

# INVESTMENT UPDATE

## THE MUNCY BANK & TRUST COMPANY

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**Points of interest:**

- A long lifespan can drain resources of those who don't have guaranteed income streams.
- Inflation is a continuing concern and demands some investment in securities that grow with rising prices.
- Today's low interest rates make it hard to rely solely on fixed-income investments.

## DO NOT GO INTO RETIREMENT WITHOUT ADDRESSING THE RISKS

**R**etirement can be the most exciting and rewarding time of all, but, like any other stage in life, there are unique financial risks that need to be addressed.

Longevity, inflation, health care needs, the death of a spouse, problems with living independently—all can affect a retiree's quality of life.

Changes in laws and social welfare programs can have dramatic effects on a retiree's status, while changes in financial markets can affect income and legacy planning.

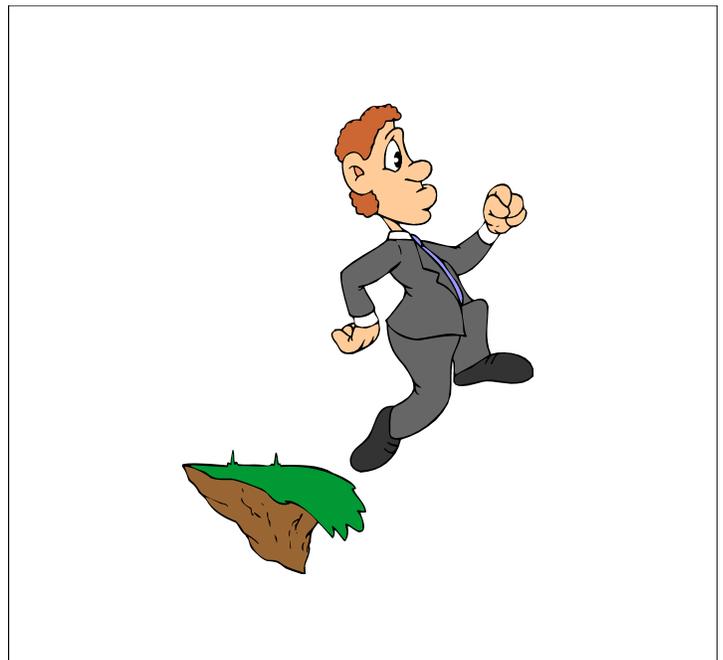
The Society of Actuaries might be the ideal organization to offer guidance on these risks, since actuaries by nature are professionals who analyze the financial consequences of risk for insurance companies, pension plans, health benefit systems and others.

The Society recently issued a guide to managing 15 specific risks endemic to retirement.

**Living too long**

A long, healthy life is the goal of many retirees but living long can also hurt the pocketbook. The Society notes that planning to live to one's average life expectancy may be foolhardy since half of retirees will live longer than that.

Guaranteed income streams such as Social Security, pensions, and annuities



Moving into retirement doesn't have to be like stepping off a cliff if you have prepared for many of the common risks.

can help to ensure that a retiree doesn't run out of income, no matter how long he lives.

However, annuities (contracts offered by insurers to pay lifetime income) have disadvantages: if the payment is fixed, it may not keep up with inflation, and the principal spent to buy an annuity is no longer available for immediate use. The Society notes that retirees can buy annuities at any time, and need not put all of their money into them at once.

Another alternative is a reverse mortgage, which allows the retiree to get an in-

come stream in exchange for giving up some of the equity in a home.

**Rising prices**

Inflation is a serious and never-ending concern. It is pretty likely that goods and services will go up in price over time. Although inflation recently has been running at a low rate, we have experienced inflation of greater than 10 percent a year in five years since 1947.

Investing a portion of your assets in common stocks, inflation-indexed U.S. Treasury securities, and commodities can help to keep up

## LOW INTEREST RATES MAKE STOCK DIVIDENDS MORE ATTRACTIVE

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with inflation, although the trade-off is the assumption of short-term market risk, the Society says.

Also, retirees who delay taking Social Security can increase the value of the inflation-indexed income they will receive once they claim it.

### Falling interest rates

Retirees have been hit hard in recent years by plummeting interest rates. It has reduced their income from bonds and bank accounts

while making the purchase of fixed annuities less attractive. If rates start rising, they will hurt those retirees who have variable rate loans or long-term bonds, it adds.

Current rates make it apparent that retirees cannot rely on fixed-rate investments as their only source of income, the Society says.

Dividend-paying stocks may be one alternative, although such investments bring volatility along with the ability to earn rising income.



Plunging rates are hurting savers.

The Society offers its guide on the internet. It is available on the organization's web site, [www.soa.org](http://www.soa.org).

## BUFFETT'S INVESTING RULES STAND THE TEST

We admit to being suckers for advice from Warren Buffett. In an investment world where very few, if virtually any, investors display real skill at beating markets, Buffett's long-term record has not been matched.

Buffett has turned a small investment pool into one of the largest portfolios in the world since the late 1950s. Back in 1962 he sent a letter to the investors in his limited partnership. That letter contained advice that is still valuable today.

### Predictions unnecessary

"I think you can be quite sure that over the next ten years there are going to be a few years when the general market is plus 20 percent or 25 percent, a few when it is minus on the same order, and a majority when it is in between," he wrote. "I haven't any notion as to the sequence in which these will occur, nor do I think it is of any great importance for the long-term investor."

Keeping cool was as

relevant then as it is now: in 1962 the world was beset by the Cuban Missile Crisis, and investors saw the U.S. stock market drop by 23 percent in the first half of the year, including a 6 percent drop in one day.

