

INVESTMENT UPDATE

THE MUNCY BANK & TRUST COMPANY

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Nervous investors have fled the market, many not equipped for retirement, and more. 3

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Points of interest:

- Countless academic studies and real-world evidence show that investors should shun individual stocks.
- Over any 10-year period the majority of stocks disappear from the market.
- Individual stock investors often pursue growth stories even though out-of-favor value stocks are more likely to win out.

SUCCESSFUL INVESTORS AVOID PICKING INDIVIDUAL STOCKS

One of the most dangerous temptations for investors is the potential for buying the next big hit stock, a stock that will grow at supersonic speed, far in excess of the overall market's growth.

The hunt for the next Microsoft (a few generations ago it was the search for the next IBM) has probably been responsible for more wealth destruction than any other investment fallacy.

Consider this:

- Although the U.S. stock market has survived periodic crises and thrived over time, the majority of stocks that make up the market vanish in any 10-year period, to be replaced by new stocks.
- Although successful investing is a long-term game, buying individual stocks shortens an investor's time horizon, forcing more decisions and increasing the risk of a bad decision.
- Using intuition or analytical skills to pick a stock often does not work because our intuition leads us to growth stories, while the market leaders year-to-year are often the counter-intuitive



Picking individual stocks, rather than investing in a broad-based stock market index, carries a whole set of particular dangers.

losers, the so-called value stocks.

Irresponsible investing

Much evidence exists to show that individual stock investing loses out to diversified market investing. Investors who ignore that evidence should be considered irresponsible, gambling with their own money or with the legacies they intend to leave to loved ones.

In the short-term, investing in a broad basket of stocks that resembles the market and investing in one or two individual stocks may have equal chances of success or failure. In fact, buying

the "right" individual stock in this scenario may give the individual investor a slight advantage of beating the market.

But studies have shown that over longer periods of time the diversified market investor has a much better chance of beating the individual stock investor.

One doesn't need a statistical analysis to intuit that result: since individual stocks can and do have larger declines than the overall market—or may cease to exist altogether—a certain percentage of individual stock invest-

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BUYERS OF SOME INDIVIDUAL STOCKS LOST ALL IN LAST BEAR MARKET

(Continued from page 1)

tors are guaranteed a much worse experience than the market.

Consider the bear market of 2008, when a diversified market investor lost 37 percent or more in American stocks. Yet individual stock investors who had been enjoying years of outstanding returns in some financial stocks like insurer AIG, Washington Mutual Savings Bank, or mortgage company Fannie Mae saw their investments sink

nearly to zero. Meanwhile, investors in Lehman Brothers did see their holdings vanish.

Diversified wins out

One study by Dimensional Fund Advisors, a California-based investment company, simulated returns on a concentrated stock portfolio and a diversified market portfolio over a 25-year period.

It found that the majority of potential diversified returns far outpaced the potential concentrated stock returns. The worst 5 percent of cases



Some stocks were wiped out in 2008.

saw the market portfolio nearly double, while the worst concentrated stock returns resulted in a loss of 91 percent.

DOWNFALL OF THE KING OF MARKET TIMERS

So you still think that it is possible for a smart investor to time the market, selling out before stocks drop and buying back in before they rise?

Even after countless studies show that this feat is next to impossible to accomplish except by luck, many investors are intrigued by the possibility of market timing. If the studies don't convince you, take a look at the results achieved by a newsletter writer who was hailed as the greatest market timer of all a few bear markets ago.

Joe Granville, guru

Joe Granville used to make the markets quake back in the 1970s through the 1980s, even though few remember him now.

He developed a financial indicator he called "on balance volume," which he claimed could predict those markets for which historical price and volume information was available.

Granville was a bear during several decades of poor markets that occurred

after the decline of the defense industry following the Vietnam War, the entry of the Baby Boomers into the workforce, and the oil price shocks that began in the 1970s.

"Sell everything"

He achieved notoriety for telling his thousands of newsletter subscribers to "sell

everything" on Jan. 6, 1981. The market had its biggest drop in over a year, which was attributed to investors taking his advice.

Even the mighty *Wall Street Journal* conceded his market-moving ability.

At the time he was earning the then enormous sum of \$6 million a year selling his newsletter, and running extravagant investment seminars that featured a trained

chimpanzee that could play Granville's theme song, "The Bagholder's Blues," on piano. He began to claim that he could predict earthquakes and told *Time* magazine "I don't think that I will ever make a serious mistake in the stock market the rest of my life."

Fall from grace

It didn't work out that way. He continued to be a bear as the market soared in the 1990s. Subscriptions fell off and he was hardly quoted by the financial media, who moved on to other gurus.

His track record also suffered, according to the *Hulbert Financial Digest*, which tracks the performance of financial newsletters. Granville sank to the bottom of Hulbert's performance list, producing annualized losses of 20 percent for investors over the past 25 years.



Joe Granville once moved markets with his timing recommendations, but long-term followers have not done well by adhering to his suggestions.

"I don't think that I will ever make a serious mistake in the stock market the rest of my life."

