

TIME TO SAVE WITH CHRIS & DAVE

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Never Forget Where You Came From!

Have you ever walked into a room and forgot what you went in the room for? I'm sure all of us have done that at one time or another. Tony Randall and Tom Hanks did a skit on this subject some time ago when they appeared together on Saturday Night Live, the late night comedy show. In this particular episode, Tony Randall played a game show host and Tom Hanks played a contestant with no short term memory. As you can expect, Tom Hanks' character kept forgetting all the questions. In fact, he kept forgetting that he was even introduced to Mr. Randall. So, every few minutes he would remark, "Hey, it's Tony Randall!" If you saw and remember this sketch, it was really quite funny.

The reason why I brought this story up is from time to time we can forget moments in our lives and how we felt during them. Just one year ago, the very fabric of our economy, namely capitalism and free markets, were being put into question. Our government, which rarely got involved in the daily operation of private companies, took unprecedented steps to prevent a systemic collapse of the entire financial system with the introduction of many new and innovative assistance programs. By the first quarter of 2009, uncertainty as to whether or not these programs would actually work led to a lot of fear and anxiety for many investors. As a result, the S&P 500 Index gradually declined till March 9, 2009 when it bottomed at 677 (source: BTN Research).



Thirteen months later, the financial system has improved and it appears we have averted a depression. Even though many Americans are still unemployed; interest rates remain low. Likewise, the flow of credit between institutions that had slowed to a trickle is once again functioning and the government is starting to rein in some of their assistance programs. As a result, all major indices have risen off their lows of one year ago. As of March 5, 2010, the S&P 500 Index stood at 1139 and the U.S. economy seems to be in for a mild recovery (source: BTN Research). Even though there remains some concern as to the viability of this recovery, I thought it would be beneficial to look back at one year ago to see where we came from and what lessons we can derive from that moment so as not to repeat the same mistakes if and when the market goes down in the future.

1. **Having an emergency fund** – There are several reasons for having an emergency fund. First of all, many people lost their jobs during this recession. Unfortunately, some people are losing their homes too because their mortgage payment was dependent upon both spouses working to make

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ends meet or they lived paycheck to paycheck. With little or no short term savings, people are forced into a bad situation where they have no money to pay their monthly bills. Since the future is always unknown and no job is 100% secure, we recommend people save between three and six months expenses in an emergency fund to meet their short term liabilities in the event of a job loss or other unforeseen event.

Secondly, as many of these events unfolded, the stock market declined to levels not seen in a decade. But, if you remember the investing principle “buy low, sell high”, this also created a wonderful buying opportunity as well. Once again, if you didn’t have any money set aside to take advantage of this moment, low prices didn’t mean very much. As such, leaving some of your money in cash and cash equivalents is a good strategy to take advantage of temporary dislocations in the market.



2. ***Not following the crowd*** – Let me provide you with two statistics from this time last year. On 3/11/09, according to the American Association of Individual Investors, 70% of investors were bearish (negative) on the US stock market. Likewise, in late March 2009, 58 out of 100 money managers surveyed by Barron’s Magazine did not believe that the bear market had reached a bottom. As a result of all of this uncertainty, many individual investors exited the stock market early last year and put their money into safe U.S. Government Bonds and money market accounts. If you asked many of these individuals their reasoning behind this decision, they may have responded by saying something like “it’s what everyone else is doing!”

This behavioral phenomenon, where people base their own decisions on what the majority of others are doing, is called “herd mentality”. Herd mentality feeds off of the human emotions of greed and fear and typically begins and ends in periods of frenzied buying (bubbles) or selling (crashes) in the stock market. Let me provide you with a few examples.

In the late 1990’s, everyone was talking about Y2K and the internet. At that time we saw many technology companies go public for the first time by listing their stock on an exchange. Typically, newer companies do this when they want to grow and expand but do not have the requisite capital. In most of these cases, startup companies do not show a profit for several years due to the large amount of debt they assume and the time it takes to grab market share. However, in the late 90’s it seemed that any internet company that went public, their stock price would double or triple in a short period of time. As this started happening more and more with each additional I.P.O, mutual fund companies and investment banks started to introduce and market more technology stocks and internet funds to the buying public. As word spread through parties and social functions, average investors started to follow the herd and invest in these companies. Eventually, though, expectations and prices became so ridiculously high that there weren’t enough people willing to take the additional risk in purchasing these poorly managed and highly leveraged companies. As a result, in March of 2000, the internet bubble burst leaving many of those who bought into the internet craze at the end saddled with the steepest losses.

