INVESTMENT UPDATE

2

THE MUNCY BANK & TRUST COMPANY

INSIDE THIS ISSUE:

Buy and hold investing lives on, despite the market's recent big swings.

Pre-retirees should consider long-term care insurance.

Empty nesters spend more than expected, women executives worry, and more.

Social Security benefits will continue, despite cash shortfalls.

Points of interest:

- Tactical asset allocators try to anticipate market fluctuations by moving money between different types of investments.
- Passive asset investors set up a diversified portfolio and let it ride.
- Strategic asset allocators set up a diversified portfolio and each year rebalance it back to its original allocation.

EVERY INVESTOR'S CHOICE: BE THE DUMB MONEY OR THE SMART MONEY

Investors have a lot of choice when deciding how to handle market fluctuations.

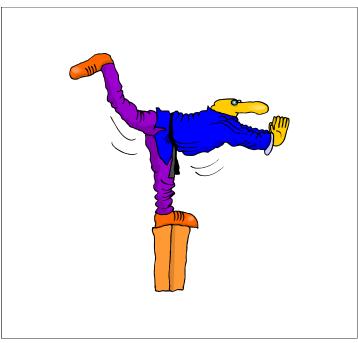
Many opt for "tactical asset allocation" - in other words, they move out of stocks, for example, when they think returns will be bad, and move back in when they expect better returns.

Many others choose a better strategy—they spread their money among a bunch of different asset classes and let it sit for a long period of time, no matter what the markets do. They tend to earn the market's long-term returns and do better than the tactical asset allocators.

But the smartest group of all takes this buy-and-hold approach a step further: they set up a specific allocation among various types of investments, and each year they put their portfolios back into their original balance by selling a portion of the investments that have gone up and putting the money into the investments that have gone down. These investors tend to earn the highest returns of all, investment studies show.

Dumb money loses
The tactical asset allocators who chase past performance of asset classes are commonly referred to as the "dumb money" by academics who study the markets.

These are the people who throw money into technology stocks or gold after they have soared, and yank it



Smart investors are like top yoga practitioners: they maintain balance among their stocks, bonds, cash, and commodities.

out after they have fallen.

These types of investors seem to have a unique ability to invest in stock mutual funds that tend to do poorly afterwards, found a recent study by Andrea Frazzini of the University of Chicago and Owen A. Lamont of Harvard.

The researchers found that winning investors do the opposite of what the dumb money investors think will earn high returns.

Tactical asset allocators are engaging in a zero-sum game, says Richard Ferri in his new book, "The Power of Passive Investing: More Wealth with Less Work" (John Wiley & Sons, 2011).

"When someone underperforms the market it means someone must have outperformed before fees and expenses," he writes.

Lower returns
From 2000 through
2009 (a period when stock
market returns were very low)
the average investor earned
1.7 percent annually from all
mutual funds, even though
the time-weighted return on
all funds was 3.2 percent, a
recent study by mutual fund
research firm Morningstar Inc.

Where did the 1.5 per-

(Continued on page 2)

Investment Update Page 2

TRADERS LOSE OUT AND PROVIDE EXCESS RETURNS FOR REBALANCERS

(Continued from page 1)

centage point difference go?

"Much of it went to brokers, brokerage firms and their trading desks," Ferri wrote. Some also went to "talented money managers who skillfully separate investors from their money."

A portion also went to buy-and-hold investors who rebalanced their portfolios annually, Ferri argues.

"Investors who lose with their tactical asset allocation strategies indirectly provide excess returns to investors who religiously rebalance their strategic allocation," he writes.

Using data provided by Morningstar, Ferri constructed a hypothetical portfolio held in January 2000 by the three types of investors. By 2009, the tactical asset allocator had earned 1.4 percent per year. The passive asset allocator who did not rebalance their portfolio earned 2.4 percent annually, while the rebalancer's return was 3.3 percent. "Strategic asset



Rebalanced portfolios earn more.

allocation and regular rebalancing provide what is widely referred to as the only free lunch on Wall Street," Ferri concluded.

THE VIRTUES OF BUYING AND HOLDING

Two of America's eminent investment researchers were recently asked whether the hyperactive markets of the last few years indicate that the concept of buy-andhold investing is outdated.

Their answer? Absolutely not, reports the *Journal of Indexes* in its May-June issue.

"Obviously, it would be much better if we knew when the market was going to go down 40 percent, and we could sell out at the top and buy at the bottom," said Princeton Economics Professor Burton Malkiel. "But nobody can do that."

Chasing the money In real life, amateur and professional investors alike seem to chase trends, rather than make smart moves in anticipation of market swings, he said.

"More money went into equity mutual funds in the first quarter of 2000, at the height of the bubble, than ever before," he noted. Then, at the end of that bad market, during the third quarter of

2002, "more money went out than ever before." Those who were trying to time the market were instead buying high and selling low.

Malkiel said that pension funds, which are managed by the smart professionals, tend to carry more cash when markets are a bargain and less

cash when markets are expensive. That is exactly the opposite of what a successful market timer should do.

Shortterm performance

should not be an incentive to invest, he said. "My own work suggests that there is very little persistence in performance, and today's hot funds are more likely than not to be tomorrow's turkeys," he said.

