

INVESTMENT UPDATE

THE MUNCY BANK & TRUST COMPANY

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Rising common stock dividends offer a good choice for income investors. **2**

Insurance is confusing and it is easy to make mistakes. **3**

Average gains aren't so average, who makes up the richest 1 percent, and more. **3**

Closet index funds charge high fees but don't deliver. **4**

Points of interest:

- As we age our knowledge of general financial concepts seems to decline steadily.
- However, it appears our confidence levels remain the same or increase.
- At age 80 we have about half of the financial knowledge we had at age 45.

FINANCIAL SMARTS DECLINE STEADILY FOR INVESTORS OVER 60

Just at the age when Americans have to make hard financial decisions about deriving income from investment portfolios, handling distributions from retirement accounts, and picking the right health insurance plan, their understanding of financial concepts begins to decline, a new study shows.

Financial literacy seems to decline at a rate of about 2 percent each year after 60, say two finance professors at Texas Tech University and one from the University of Missouri.

At the same time, confidence in the ability to make decisions does not decline, say Michael S. Finke, John S. Howe, and Sandra J. Huston: "Increasing confidence and reduced abilities can explain poor credit and investment choices by older respondents."

The literacy test

They note that other studies have indicated that the cognitive abilities and math skills necessary for making money decisions tend to decline with age. Their study uses a 20-question test to see if corresponding financial knowledge changes as individuals age.

Four of the questions asked how confident the test-taker was in making money, credit, investment, and insurance decisions.

The other 16 questions touched on basic knowledge

necessary to make decisions in these four areas.

The most financially literate responders were between 45 and 49: they answered an average of 63 percent of the questions correctly.

At age 70, however, the average rate of correct answers was 45 percent, and by age 80 it was just 31 percent.

Try it yourself

How literate are you?

Here are questions from the test:

1. Savings account and money market accounts are most appropriate for A. Long-term invest-

ments, B. Emergency funds and short-term goals, C. Earning a high rate of return.

2. To reduce the total finance costs paid over the life of an auto loan, you should choose a loan with the A. Lowest monthly payment, B. Longest repayment term, C. Shortest repayment.
3. On which type of loan is interest never tax deductible A. Home equity loan, B. Adjustable rate mortgage, C. Personal vehicle loan.
4. The benefit of owning

(Continued on page 2)



As Americans age they start to lose the abilities and knowledge necessary to make sound financial decisions.

SEE JUST HOW GOOD YOU ARE AT THE FINANCIAL LITERACY TEST

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investments that are diversified is that it A. Reduces risk, B. Increases return, C. Reduces tax liability.

- The main advantage of a 401k plan is that it A. Provides a high rate of return with little risk, B. Allows you to shelter retirement savings from taxation, C. Provides a well-diversified mix of investment assets.
- To ensure that some of

your retirement savings will not be subject to income tax upon withdrawal, you should contribute to A. A traditional Individual Retirement Account, B. Roth IRA, C. 401k plan.

- If you have an insurance policy with a higher deductible, the premiums will be A. Higher, B. Lower, C. The same.
- Which policy provides the most coverage at the lowest cost for a young



Does your know-how beat a coin toss?

family A. Renewable term life, B. Whole life, C. Universal life.

Answers: 1-B; 2-C; 3-C; 4-A; 5-B; 6-B; 7-B; 8-A.

WANT INCOME? STOCKS ARE YOUR BEST BETS

For many years investors who wanted steady income turned to the bond market, where high interest rates offered a steady influx of cash without too much principal risk.

Those days are over, at least for now: the severe recession of 2008 and subsequent central bank actions have pushed long- and short-term rates down to near unprecedented lows.

In fact, yields on U.S. Treasury inflation-linked securities recently went negative, after yielding an average of 2.5 percent since they were first issued in 1997.

Lending money for free

This means “investors are now lending money to the government with the hope of receiving a sum 10 years from now that is worth less in purchasing power than the dollars they fork over today,” Wharton School Professor Jeremy Siegel recently wrote in a *New York Times* op-ed.

After a decade of slow growth and two severe recessions,

the negative yields reflect “extraordinary pessimism about the prospects for the U.S. economy,” added Siegel, author of *Stocks for the Long Run*.

Siegel thinks those concerns are overblown and recommends that income investors look to another source:

dividends on common stocks.

The average dividend on stocks in the Standard & Poor’s 500 Index exceeds 2 percent a year, he

notes. U.S. corporations have been steadily improving their productivity and selling more goods overseas. Their dividends represent only about 30 percent of their profits, meaning they have room to increase dividends. He believes that companies will do

just that.

Five percent growth

Per share dividends on S&P 500 companies have increased by 5 percent annually since the early 1960s, Siegel wrote.

And stock dividend growth

beat inflation in both the low inflation decades of the 1960s, 1990s, and 2000s as well as in the high inflation 1970s and 1980s.

Dividend growth has averaged 10 percent per year in recent years, he wrote

“Despite the sluggish economy,

the corporate sector is churning out record profits and increasing dividend payments,” wrote Siegel. “We believe dividend-paying stocks are the answer to a Treasury bond market that looks more dangerous than ever.”



Buyers of U.S. Treasury inflation-linked bonds are lending money to the government at a loss as interest rates have gone negative.

“The average dividend on stocks in the Standard & Poor’s 500 Index exceeds 2 percent a year.”