ROTH IRA CONVERSION HAS ITS BENEFITS, BUT DECIDING IS TRICKY

Financial services companies are using a temporary change in Roth IRA conversion rules to roll out a marketing juggernaut to convince you that conversion is the greatest opportunity ever. Coincidentally, they also hope to convince you to use their services.

Temporarily next year anyone can convert a traditional IRA to a Roth, regardless of income. Currently only those with incomes of less than \$100,000 can make the switch.

Is a Roth conversion a wonderful opportunity? Maybe for some retirement account holders, but certainly not for everyone. The decision to convert is also very complicated and needs to take into account an individual's taxes, estate planning, retirement income needs, and predictions of future tax rates.

Immediate tax bite

Marketers are touting all the advantages of a Roth IRA: tax-free growth and withdrawals, tax free inheritance, and no required distributions after

age 70.5. But they don't emphasize the immediate tax hit, which discourages many IRA conversions.

The owner of a \$250,000 IRA who is in the 25 percent federal tax bracket and a 6 percent state tax bracket, for instance, would have to pay \$77,500 in additional taxes to convert. And that money cannot come from the IRA: it has to come from another source, such as a bank or broker account.

Estate benefits

Some conversion benefits only apply to the rich. Those who are leaving behind millions of dollars and worried about estate taxes might do better converting now and paying state and federal income taxes, because the state income tax is deductible for federal tax purposes.

Leaving the money behind in a taxable IRA instead would cost more, because there is no deduction for state



A host of factors determine whether to convert a traditional IRA nest egg to a Roth IRA.

estate taxes after death.

Also, high income taxpayers who have big income tax deductions that they can't take in 2010 would benefit by creating taxable income through a conversion, allowing them to use the deductions.

IRA owners who do not plan to spend any of their IRAs in retirement may also want to convert to a Roth in order to avoid required distributions at age 70.5 and so that heirs get their IRAs tax free.

"But they don't emphasize the immediate tax hit, which discourages many IRA conversions."

SCARED INVESTORS, NO RETIREMENT, & MORE

The 2008 bear market may have chased away a generation of investors, found a new survey by international consulting firm AlixPartners.

The August survey found that 49 percent of respondents who identified themselves as "previous investors" had either stopped or reduced their investing in stocks or mutual funds.

Another 26 percent said they "had no intention of investing" in stocks or funds over the next three years,



while 27 percent were unsure whether they would invest again. Clarence Hahn of AlixPartners said investors are "cross, cautious, and confused" by the 2008 drop.

Too poor to retire

The number of American households ill-equipped to retire successfully is growing, according to the latest National Retirement Risk Index, which is maintained by the Center for Retirement Research at Boston College.

The index of those at risk

increased to 51 percent of households from 44 percent in 2007. The biggest change was in younger households, the Center said.

Income slides

The median income of U.S. households declined in 2008 by the largest amount since 1967, says the U.S. Census Bureau.

The median was \$50,303 in real, inflation-adjusted dollars, down 3.6 percent from 2007.

The Economic Policy Institute forecasts a similar decline in 2009.

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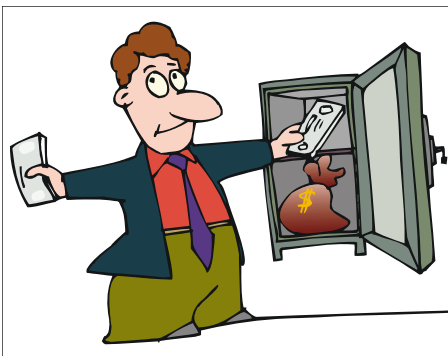
INVESTORS SHOULD LOOK FOR FUNDS WITH BIG MANAGER STAKES

Mutual fund investors may want to restrict their purchases to funds whose managers eat their own cooking, says a new report by Morningstar Inc.

The mutual fund analysis service looked at the levels of fund ownership by their managers and found those who put more than \$1 million of their own money into their funds outperformed their peers.

"The best managers that we've followed and respect a lot tout the fact that they're investing alongside investors," Karen Dolan, director of fund analysis for Morningstar, recently told *Investment News*.

She found that managers with a million or more in their funds ranked on average in the 42nd performance percentile over the five years



Fund managers who are aligned with their investors' interests put money into their own funds.

ended in July, beating 58 percent of peer funds.

Meanwhile, Dolan said the analysis found that slightly more than half of mutual fund managers invest nothing at all in their own mutual funds.

Morningstar found that only 413 funds out of 4,383 had more than \$1 million in investments by their managers. Another 876 funds had

manager stakes of between \$100,000 and \$999,999, the study found.

Dolan said the company is not yet sure whether ownership levels affect fund performance, but she thinks further study will show there is a relationship.

Although there are certain cases where managers have legitimate reasons for not investing in their own funds, in most cases there

is no reason why they can't.

Younger managers who have not built up significant wealth may not have \$1 million to invest, but they should at least have something in the game, Dolan said.

"How you define that could vary, but it's something more than zero," she said. Some funds have begun paying bonuses in fund shares to avoid bad publicity.