like Mr. Berra, they are not very hungry...and in many cases they have completely missed out on a very strong bull market that has more than doubled since its bottom in 2009.

According to a new study published in the Financial Analysts Journal, investors have the lowest percentage of their portfolios invested in stocks since the group began collecting data in 1959 ; just 37.7% are in stocks positions.

When we extrapolate the worldwide numbers and examine the global market for investable assets - $90.6 trillion – what we see is that there are $56.4 trillion mostly in cash and bonds! In the USA, our portion is $2.59 trillion.

So what happens to this cash. Well, some goes into Treasuries. If someone invested in a 1-year Treasury bill paying a whopping 0.1%, it would take 720 years for their money to double. That's longer than most people are willing to wait.

This commentary is not to cast a reproachful eye on those intrepid souls who sat out the past 5 years. After all, many were horribly burned twice in modern history: 2000-2002 and then again in 2008-2009.

But, more than any other reason, this bull market will probably continue just because the masses have not yet arrived at the ball and haven't sipped from the punch bowl.

Bull markets typically don't end until everyone has climbed aboard the 'A' train. We could grind higher for quite some time yet.

Our biggest and best ally is the Federal Reserve. In their most recent meeting, they concluded that the growth expectation for the U.S. this year will be between 2.1% to 2.3%...well below the previous forecast.

As a result of their latest proclamation, we are able to deduce that their benchmark rate will stay low (close to zero) for an extended period of time, which in turn helps promote higher asset values.

Stock valuations, by the way, are not out of whack. They're not cheap....but neither they overly expensive. Right now 85% of all stocks are trading above their 10-day moving average. This signals both a healthy market as well as strong price momentum.

No matter what the experts predict, the truth is nobody knows where the markets will go on a short-term basis. This is best illustrated by the Wall Street joke of a wife asking her investment-pro husband about what's going to happen in the market.

He replies that it all depends on China fighting with its neighbors, Russia and the Ukraine conflict, elections in the middle east, etc. Finally, she tells him to stop and says, 'If you don't know, why don't you just say so'.

There are several indicators that will tell you when to fear a market correction:

1. Inflation, which reduces purchasing power.
2. Rising interest rates, which reduce purchasing power.
3. A recession, which reduces purchasing power.
4. Asset bubbles which reduce purchasing power due to overpaying for what you buy.

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(REMEMBER: The American consumer is responsible for 70% of Gross Domestic Product. No spending – no growth.)

So, is everything 'rosy' out there?

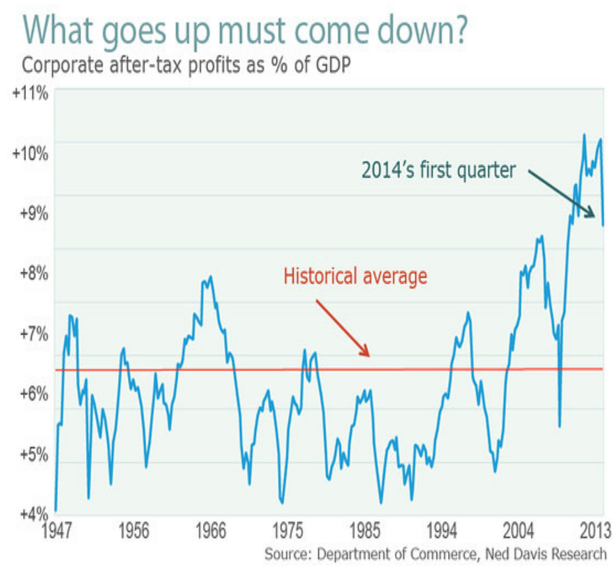
No, not everything. There are two areas that merit some concern.

To begin with, as you can see from the chart below (courtesy of Ned Davis Research), corporate profits have been coming down since 2010. In fact, that number for Q1 is down 14% from the 4th quarter of 2013.

The S&P continues to upgrade profit numbers but there is a large portion of that coming from share buy-backs. In the 12 months ending March, 2014, corporate America has purchased $534 billion of its own stock.

