

# INVESTMENT UPDATE

## THE MUNCY BANK & TRUST COMPANY

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### Points of interest:

- U.S. government bonds have beaten U.S. stocks over the last 5-, 10-, and 20-year periods.
- Bond investors gained 8.62 percent on an average annual basis since 1989.
- Stock investors gained 7.76 percent on an average basis since 1989.
- Bonds offered big capital gains over the years as interest rates declined.

## BONDS HAVE TRUMPED STOCKS, BUT WHICH WILL WIN IN THE FUTURE?

**T**he historic bear market of 2008 has shaken a foundational faith of many investors. It has long been believed that stocks offer the best returns over lengthy periods of time.

Instead, the latest statistics show that long-term U.S. government bonds have offered higher nominal returns than stocks over the last 20 years, 10 years, 5 years, and 1 year through June.

Some investors may be kicking themselves for ever investing in stocks and suffering through two major bear markets and one minor bear market over the last 20 years.

Since June 1989 the Standard & Poor's 500 Index has offered a 7.76 percent annualized return. The Ibbotson and Sinquefeld index of long-term government bonds, however, has gained 8.62 percent a year on an annualized basis.

Indeed, government bonds gained 7.55 percent per year over the last 10 years, beating stocks by almost 10 percentage points annually. Stocks lost 26.22 percent over the year ended in June vs. a gain of 7.67 percent for bonds.

### The great deflation

The reason bonds did so well is easy to see: interest rates hit their highest peaks of the 20th century back in the early 1980s as the Federal Reserve Board pushed up rates to fight double-digit



Owners of government bonds have been a lot happier than common stockholders in recent years.

inflation. Twenty years ago government bonds with 10 years or more to mature yielded 8.2 percent, according to the Federal Reserve Bank of St. Louis.

Since then bond yields have steadily fallen as inflation has declined. As yields on new bonds decreased, older bonds with higher yields commanded higher prices. Thus investors who bought bonds at the peak of the yield cycle 20 years ago have enjoyed capital gains on their investments.

An investor looking at past performance statistics might draw the conclusion

that bonds are a better bet than stocks.

### No repeats?

That is not very likely, however. Long-term government bond yields today stand at around 3.6 percent, and offer little room for further declines that would lead to capital gains.

Indeed, the president of Ibbotson Associates has warned that investors probably won't get the returns from bonds that they need to keep up with inflation going forward.

"This is the worst time to put all of your money into

*(Continued on page 2)*

## BOND MARKET RETURNS GOING FORWARD MAY BE FAIRLY MODEST

(Continued from page 1)

bonds, given the low-yield environment," said Peng Chen upon release of a report by his company on stock and bond returns over the last 40 years.

Ibbotson forecasts that bond returns going forward will average about 3 percent to 4 percent annually. Stocks, which hit bargain levels at the market's low on March 9 of this year, may have better prospects.

Indeed, through June of

this year the S&P 500 gained 3.2 percent since Jan. 1 while long-term government bonds lost 13.7 percent.

Ibbotson's study showed that the best bet is to avoid a choice between stocks and bonds. Instead, it is better to own both.

It constructed a portfolio of 60 percent stocks and 40 percent bonds and tracked its performance over the last 40 years. It had an average return of 9.1 percent, beating the 8.8 percent return on bonds and the 8.7 percent



Stocks may be set to beat bonds.

return on common stocks. The diversified portfolio also offered a more stable return than the stock market over the years.

## BE WARY OF ANNUITIES WHEN RATES ARE LOW

The market turmoil of 2008 and 2009 convinced some investors to yank their money out of a volatile stock market in favor of something more staid.

Insurance and investment salespeople have been touting fixed, tax-deferred annuities as alternatives to the stock market and to low savings rates offered at banks and money market funds.

Fixed annuities pay a specific interest rate each year and the interest accumulates tax-free until withdrawn or the annuity is surrendered.

**A form of insurance**  
Insurance companies sponsor the annuity contracts, and also promise to pay at least the original principal value—or the principal plus interest—to beneficiaries if the annuity owner dies.

But the main attraction for buyers is "safety" of principal and an attractive interest rate.

Recently some insurers have offered rates as high as 4.5 percent during the first

year the annuity is held. That rate is far higher than the certificate of deposit and money market savings rates offered by banks.

However, usually the initial interest rate is a "teaser," and the rates paid in subsequent years may be much lower.

If you could easily get out of the annuity and reinvest elsewhere when rates rise there would be no problem, but you can't.

Virtually all annuities charge a surrender penalty if you cash out within the first five to seven years. That penalty is steep in the early years, often equal to 7 percent of your investment.

Some annuities allow you to withdraw up to 10 percent

of your principal each year without penalty, but the remainder stays locked up.

### Inflation hurts

Right now we are in a period of low inflation and abnormally low short-term interest rates. The Federal Reserve has pushed short-term rates nearly to zero in order to combat the

recession.

This state of affairs will not last forever. Economic experts predict that as we move out of recession, inflation will pick up and interest rates will increase.

