

# INVESTMENT UPDATE

## THE MUNCY BANK & TRUST COMPANY

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### Points of interest:

- Inflation has averaged 2.3 percent over the last decade.
- In recent years, it has been even lower, running at 1.4 percent.
- Oil prices have been sending inflation higher in recent months.
- Inflation silently sucks the value out of fixed income investments.

## YOUR BIGGEST LONG-TERM FINANCIAL ENEMY IS INFLATION

A silent killer of wealth is once again stalking the land, and it isn't Bernie Madoff: it is the old nemesis of investors and savers, inflation.

Inflation has been remarkably subdued since 2001, running at a 2.3 percent annualized rate as measured by the Consumer Price Index. Since the recession that began in Dec. 2007 (and ended in June 2009) inflation has been even more subdued at only 1.4 percent per year.

But recent months have seen ominous double digit increases in energy costs, along with rising food costs. The CPI increased by one-half of one percent in February. It is currently rising at an annual rate of 2.1 percent, higher than the 1.5 percent increase during the 2010 calendar year.

**Savers get hurt**  
Inflation eats at every financial instrument, but no one is hurt more than those who have fixed rate investments, such as bonds or savings instruments like certificates of deposit and bank savings accounts.

The Federal Reserve continues to hold short-term interest rates at artificially low levels as it waits for the lagging job market to recover from the recession. Millions of jobs were lost and the recovery has been agonizingly slow.

But savers who are getting 0.5 percent on their sav-



Inflation may be subdued but it is not dead. When it comes back, fixed income investments won't be your best bet.

ings accounts or 1 percent (if they are lucky) on their one-year CDs are literally watching a portion of their savings go up in smoke day after day.

Once they are done paying income taxes on their paltry interest earnings their savings accounts are shrinking in terms of real buying power.

**No recovery**  
This is a real, permanent loss. If their money was invested in the stock market and the market lost ground, they could wait out the decline and see their principal recover and grow again as the market recovers. But fixed

income purchasing power losses are real and can only be made up if a period of deflation ensues.

In deflation, prices fall and a dollar doesn't even have to earn interest in order to grow in terms of purchasing power.

Savers should not hold their breath, however: Aside from two tiny annual declines in the CPI in 1954 and 1949, prices have not fallen on a consistent basis since the Great Depression of the late 1920s and early 1930s.

Retirees often seem to fear the stock market due to

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## TO OBTAIN REAL RETURNS AFTER INFLATION YOU SHOULD BUY STOCKS

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its large fluctuations. But inflation is a far greater risk for them, says William Goetzmann, a finance professor at Yale University.

"If you put all your money into bonds when you retire because you think they are safe, but then the governments of the world decide that inflation is the only way out of their current predicament, that will come right out of your savings," he says.

Stocks are one instru-

ment that offer long-term inflation protection. In the short-term they may not work as inflation hedges: The Standard & Poor's 500 Index lost 0.5 percent annually on an inflation adjusted basis from 1999 through 2010. However, short term savings didn't do so well either: One-month U.S. Treasury bills gained only 0.2 percent annually after inflation.

But the S&P did a much better job over longer periods. For instance, it gained 6.5 percent a year after inflation



Stocks beat bonds in inflationary periods.

from 1989 through 2010, and 7.5 percent a year from 1979 through 2010, after adjusting for inflation.

## ARE BOOMERS GETTING TOO CONSERVATIVE?

Baby Boomers approaching retirement were hit hard by the 2008 bear market and recession.

A study by Cogent Research of affluent boomers who are 55 to 64 years old found that in Oct. 2010 they had \$100,000 less in their retirement portfolios than four years earlier.

Cogent said the group studied—boomers with at least \$100,000 in investable assets—had an average of \$708,000 last October, compared with an average of \$809,000 four years earlier.

The firm, based in Cambridge, Mass, surveyed 4,000 affluent consumers.

Although they still had sizable portfolios, the decline in value was "particularly hard for those approaching retirement," said John Meunier of Cogent.

### **Pulled back from stocks**

There is evidence that this group of boomers lost confidence in the financial markets after the 2008 bear market and reduced the risk

in their portfolios, he added.

"We saw a significant increase among older boomers last year in allocations to lower-risk investments just as the market was rebounding," he said. "Unfortunately, this only served to dampen their ability to regain losses sustained in the downturn."

A study by T. Rowe Price also indicated that investors have been taking money out of stock mutual funds since 2007.

However, those investors who stayed with stocks continue to beat inflation, the mutual fund company said.

Younger baby boomers took the bear market more in stride, Cogent said. Its survey showed that boomers ages

45 to 54 had higher exposure to stocks than their older cohorts and had continued to contribute more money to employer retirement plans.

### **Still contributing**

Some 84 percent of this group contributed to the plans in 2010, up from 79 percent in 2009. "Some investors are

once again thinking ahead and planning for the future instead of (like) last year when they were still hunkered down waiting for the storm to pass," said Meunier.

It is a common feeling at retirement to think that a portfolio must be made conservative in order to avoid loss. But those contemplating retirement should realize that they won't be using all of their assets in the first year and that a good portion should remain in stocks to combat inflation over time.