INSURANCE IS VITAL, BUT DON'T MAKE THESE BUYING MISTAKES

Deductibles, exclusions, premiums, terms, riders: the jargon and complexity of insurance baffles many consumers.

Unfortunately it also leads to lots of insurance mistakes. Here are some of the most common. All of them can imperil your financial plan. Use this list as a check-up for your own needs (and make sure you talk to your financial planner and insurance professional before making any rash decisions).

Buying too little

Homeowners run the risk of not being able to rebuild their homes if they carry too little replacement coverage. Young families often fail to get enough life insurance to cover expenses for survivors if a chief breadwinner dies early.

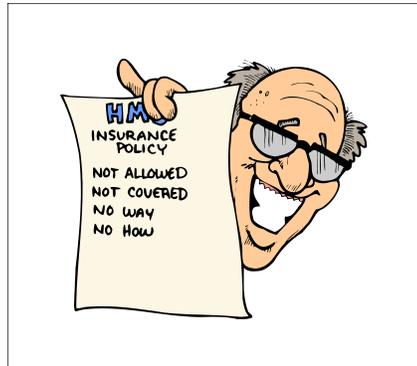
Buyers of cash value life insurance are frequently seduced by the "investment" aspects of the policy. In many cases long-term investment can be done more cheaply and tax effectively outside of a life insurance policy.

Ignoring potential liability can be damaging. When was the last time you saw someone who was injured go to court for less than \$1 million? A \$1 million umbrella liability policy may cost as little as \$200 a year and will supplement your homeowner's and auto policies.

Ignoring disability

Although a young family should have adequate life insurance, an even bigger risk is loss of income due to a long-term disability. Workers under 65 have a greater chance of becoming disabled than of dying. A disability policy can be invaluable if this happens.

Filing small claims, especially on a homeowner's policy, may cause higher premiums or even cancellation of insurance. Consider your homeowner's and auto policies as disaster coverage, rather than a piggy bank for small repairs and damages. Self insure for small items by



Buying the right types and amounts of insurance prevents costly problems later.

increasing your deductible, which will result in a lower premium.

Buying narrow coverage

Too many consumers succumb to sales pitches or specialized insurance policies. Burial insurance, cancer insurance, accidental death insurance and others may seem cheap, but that's because they are unlikely to pay off.

Instead, a good life insurance policy will handle those eventualities and any others that result in death.

"Filing small claims, especially on a homeowner's policy, may cause higher premiums or even cancellation of insurance."

AVERAGE GAINS, THE 1 PERCENT, & MORE

There are no such things as "average stock market returns" when considered on a calendar-year basis, says Vanguard, one of the biggest U.S. mutual fund companies.

Yes, the annual average return on the Standard & Poor's 500 Stocks index was 9.9 percent from 1926 through 2010, but that doesn't mean it delivered a 9.9 percent return in any particular year.

In fact, in only 6 out of the last 85 years did the average's return come close to

that 9.9 percent average, Vanguard says: "Financial markets, particularly stocks, are inherently volatile over the short term."

Who are the 1%?

The Occupy Wall Street protesters say the richest 1 percent are taking advantage of everyone else. But who are they?



Federal Reserve statistics indicate that it takes \$9 million of household wealth to earn admission to the 1 percent. When the 1 percent is defined by annual

income, you must make more than \$700,000 to join the club.

Dangerous activity

Many an academic study has shown that too much activity leads to poor investment results. Market observer Fred Schwed Jr. ("Where Are the Customer's Yachts?") already knew this when he wrote his humorous book in 1940: "Your average Wall Streeter, faced with nothing profitable to do, does nothing for only a brief time. Then, suddenly and hysterically, he does something which turns out to be extremely unprofitable. He is not a lazy man."

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WHY PAY HIGH FEES FOR ‘ACTIVE’ FUNDS THAT ARE CLOSET INDEXERS?

Indexed mutual funds that passively follow the makeup of a market index without making active decisions on where to invest have a huge cost advantage over their actively-traded counterparts.

Many funds that are indexed to the Standard & Poor’s 500 Stocks Index, for example, have expenses of just 0.07 percent of assets. That compares to an average expense ratio of nearer to 0.70 percent for funds that actively invest in large stocks.

For that extra expense investors are supposed to be receiving the benefits of the manager’s expertise in both stock selection and timing.

Unfortunately, a lot of actively-managed large-cap U.S. stock funds invest so closely to the S&P 500 Index that their portfolios and re-



Some funds charge investors for active management, yet end up acting like index funds.

turns are practically indistinguishable from the benchmark, says Morningstar, the mutual fund research firm.

That leaves investors in those funds with the worst of all possible worlds: they get an index fund, but with the high cost of an actively managed fund, it says.

Morningstar measured how much of each funds’ portfolio differed from the

benchmark. Funds with less than 60% of their portfolios differing from the index were labeled “closet index funds.”

Funds from such popular providers as American Funds, Fidelity, Vanguard, Putman, JP Morgan, and Russell made the Morningstar list.

Expense ratios on the funds ranged from 0.36 percent to 1.16 percent, it said. The fund with the

highest expense ratio—Putnam Fund for Growth & Income, had a five year annualized loss through 2010 of 0.38 percent, compared to a five-year gain for the S&P 500 of 2.3 percent.

Morningstar noted that large fund companies had more incentive to hug the indexes in order to avoid underperforming them and losing customers.