The bursting of the internet bubble led to the next herd story. To combat the declining stock market from 2001 to 2003, the Federal Reserve lowered interest rates to extraordinarily low levels. This allowed many people to buy first or second homes. As more and more people started to buy real estate, home builders increased production to keep up with demand. When they couldn’t build homes fast enough, many people started to follow the crowd yet again by purchasing existing homes and then flipping them shortly thereafter for a significant profit. Some of these people had very little home remodeling experience but they knew they

could make a lot of money doing it. When home prices started to get too high, mortgage companies pushed interest-only mortgages, or mortgages with a low introductory interest rate for the first five years and where you only have to pay interest and no principal during this period. As more and more people's family and friends started to purchase homes, everyone else wanted to own one too, even if their income was more conducive to renting. Eventually though our country reached a point where the majority of the people that qualified for a mortgage had one. Also, some of these interest-only loans that were sold in early 2002 and 2003 started to reset at higher interest rates. This left many people with mortgage payments they couldn't afford. As a result, by 2008, the demand for housing started to fall and the supply of homes grew. As such, those individuals who were buying homes to flip and those companies that bet heavily on the housing and mortgage industry continuing its meteoric rise were now being left with the overpriced supply and bad loans as demand fell.

As mentioned before, in reaction to the housing market bubble bursting, many people followed the herd yet gain and sold out of the stock market thereby putting their money into U.S. Government bonds. But, since March of 2009, the rate of return on stocks from the market low is 68% whereas the rate of return on Treasury bonds is 5.3% (source: BTN Research & Morningstar Direct).

As you can see, these are just three good examples of herd mentality over this past decade. In each of these cases the prospect of enormous wealth blinds people in their decision making to follow the crowd. Yet, what happens to many investors when they do this is, by the time they hook up with the herd, the majority of profits have already been made thus saddling them with the biggest losses. You would think that investors would learn the importance of not following the crowd by seeing what happens to those who do. Yet, many do not. One way to possibly avoid losses in your investments is to do the opposite of what the majority of others are doing. While not the popular choice at the time, it may be one strategy to reap a greater reward in the end.

3. ***Finding opportunities in a crisis*** - Another thing that amazed me with this market decline was how quickly fear and uncertainty spread as a result of the media. With the advent of CNBC, the internet, texting, and social networking sites like Twitter, information flows so much faster than it did just a decade ago. And, along with the speed of information, emotions and rumors can be spread just as fast. The problem that I have with information flowing so quickly is that information is so one sided and biased towards the negative. It seems that no one wants to say anything positive because good news doesn't sell. And, since all everyone hears is pessimism, everyone assumes the absolute worst. Let me give you an example.



Last year it seemed that all the news stories were devoted to the "Great Recession." Job layoffs, bankruptcies, sluggish car and retail sales were all you heard about. What the media didn't report was that interest rates had come down significantly allowing people to refinance their mortgage. Also, the wage tax had decreased putting more money in people's paychecks. Finally, if no one was spending money on going to the movie theater, eating out, or buying a new car, doesn't that mean that more people were watching movies at home, eating in, or buying a used car or repairing the one they already owned? Aren't there companies that focus on slower consumer spending and will benefit financially from that? Absolutely, but you didn't hear that message from the media. I guess what I am trying to say is there are always two sides to every story and there are opportunities to make money even when the market goes down. Just please be aware of this fact before rushing to any decision.

4. ***Market movements are random*** - Physics laws say that objects in motion tend to stay in motion. Last year, I can't remember how many clients said to me "at the rate the market is moving down I'm not going to have any money left in a few months!" This is a common behavioral misconception because the brain is constantly looking for patterns in the world around us. Saying that stock prices will continue in the direction they are currently going is an example of this phenomenon. Just so you know, the stock market moves on people's emotions and any new information that

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becomes available. Depending upon whether news is good or bad should determine the direction of the market that day. And, just because one day there is more bad information than good, doesn't mean that the next day it will be the same. For anyone who wants to invest in the stock market, they must accept this undeniable fact that on any given day the market could go up or it could go down. So, just like a rubber ball will stop and go in the opposite direction when it hits a brick wall, the market will stop falling and change direction when there is more positive news than negative news.

5. ***The importance of leadership and integrity*** – Having a good leader in a time of uncertainty can make all the difference in the world between succeeding and failing. One example of a good leader would be President John F Kennedy during the Cuban Missile Crisis. On the opposite end of the spectrum would be Michael Brown, the head of FEMA (Federal Emergency Management Agency), who failed to immobilize our country's resources after Hurricane Katrina hit the southern United States. In the business world, a leader with integrity would be someone like Warren Buffett who is paid only \$100,000 a year to be CEO of Berkshire Hathaway. On the opposite end of the spectrum would be John Thain, the former CEO of Merrill Lynch who, when faced with the prospect of his entire company declaring bankruptcy and bringing down the entire financial system, spent his time negotiating a highly paid compensation package for himself and other executives for merging his company with Bank of America. No matter what political party affiliation you support, the work of Ben Bernanke, the Federal Reserve Chairman, and Henry Paulson, the Secretary of the Treasury, in late 2008 and early 2009 possibly averted another depression. Did they do absolutely everything right? No. But they were able to do enough right to make a difference.

When selecting investments for our clients, we try to follow a similar philosophy in that we try to find companies that are run by competent individuals, with lots of integrity, who are fairly compensated, and are able to make good decisions under pressure.