"Six months' or even one-year's results are not to

be taken too seriously," he wrote. He added that investors should judge "over a period of time, with such a period including both advancing and declining markets."

Buffett is a long-time practitioner of value investing, buying stocks or companies at bargain prices so that they can be sold at a profit later on.

He advised investors in 1963 to buy at a deep bargain, so that even a lousy sales price would bring a profit.

### Let it grow

In the letter Buffett warned his investors that it was better to let their money grow than to spend it. "In no sense is any rate of return guaranteed to



Warren Buffett has long advised investors to keep cool when things look bad and to maintain a long-term focus unruffled by current events.

partners. Partners who withdraw one-half of one percent monthly are doing just that— withdrawing."

Buffett also noted that the key to avoiding permanent risk of capital loss lay not in hiding from market volatility, but in investing

wisely "by obtaining a wide margin of safety in each commitment and a diversity of commitments."

Buffett started investing in 1956 with \$105,000; *Forbes* this year placed his wealth at \$44 billion.

*"Six months' or even one-year's results are not to be taken too seriously."*

## GOLD'S REPUTATION AS AN INFLATION HEDGE IS VASTLY OVERDONE, STUDY SAYS

Gold has soared in popularity in recent years as a hedge against inflation and weak currencies. Unfortunately for the gold bugs, a new study shows it is neither.

In fact, the only time period for which gold has served as an adequate inflation hedge was the last 2,000 years. Any holding of less than that did not hedge inflation, say investment executive Claude B. Erb and Duke University finance professor Campbell R. Harvey.

Their paper, "The Golden Dilemma," which is still being revised, found that gold ownership poses an even greater financial risk than inflation.

### Failed arguments

They also discounted five additional arguments for holding gold. For instance, they found that gold does not provide a good hedge against currency fluctuations. Instead, holding another country's currency to hedge against changes in one's own currency is a much better hedge, they said.

Another argument, that gold is a *de facto* world currency standard, does not hold water, they said: it is not any country's official standard and has not been officially convertible into any country's currency since the year 2000.

### No inflation help

Most of the arguments for gold boil down to it being an inflation hedge. Erb and Harvey looked at inflation rate variations and gold price fluctuations over all 10-year periods since 1975.

They found that returns on gold varied from a loss of 6 percent per year to a gain of 20 percent per year, while inflation ran at a low of 2.3 percent to a high of 7.3 percent per year. The finding "suggests that gold is not a very effective long-term inflation hedge when the long-term is defined as 10 years."

In the long, long term, it may be a good inflation hedge: research done on the



Gold may glitter, but it isn't a good hedge against inflation or currency devaluation.

pay rate in gold for Roman soldiers under Emperor Augustus showed that the pay was almost exactly the same as the gold equivalent of the same pay for U.S. Army soldiers today.

The only short-term inflationary scenario in which gold might be a good hedge would be hyper-inflation, they concluded.

In that case, many types of hard goods would be able to be cashed in for more money once a currency stabilizes, they added.

*"Gold ownership poses an even greater financial risk than inflation."*

## SAVING EARLY, FIGHTS OVER MONEY, & MORE

What would average middle-income retirees do better financially if they could travel back in time?

They would start saving for retirement early in life, said retirees participating in a survey for Bankers Life and Casualty Co.

Some 93 percent said they would have started saving earlier. Some 84 percent would have made better use of their work retirement plans, while 61 percent said they would have planned more.



When asked what they wanted to know more about now, the majority said "making your money last."

### Money squabbles

Different perceptions of needs and wants cause the most financial squabbles between couples, found a survey for the American Institute of CPAs.

Unexpected expenses were the next biggest cause, followed by insufficient savings.

Couples said the best way to avoid misunderstand-

ings was to set aside a routine time to discuss concerns with a partner.

### Bill Gross a stock bull?

Bill Gross, manager of the world's largest bond fund for Pimco, recently proclaimed that stocks will not provide big returns in the future.

His warning might be good for stock investors: the last time Gross spoke out against stocks was December 2008. He said the Dow Jones Industrial Average would sink to 5,000. Instead, a bull run that began a few months later has taken the Dow above 13,000.

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## BALANCED PORTFOLIOS ARE BEATING THE HEDGE FUNDS SO FAR THIS YEAR

The investment climate has been almost manic over the last year, with wild swings in global markets due to economic news and the financial crisis in Europe.

At times like these some in the investment world argue that passive investors who sit on a diversified portfolio will get whipsawed. Instead, the argument goes, they should hand their money to an expert who can react quickly to market moves and make investments that hedge against sudden declines.

That is, of course, what hedge funds try to do. These lightly-regulated investment pools open only to wealthy investors are allowed to go anywhere and do anything to offer high returns and to avoid big declines.

A typical hedge fund one



Professional hedge fund managers have failed to keep up with fast-moving markets.

day may buy Australian dollars while betting against the Japanese yen, and the next short U.S. stocks while buying Swiss bonds.

Hedge funds that made big bets based on economic trends got very popular after the 2008 bear market. At that time it looked like some hedge funds had protected their investors from the sharp declines in stock prices.

This year, however, it isn't working. *The Wall Street Journal* reported in early August that many funds were not able to keep up with fast-moving markets.

Last year the average hedge fund lost 4.2 percent, compared to a slight gain in big American stocks. During the first half of this year, the average fund lost 0.5 percent while the Standard & Poor's 500 Stocks Index gained 9.5 percent.

Hedge Fund Research Inc. noted that investors withdrew \$3.5 billion from these funds in the second quarter. Several funds have returned money to their investors, saying they could not deploy it effectively.

Once again it appears diversified investors have beaten the pros.