Although one would think that this should ***increase*** corporate profits per share...which it does...you can see it doesn't mask the after-tax profits, which are ***real dollars.***

According to Howard Silverblatt, senior index analyst for Standard & Poor's, the lower share count boosted earnings per share by more than 4%! Overall, 290 companies in the S&P 500 reduced their float in the first quarter of this year alone.



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If corporate after-tax profits revert to the mean historical average of about 6.4% of GDP, we have quite a ways to fall from current levels.

The 2nd concern that garners attention as of this writing, is the 'recession' thing. At the end of June, the Commerce Department stated that the economy shrank by 2.9% in the first quarter of 2014; a large decrease over the previously reported drop of 1%.

This is certainly not to say that a recession is in the cards, but it is something to keep an eye on.

How to protect yourself in any market!

Be Defensive. Protect what you have.

As simple as this sounds, it is advice that few investors follow. I believe, this is because many people have never been shown how to do this. What I'll try to do here is offer (in plain English) what it is that you should do:

1. Don't overpay for any stock. When you buy a security below its intrinsic value you have already built in a margin of safety. Be very stingy with your investment dollars. Try not to buy anything that isn't a screaming deal. If the market goes down and you are holding a company that you bought below cost, it is highly likely that it will hold its value better than the rest of the market.
2. Next, it is **so important** to know when to sell. The easiest way to do this is to stick with trailing stop losses. You set those up when you first buy a stock. For example, let's say you bought a security for $25 and are willing to lose up to 25% on that stock. If the price goes to $18.75 sell...and don't look back.
3. Ok, so you now know when to cut your losses, however; you also want to protect your gains and not sell too early. The easiest way to do this is to set your stop-loss as a ***trailing stop loss***. The way this works is when you buy that $25 stock and are willing to lose 25%, you are also saying that you can let it run up, and then pull back, 25% before you sell it.

The example works like this:'

You pay $25 and set the trailing stop loss for 25%. The stock goes up to $50, and although you may be tempted to sell on the way up, you hold on until it retreats 25% from its high.

So, when the stock retraces from $50 to $37.50 you sell. What you don't want to do is sell too early. The stock may go up to $75...or $100. Knowing that you have a system in place allows you to let it go as far as it wants. If it hits $100, you sell when it retraces to $75.

4. Part of portfolio risk-management has to do with never putting too many eggs in one basket (no matter how enticing.

The rule here is to cap any one investment at no greater than 5% of your portfolio value. So, if you have a portfolio of $250,000, the maximum you'll invest in any one stock is $12,500.

Now, in keeping with our 25% trailing stop-loss, this means that if your $12,500 drops by 25% down to $9375, all you have lost is $3125 which represents .0125% of your nest-egg. You can probably live with that.

5. Always know why you own a particular stock. That way, if the reason for owning it goes away, you'll know it's probably time to sell.

6. Try to keep your investments in tax-deferred accounts. This truly illustrates the magic of compounding.

7. If you can't find something good to buy...don't buy anything. Hold your cash until that screaming bargain comes to you again.

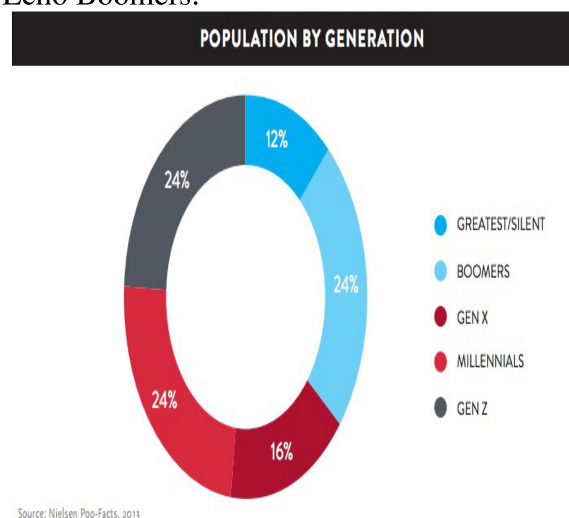
Demographics: Predicting the future stock market.

