

# INVESTMENT UPDATE

## THE MUNCY BANK & TRUST COMPANY

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### Points of interest:

- Howard Ruff was a gold advocate who was let down by gold's crash in 1980.
- Joe Granville said "sell everything" and enjoyed fame until a new bull market left him in the dust.
- Pierre Rinfret missed the beginning of the 1982 bull market and then suffered a stunning loss in a gubernatorial race to Mario Cuomo.

## SCARY PREDICTIONS BY PERMA-BEARS END UP BEING HOT AIR

Volatile stock markets generate a peculiar type of celebrity known as the "perma-bear." This is the highly negative forecaster who gets credited with calling a bear market before it starts.

What you usually don't get told is that he or she has been calling for a bear market for years without success. When their big chance finally comes, perma-bears milk it for all they've got, selling books, newsletters, speaking tours and getting on television every time the market moves a squiggle down.

### Roubini's warnings

The latest famous soothsayer is Nouriel Roubini, who teaches at New York University and operates Roubini Global Economics.

He began calling for a collapse of the housing market and subsequent recession in 2005; three years later he was vindicated by the 2008 financial crisis and bear market. Roubini, who is now sought out by governments and investors worldwide, remains bearish and has earned the nickname Dr. Doom.

The problem with being a perma-bear is that you will only be right about a third of the time: in the past stock markets and the world economy have been in expansion the other two-thirds of the time.

### Ruff times

One of Roubini's prede-

cessors in the perma-bear role was Howard Ruff, a famous financial advisor and hard money advocate in the 1970s. He wrote a bestseller, "How to Prosper During the Coming Bad Years," in 1979, just a few years before the greatest bull stock market of the century began.

Ruff was a critic of stocks and advocated owning precious metals, art, and coins. He lost favor after gold peaked in a speculative bubble in 1980. In February 2009 he was at it again: he predicted stocks would crash just as a new cyclical bull market was beginning, leading to a doubling of stock prices.



Stock market forecasters who are permanently bearish often find themselves out of favor because markets rise more often than not.

### Joe Granville

A contemporary of Ruff's, Granville achieved huge popularity in the 1980s by claiming to use his own form of technical analysis, "on balance volume," to predict future stock prices. For one investment seminar, Granville dressed as Moses, carrying stone tablets and wearing a crown.

His market call to "sell everything" dropped the Dow Jones Industrial Average by 4 percent on April 22, 1980. He continued to proclaim the market was headed for imminent collapse after the last

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## PERMA-BEARS CONTINUE TO SEE BEAR MARKETS WHEN BULLS ARE NEAR

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secular bull market began in 1982. His popularity declined and he later wrote a book about winning at bingo. His latest call at age 88 in January was for a 50 percent market plunge this year.

### Political ambition

Another forecaster also failed to become governor of New York in one of the worst losses on record in the state. Wall Street financier Pierre Rincret was an advisor to presidents Kennedy, Johnson

and Nixon and a noted bear in the early 1980s.

On a speaking tour in New York the day the 1982-1999 bull market began, he said economic and stock market conditions were dismal and held no promise for recovery.

Rincret was beaten so soundly by Democrat Mario Cuomo for governor of New York in 1990 that he almost dropped the Republican line to third on state ballots.

Investors who seek guid-



Perma-bears make scary predictions.

ance when times are hard and markets are falling should always remember that, as Yogi Berra once said, it is hard to make predictions,

## BUY OR SELL? STOCK VALUATIONS SAY BUY

Economic turmoil in Europe, a slowing economy in China, and stubbornly high unemployment in the United States have scared a lot of investors out of the stock market.

Each day new headlines detail slowing growth and economic problems. In May U.S. stocks swooned by 6 percent and international stocks fell even further.

Yet it is times like these when investors should resist selling stocks out of their portfolio in order to gain a false sense of security by holding assets in cash and bonds.

In fact, now may be a great time to buy stocks for the long term.

### Bargain valuations

Stocks are relatively cheap compared to bonds. At the beginning of June the 10-year U.S. Treasury yield was just 1.47 percent. The earnings yield on U.S. stocks was 8.95 percent.

David Kelly, chief market strategist for J.P. Morgan

Funds, recently wrote that stocks are cheaper compared to Treasuries than at the end of any quarter in almost 60 years.

Meanwhile, Wells Fargo Advisors notes that the Conference Board's composite of Leading Economic Indicators has increased by 1.92 percent

through April. Since 1970 the index has increased at that pace eight times, and the average gain for the Standard & Poor's 500 Stocks

the next year was 12 percent.

The Federal Reserve and its counterpart central banks in Europe and Asia have all turned on the money spigots over the past year, keeping interest rates at historic lows

and supporting bond prices. Such actions in the past have always led to higher stock prices as both economic activity picked up and low interest rates made alternative investments unattractive.

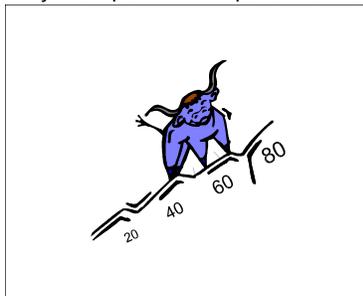
### Housing bottoms

Finally, several recent reports indicate that the housing

market has reached a bottom and may be starting a recovery. It was housing that brought the 2007-08 financial crisis to a head.