**Older boomers nearing retirement were hurt by the 2008 bear market and now may feel confused over how much risk to take with their investments.**

*"We saw a significant increase among older boomers last year in allocations to lower-risk investments just as the market was rebounding."*

## DON'T PUT YOUR RETIREMENT IN JEOPARDY OVER COLLEGE EXPENSES

Middle-aged parents face two huge expenses: college costs for their children and the even larger eventual cost of retirement.

Many find it hard to juggle the two and get confused over priorities and where to allocate resources.

A recent Gallup survey done for Sallie Mae, the large student lender, found that 6 percent of parents in 2010 had withdrawn money from an employer retirement savings plan or an IRA to cover college costs for a child.

That compared with 3 percent who took retirement withdrawals for college expenses the previous year, Sallie Mae said. The average withdrawals also grew, to \$8,554 from \$5,318.

Three percent of parents also said they took a 401k loan for college costs.

### Robbing Peter

This can cause big problems later in retirement, says New York's College Savings Plan.

Parents who rob from

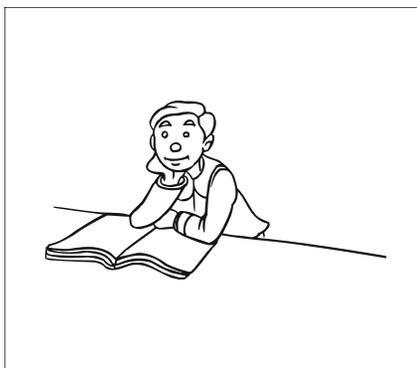
their retirement accounts to pay college bills are probably doing so during the ages of 40 to 60. That gives them little time to make up for the hit to their retirement accounts.

The 529 plan sponsor noted that while an \$8,554 withdrawal doesn't sound big, it adds up if done for all four years of college, and gets worse if done for a second or third child.

Also, it said building up debt in a 401k plan before retirement adds to a potential retiree's financial burden.

It also notes that parents must pay income tax on withdrawals from an employer savings plan or an IRA. If done before age 59.5 from an employer plan, an additional 10 percent tax penalty is assessed (the penalty is waived on IRA withdrawals for college.)

The withdrawals, taxes,



Robbing your retirement account to pay for junior's college education is dangerous.

and penalties leave parents with less money in their retirement plans to compound and grow for the future.

### Limited expense

Parents should realize that as expensive as college seems to be, it is limited to the years a child is in college. Retirement, however, can last for many years and the overall expense can be hundreds of thousands of dollars higher.

In the end it may be better to have children borrow for their own education than to endanger your retirement.

*"Building up debt in a 401k plan before retirement adds to a potential retiree's financial burden."*

## SMART STATES, HEALTH SAVINGS, & MORE

New York, New Jersey, and New Hampshire are the most "financially literate" states, found a survey by the U.S. Treasury Department and FINRA, the brokerage industry regulator.

The survey measured the ability of households to plan ahead, make ends meet, manage financial products, comparison shop, and make financial decisions.

The national average of households that spend less than their income was 42

percent; New Jersey scored the highest at 49 percent.

The worst scores were found in Missouri and North Carolina.

### Health savings

Americans' health savings accounts totaled \$7.7 billion in 5.2 million accounts at the end of 2010, said the Employee Benefit Research Institute.

However, average balances fell by 4.5 percent to \$1,355 from 2009. The biggest declines came for those with household in-

comes between \$50,000 and \$99,000; those with higher or lower incomes saw increases.

### Spending tax cut

Working taxpayers received a cut in Social Security taxes this year and many plan to spend the extra income, found the RBC Consumer Outlook Index.

About 42 percent of taxpayers said they would spend the extra income while just 26 percent said they would save all of it.

A majority of respondents also said they were upbeat about their local economies.



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## IT TAKES MORE THAN A MILLION TO MAKE THE RICH FEEL WEALTHY

What does it take to feel wealthy? About \$7.5 million, according to a group of people who should know.

That finding came in a recent survey of 1,000 millionaire households by Fidelity, the second-largest mutual fund company.

The average wealth of the households surveyed was \$3.5 million, and surprisingly some 42 percent of those respondents said they do not feel wealthy.

How wealthy someone feels may be relative to age and working status, the survey indicated.

Younger millionaires who still have years to work and accumulate wealth generally said they already felt wealthy.

But millionaires near or in retirement wanted more money to feel wealthy, proba-



Rich people generally feel wealthy when they have amassed \$7.5 million or more.

bly because they face years of supporting themselves on their wealth while dealing with inflation.

On the whole the millionaires surveyed said they were more optimistic about the future than they have been in the last four years.

Some 83 percent said the financial crisis of 2008 did not shake their confidence in investing, and 43

percent plan to invest more money in stocks over the next year.

A majority said their goal when investing was to preserve their capital, not to generate aggressive growth of their portfolios.

Their planned charitable giving increased to \$38,000 in the latest survey, up from \$36,000 in a 2009 survey.

The Federal Reserve's latest triennial survey of household finances found that there are 5.5 million households with at least \$1 million in assets.

Millionaire households make up just 5 percent of the U.S. population, but they control 56 percent of the nation's wealth.

That would mean they control almost \$32 trillion of the nation's \$57 trillion in personal wealth.