William Bernstein, author

of "The Four Pillars of Investing" and "The Investor's Manifesto," said investors don't often understand the concept of buy-and-hold.

Rebalancing is vital "What they forget is that the name of the game is not buy-and-hold—it's buy, hold and rebalance," he said. Investors

who set an investment allocation, and then stick to it by selling asset classes that have appreciated and buying those that have declined, have done very well over the past

tor to sell some stocks at the heights of the markets in the late 1990s and in 2007, and to buy some when they were at their low points in 2002 and early 2009. "That has been a fairly successful strategy," Bernstein said.

"Short-term performance should not be an incentive to invest."



Frenetic traders who try to time the ups and downs of the markets are doomed to fall behind those who buy and hold and rebalance regularly. 20 years.
Such a strategy would have forced an invesne stocks at the

Investment Update Page 3

DON'T WANT TO BURDEN YOUR KIDS? BUY LONG-TERM CARE INSURANCE

Retirees and those planning to retire say they are very fearful of uninsured health care costs, according to a number of financial surveys.

And the big worry for many is that they will end up being "a burden on my family," says Genworth Financial, which did a survey in 2010. That fear even outranked the fear of ending up in a nursing home.

Even though they openly worry about long-term care costs, relatively few Americans have made provisions for them, says the American Association for Long-Term Care Insurance.

Coverage crisis
The best antidote may be
the purchase of long-term
care insurance, but confusion
over coverage and the perception of high costs discourage potential purchasers.

Adding to the disincentive is current turmoil in the marketplace as some companies have stopped selling the insurance, while others are asking state regulators for

large rate increases.

Ironically, the market's problems illustrate the value of the insurance: insurance companies are finding that more long-term care policy owners hold onto their policies than expected, even in the face of rate increases. They have also found that they underestimated the claims that owners would make.

Apply early
Anyone who intends to consider long-term
care insurance should apply
for it years ahead of retirement, the Long-Term Care
Association advises.

Older applicants get turned down for coverage more frequently due to health conditions they have developed. Only 14 percent of applicants between age 50 and 59 are rejected, while 45 percent of those between age 70 and 79 are turned down.

Applicants who are married can keep costs down by



Long-term care insurance can take the bite out of nursing home costs.

applying for joint policies. The Association estimates it costs an average of \$2,350 a year for a 55-year-old couple to buy \$338,000 of combined benefits. If they buy an inflation rider, those benefits can grow to a potential \$800,000 by age 80.

Still not convinced you need this coverage? The Association estimates that 40 percent of those over age 65 will need two years of care, while 20 percent will need more than five years of care.

"Anyone who intends to consider long-term care insurance should apply for it years ahead of retirement."

EMPTY NESTERS, FEMALE EXECS, & MORE

Many parents assume that once they are done paying their children's expenses they will save more for retirement.

It may not be so, found a new survey by the Center for Retirement Research at Boston College.

It studied 5,000
households without children and found they spent an average of \$8,800 to \$10,300 per person on food, clothing, leisure items, vacations and the like.

Households with children

spent much less per person, an estimated \$4,700 to \$5,800 per person, the researchers said.

Female execs worry
Women in executive positions who make more
than \$75,000 a year
worry they will not have
enough money to retire,
found MetLife's Study of
Finances and Female
Executives.

Although they feel competent in other areas, including managing their household's finances, 62 percent said they were concerned about retirement. MetLife recommends more women protect themselves with disability and long-term care insurance while using an adviser to help them invest.

Retirement anxiety
Anxiety about retirement
finances tops the list of worries
for the general population as
well.

A new survey by Harris Interactive of over 1,000 adults found them worrying more about retirement than about uninsured medical expenses, rising gasoline costs, or soaring college tuitions.

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WILL FUTURE RETIREES BE ABLE TO DEPEND ON SOCIAL SECURITY?

With the release of the recent report by the trustees of Social Security about its future, scary headlines once again are proclaiming that its reserves will be exhausted in a few decades.

The latest report estimates that the reserves may be gone by 2036, one year earlier than previously estimated. The date was moved up due to the economic crisis of recent years, which reduced payroll tax collections used to fund Social Security.

How should this be viewed by those who are currently retired, planning on retiring in 10 years, and those planning on retiring in more than 10 years?

First of all, there is no need to panic. The depletion of the trust funds merely means that there won't be

date was moved up due to full benefits past 2036, recent estimates show.

enough money to pay 100 percent of promised benefits to retirees after 2036. Instead, Social Security will have to rely entirely on current payroll tax collections to pay benefits.

The latest estimates are that in 2036 it will pay 77 percent of promised benefits, and that by 2085 it will still be able to pay 74 percent of benefits. That means that

even if the system is not reformed before then, everyone should be able to count on receiving benefits. It is unlikely any other private or public pension system can count on that level of benefits that far into the future.

Second, it is likely that the closer we get to 2036 that Congress will enact reforms to keep the system operating at full capacity.

Back in 1983 when the system was threatened, a reform was instituted that extended full benefits for many years. At that time, the age of full benefit entitlement for younger workers was raised from 65 to 67 and Social Security payroll taxes were increased.

Without those reforms it was estimated at that time the system would go broke within a few years.

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