Fixed annuity owners may be stuck with interest rates that are less than inflation and no ability to reclaim their investment and put it elsewhere. A good alternative right now would be short term corporate or municipal bonds, which pay high rates and are more flexible.



It may not be wise to tie up your nest egg right now in a fixed rate annuity. Surrender penalties could hamper you when interest rates rise.

*"Virtually all annuities charge a surrender penalty if you cash out within the first five to seven years."*

## PERSONAL DEBT IS NO LONGER COOL. HOW TO PAY IT OFF QUICKLY

The subprime mortgage debacle, high unemployment, and a weak economy has put personal debt in the spotlight for American consumers.

Many are rethinking a lifestyle that requires constant borrowing, monthly payments, and high interest charges.

It has long been an axiom of good financial advice that personal debt is a non-productive drain. The less debt you have, the more ready cash for saving and investing.

### False benefits

Most borrowers understand that consumer interest on car loans and credit cards is not tax-deductible. But it has been a matter of faith that mortgage and home equity interest is "good," because it is tax-deductible.

But there is another way to look at it: the tax savings you get from deducting interest is worth less than the dollars you would save by not paying any mortgage or home equity interest.

For instance, \$4,000 in mortgage interest would only save you \$1,000 in federal taxes if you are in the 25 percent bracket. So not paying the interest would increase your taxes by \$1,000, but you would still be \$3,000 ahead.

### How to pay it off

There is a relatively painless way to accelerate the repayment of a group of debts without increasing your current monthly payment burden.

Just add up the total monthly payments you make today, and vow to continue paying that total amount until the last debt is gone.

This means that after the smallest or shortest-term debt is paid off, you will apply the payment from that debt to the next smallest loan. Eventually, all of the payments for the loans you have paid off will be applied to the largest loan, and you will greatly decrease the time it will take to repay it.



Feel burdened by loan payments? You can pay them off using a simple method.

For instance, say you have a 36-month car loan at \$250 a month, a 10-year home equity loan at \$500 per month, and a 30-year mortgage at \$750 a month.

As soon as you pay off the car loan, add \$250 to the home equity payment to accelerate its payoff. Once that is paid off, you can double your mortgage payment to \$1,500 per month and shave off years of payments and interest, eventually leaving you free of debt.

*"Just add up the total monthly payments you make today, and vow to continue paying that total amount until the last debt is gone."*

## RETIRED WOMEN, RICH FEEL BETTER, & MORE

Women face a tougher road in retirement than do men, a study by the Women's Institute for a Secure Retirement found.

One in five single women over age 65 live in poverty. That problem could grow worse.

Women at age 65 on average live four more years than men, so they need to have more resources at retirement. Also, women are more likely to spend some of their retirement years alone due to divorce or widowhood.



Finally, nearly 40 percent of women living alone depend on Social Security for most of their income.

### Confident millionaires

Millionaire households are becoming confident about investing again, a survey of 1,000 millionaires by Fidelity Investments found.

A third said they would add bonds to their portfolios over the next year, while another third said they would invest more in stocks.

They advised other inves-

tors to remain optimistic, cut back on spending, and save more.

### Fewer wealthy people

The number of high net worth people with \$1 million or more to invest declined by almost 19 percent last year.

The smallest decline was felt in New York City, where those in the high net worth club dropped by 13.6 percent, said the consulting firm Capgemini.

The sharpest decline was recorded in Orlando, where the number of wealthy declined by 42 percent, followed by Las Vegas with a 38 percent drop.

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## ARE BROKERS FINALLY READY TO PUT THEIR CLIENTS' INTERESTS FIRST?

Wall Street may finally be ready to accept the higher standard of client care that it has opposed for years.

Customers of stockbrokers and investment representatives at banks may think their representative is giving them impartial investment advice, but current standards do not require that.

Stockbrokers currently are not required to disclose conflicts of interest or to place their clients' interests ahead of their own.

For instance, they may push a stock that has been underwritten by their company without disclosing that they may get a better commission for selling that investment.

The main lobbying group of the broker industry, the Securities Industry and Finan-



Brokers may have to decide whether or not to place their clients' interests ahead of their own.

cial Markets Association, in July said it would support the Obama administration's proposal to make brokers adhere to a higher fiduciary standard.

Fiduciaries are required to place a client's interest first when providing investment advice and to disclose any potential conflicts.

Independent advisors regulated by the Securities and Exchange Commission

and who have the Certified Financial Planning™ designation have long acted as true fiduciaries.

Ironically the broker industry seems to think that accepting the higher standard will be in its self interest because it will promote the use of more fee-based accounts, which could improve broker firm revenues.

However, it is possible the fiduciary standard will have to be watered down when applied to brokers, reported *The Wall Street Journal*.

It said there is still concern about how to treat brokers who sell securities underwritten by their firms or held in the firm's inventory.

The standard may only be applied when providing certain forms of personalized investment advice, but not when trading securities.