Investors who are too nervous to increase their stock allocations should at least make sure their

portfolios are rebalanced so that stocks and bonds are at their target levels. Any purchase of stocks now should be considered at least a five- to 10-year holding, and money due to be spent should be kept in cash.



There are several reasons to be bullish about stocks, despite the ongoing crisis in Europe and high unemployment in the United States.

*"Stocks are cheaper compared to Treasuries than at the end of any quarter in almost 60 years."*

## RUNAWAY INFLATION IS NOT BAKED INTO TODAY'S ECONOMIC CAKE

Although inflation currently is very low, higher food and gas prices, coupled with the Federal Reserve's pump priming operations, have some worried that we are headed back to the high-inflation days of the 1970s and early 1980s.

Critics of the Fed and other big central banks say their attempts to create growth by flooding the world with cash at low interest rates will inevitably result in double-digit inflation.

These worries are unfounded because the conditions for a return of high inflation do not exist right now, says the Vanguard Group's chief economist, Joe Davis.

### Carter and Reagan

Inflation hit its highest levels of the 20th century during the presidencies of Jimmy Carter and Ronald Reagan.

A sharp run up in oil prices during the Carter years helped to push inflation to just under 10 percent, followed by another run to over

11 percent during Reagan's first term.

The Federal Reserve Chairman under Reagan, Paul Volcker, raised short term interest rates sharply to slow the economy down, finally breaking the back of the inflationary spiral.

### Different times

But times are different today, and economic conditions are not like they were prior to the inflationary 1970s and early 1980s, Davis says.

There are five drivers of inflation: growth in disposable income (your take-home pay); growth in gross domestic product; the money multiplier, which measures how fast money moves around in the economy; home prices; and growth in bank credit.

All of those measures are far lower today than they were prior to the two periods of inflation under Carter and Reagan. Home prices, for



High inflation squeezes the value of future dollars.

instance, are falling, rather than rising at a 13 percent pace like they did in the early 1980s.

Although the Fed has created a lot of extra money, it is not circulating—banks are not lending and the money is sitting in bank reserves. Wages are stagnant, so there is no money to push up prices.

Davis recommends a balanced portfolio of stocks and bonds to deal with moderate to higher inflation over time.

*“Economic conditions are not like they were prior to the inflationary 1970s and early 1980s.”*

## GOLD DISAPPOINTS, 401KS GROW, & MORE

Gold has been on a tear since 2000, but its long-term record of growth for individual investors is pretty poor.

From the end of 1999 through 2011, gold beat most major equity asset classes, gaining an average of 12.3 percent per year, says Dimensional Fund Advisors, a large California-based investment firm.

But the record since 1975, when individual U.S. investors were first allowed to own gold, has been much worse. Since then gold has

returned only 1.82 percent per year, much less than stocks, DFA said.

### 401ks recover

The average 401k balance increased to \$474,600 by the end of March, up 8 percent since the beginning of the year, says Fidelity Investments, operator of Fidelity mutual funds.

Strong stock market performance accounted for 80 percent of the first quarter's growth, and contributions accounted for the other 20 percent, it said.

Fidelity's average 401k account has gained 62 percent since the bear market ended in March 2009, it added.

### Best online broker

Charles Schwab & Co. was selected as the best online stock broker by the ratings firm J.D. Power and Associates, it said.

Schwab had the highest customer satisfaction, followed by Vanguard, Scottrade, T.D. Ameritrade, and Fidelity Investments.

J.D. Power surveyed 3,730 investors to come up with the rankings.



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## SOME HEDGE FUNDS RUN INTO TROUBLE, BAIL OUT ON INVESTORS

As stock and bond markets were shaken by the 2008 mortgage crisis, the 2011 U.S. debt crisis, and now the European debt crisis, hedge funds have been touted as an alternative for investors seeking shelter and profit during volatile times.

Hedge funds are lightly-regulated investment pools for qualified investors whose asset levels and investment experience indicate they can take more risk than the average person.

Hedge fund promoters cite their ability to go anywhere and do anything, such as shorting foreign currencies and specific stocks, buying and selling options and futures, and moving into and out of entire asset classes on a moment's notice.

Recent years have shown



Recent market volatility has created massive headaches for some hedge fund operators.

that hedge funds are no panacea, however, and that they rightly deserve the adjective “risky” in their descriptions.

Unlike open-end mutual funds, a form of investment pool closely regulated by the Securities and Exchange Commission, hedge funds can close their doors at any time, giving investors no chance to make back their losses.

In recent months a num-

ber of well-known hedge funds have thrown in the towel due to bad bets on the European debt crisis.

Expo Capital Management, a \$458-million fund in Los Angeles, folded this month after two years of losses in its health care stock portfolio. The Fortress Investment Group in New York City liquidated its \$500 million commodities fund in May after losing 13 percent in the first four months of the year.

Others have followed suit. Hedge Fund Research of Chicago said 775 hedge funds went out of business in 2011, the highest number in several years.

Meanwhile, the traditional mutual fund industry saw only 194 fund liquidations during the year, said the Investment Company Institute.