I love statistics. Well, not really...they tend to lie a bit. What I do love, however, are demographics. It's a science that undoubtedly gives us a peak into the future.

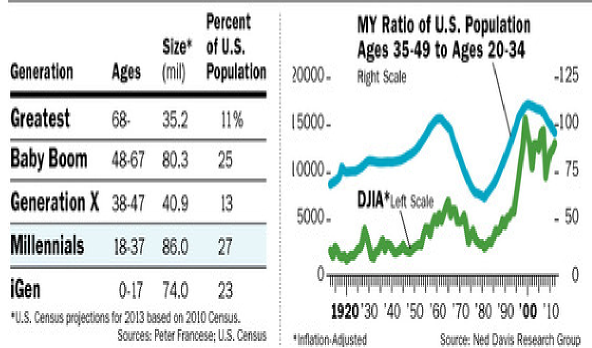
As you can see from the chart below, according to the U.S. Census Bureau, total consumer spending tends to peak at about age 46. This foretold the booming stock market based on baby boomer spending through the 90's and up till about 2007, when the last of the boomers were going through that peak-spending phase of their lives.

So, now we ask: what's going to be ACT 2, and how is it going to affect our investments? In retirement, that's a pretty important consideration.

Well, here it is. The Millennials: AKA , GenY and the Echo Boomers.



As the previous chart illustrates, the Millennials are as big as the Boomer generation...actually a little larger.



Generation	Ages	Size* (mil)	Percent of U.S. Population
Greatest	68-	35.2	11%
Baby Boom	48-67	80.3	25
Generation X	38-47	40.9	13
Millennials	18-37	86.0	27
iGen	0-17	74.0	23

*U.S. Census projections for 2013 based on 2010 Census.
Sources: Peter Francese; U.S. Census

According to economists, they are predicting that we will feel the effects of GenY spending probably sometime around 2020-2023. Oops. So what happens for the six to nine years between now and then? And, how is group going to spend their money?

HERE ARE A FEW PREDICTIONS:

Housing

Millennials appear to want to maintain smaller houses than the ones we grew up in. Right now, home builders are benefiting from the sale of larger, more expensive homes, largely because of the baby boomers. But look for the tide to turn.

As millennials approach their 30s, they are likely to focus on smaller, less expensive homes. As an investor, you should focus on home builders that cater to this trend.

Cars

Millennials increasingly prefer to live without cars, with many of them choosing to live in urban environments. My own two millennials do not own a vehicle and have no desire to have one.

The fact is you should look for fewer cars per household, and look for those cars to last a very long time, as the trade-up trend starts to fade.

E-Tailing

In an extension of a trend that has been underway for more than a decade, look for more retail sales to take place online, and fewer in brick-and-mortar stores.

For the echo boom generation, looking at products on the shop floor, but turning to the Internet to make the purchase at the lowest price is a way of life.

As an investor, look to which online retailers are building a strong and loyal base of customers. Conversely, you should tread lightly with any legacy bricks-and-mortar retailer that has failed to embrace the world of digital shopping.

Ethnicity

The millennials are much more ethnically diverse than their parents, which is already impacting consumption trends. For example, Spanish-language media and entertainment has grown at a fast pace over the past decade, and even as many Hispanic Americans eventually transition into English-speaking households, they are still likely to be avid consumers of Hispanic food and culture.

The Next Boom

In a survey conducted by the Pew Research Center, only 15% of millennials expressed a desire to have a high-paying career, while 52% of them expressed the desire to be good parents as their number one goal.

This suggests that this 82 million-strong demographic will be buying a lot of baby formula and diapers, and consuming a lot of educational programming on TV and online.

The Investing Answer:

The millennials will slowly become a powerful economic demographic. That makes this a good time to study their consumption patterns and start identifying the companies that stand to benefit the most from their coming wave of spending.

In the meantime stay invested with the best companies you can possibly own, and make sure that those dividend checks keep rolling in.

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