In reaction to all that has happened, there has been a profoundly noticeable shift in Americans attitudes towards their own personal finances. In particular, many people are adjusting their spending habits and looking to save more for the future. In general, people are taking more responsibility and control over their personal finances. The one concern that Chris and I have though is will investors make the same mistakes the next time the market drops because they forgot what one was like? We hope not. But by remembering the five points above and having the advice and guidance of a financial advisory team that understands all the nuances and emotional mistakes that investors make and that can cost them money is a step in the right direction. I hope you know that Chris and I try in each and every newsletter and meeting to educate and provide you with the best advice we can. The message we continuously repeated over this past year and a half was to remain patient, stay invested, and have a plan in place. In time, the market would come back and those who remaining disciplined and had a strategy in place would be better off than those who did not. I hope that by analyzing previous historical downturns and remembering where we came from you can now see and understand a little better the reasoning behind our statement.

The "Things To Do When The Market Goes Down" List

Another important lesson we learned last spring was sometimes life isn't all about money. (Yes, those words just came out of the mouth of a financial advisor.) But it is true. As the stock market declined in 2009, Chris and I found ourselves reminding some clients who were stressed out over the value of their accounts that there are so many more enjoyable activities to do in life by just turning off the TV set. Well, I recently decided to compile a list of inexpensive things one can do instead of following the stock market. Here they are below. Please feel free to e-mail me if there is something you did or anything you can think of that should be added to the list:

- ◆ Rent a feel good movie like "Rudy", "It's A Wonderful Life", "Miracle", "The Terminal", or "Pursuit of Happyness".

- ◆ Call a friend you haven't spoken to in a while.
- ◆ Visit a shut in or elderly person in a nursing home.
- ◆ Write a letter to a soldier or thank a veteran.
- ◆ Read a book to yourself or a child.
- ◆ Tell stories of your past to your grandchildren.
- ◆ Organize your old pictures and photo albums.
- ◆ Listen to music.
- ◆ Visit the zoo or museum.
- ◆ Volunteer at a charity that you enjoy.
- ◆ Go for a bike ride, hike, or walk in one of our scenic parks. (Any exercise is good!)
- ◆ Build a puzzle or do a crossword
- ◆ Revisit an old hobby that you may have neglected recently.
- ◆ Play a board game with friends and family
- ◆ Pay someone a compliment.
- ◆ Make a list of things you are grateful for.

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Life is too short and the years go by so fast to worry about what the stock market is doing on an hourly basis. At the end of one's journey on this Earth, I truly doubt that we will regret not buying or selling that stock when we had the chance. In the end, it's the little things in life that count. Sometimes we need reminded of that as well.

Product Update

Doesn't it seem like just yesterday that your children and grandchildren were born and now they are graduating college? For those who have family graduating college this spring, it marks a wonderful milestone in their life. Graduation also introduces college students to the real world and the very important issue of what to do about health insurance coverage now that they will no longer be eligible to remain on their parent's plan. Going without health insurance coverage can be a very risky decision. In fact, according to a 2007 study by Harvard Medical School, 62.1% of 2,314 random people that declared bankruptcy, did so due to unforeseen medical expenses and going without health insurance coverage.



One way to prevent this from happening is to purchase a Short Term Medical policy to bridge the gap between the time a son or daughter comes off their parents coverage and when their new work benefits begin. This type of coverage is usually good for 30-365 days and protects someone from major expenses associated with hospital visits, prescription drugs, and surgery. It can cover up to \$2 million in medical related expenses but it will not cover a pre-existing condition. The premium is relatively inexpensive and an application and payment can be accepted online for coverage to begin the following day. If you or someone you know has a young adult graduating college this spring, please inform them of this type of insurance and have them give us a call to get a free quote and talk about the basics of these programs in more detail.

Speaking of college, if you haven't heard of the American Recovery and Reinvestment Act of 2009 bill that was signed into law in early 2009, you may want to read below. This bill was created as an expanded version of the Hope Scholarship tax credit and is called the "American Opportunity Tax Credit."

This new credit is available for parents who spend \$4,000 of their own money on their child's post-secondary tuition, fees, books, and materials. This credit is only applicable for undergraduates in their first four years and enrolled at least half time. The credit is dollar for dollar on the first \$2,000 of expenses and 25 cents on the dollar for the next \$2,000 of expenses up to a maximum of \$2,500 per student. Please note that the parents modified adjusted gross income must be below \$160,000 for married couples filing jointly and \$80,000 for single taxpayers. (There is a partial credit between \$160,000 and \$180,000 and 80,000 and \$90,000.) As always, please check with your accountant to determine if you are eligible for this credit.

On a similar note, please remember that if you are a PA resident and contributed to 529 College Savings Plan in 2009, then you can deduct that amount from your PA taxable income when you file your state tax return. If you live in any other state, please check with your accountant or Department of Revenue.

Tax Tips
Tax Tips

**** A Final Word From Dave ****



I forgot to mention in the last newsletter that Chris and Ruth Ann Volk's daughter gave birth last December to a healthy, 9 lb, 1 oz, baby girl named Liliana. It is Kim and Chad's first child and Chris and Ruth Ann's first grandchild. Please congratulate them on this glorious event if you should speak with any of them. In light of this wonderful news, the next newsletter issue I'm going to talk about ways to educate your children about money. Stay tuned...

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