

# INVESTMENT UPDATE

## THE MUNCY BANK & TRUST COMPANY

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### Points of interest:

- Five years after the 2001 terrorist attack the S&P 500 Index was up 84 percent.
- The beginning of the first Gulf War was scary, but a year later stocks were up by 5 percent.
- President Kennedy's tragic assassination was followed by a 25 percent market rally over the next 12 months.

## WHAT WILL THE PRESIDENTIAL ELECTION DO TO THE MARKET?

**S**poiler alert: You are about to hear what effects this year's Presidential election may have on the U.S. stock market six months down the road.

Are you ready? The answer is probably not much. That's right: a hotly contested election pitting competing economic policies against each other in a time of world financial crisis probably will make little difference to your portfolio.

How do we know this? Many academic studies have shown that political events usually don't have lasting effects on stock prices. Although highly-charged events such as electoral upsets or terrorist attacks or assassinations may jerk prices around for a few days, in the long run market prices are determined by investors' perceptions of corporate earnings.

**A crisis record**  
Consider some of the major political events of the post-World War II period.

In September 2001 a horrifying terrorist attack virtually shut down the United States for several days. The market was down 4 percent a month later, up 11 percent six months later, and down 9 percent a year later. Five years later it was up 84 percent.

In 1990 Iraq invaded Kuwait, precipitating the first Gulf War. Six months later the market was down by 5 per-



It is pointless to try to manage a portfolio according to the headlines. Research shows they will have little long-term effect.

cent, but within a year it was up 5 percent. The shocking assassination of President Kennedy in 1963 was followed by a market rally of 15 percent over the next six months and 25 percent a year later.

What about the latest political crisis—last year's battle over the debt ceiling and the downgrade of U.S. debt? A year later the market is up a couple of percent.

### Presidential cycle

A popular belief that the presidential election cycle influences markets says that an election year should be one of the best for investors.

Indeed, the S&P 500 Index has risen in 12 of the 16 election years since World War II, but that's not so unusual: that's about the same percentage that the market has risen in *all* years in the same period, says Baltimore-based investment firm T. Rowe Price.

*Forbes.com* noted in March that the stock market fell by 34 percent during the last presidential election year in 2008. "Trying to predict market cycles can lead to oversimplification" *Forbes* said. "Market behavior is difficult to predict and sometimes

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## IN MANY CASES, STOCKS RISE SIX MONTHS AFTER A BIG HEADLINE

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the likelihood of future outcomes are already priced into equity and fixed income markets.”

### Big event? Big whoop

Former Secretary of the Treasury Lawrence Summers conducted research when he was at Harvard 20 years ago with two other economics professors to test whether big world events had a noticeable impact on stock prices. Their conclusion was that non-economic news has “a sur-

prisingly small effect.”

Ned Davis research did another study to see what happens to the market in the intermediate term after a big political or economic crisis. It looked at 28 events prior to 2001. In 19 of the 28 cases, the Dow Jones Industrial Average was up six months after the crisis hit.

These studies reinforce the suggestion that investors should not make changes in their portfolios in reaction to headlines, no matter how major they are. The



Bad news may not hurt your portfolio.

outcome of those events is unpredictable and in most cases will probably not have a lasting effect on stock prices.

## TRYING TO AVOID RISK CAN BE VERY COSTLY

Some investors today are doing what worried investors always seem to do in times of stress—trying to avoid “risk” by buying the “safest” assets.

In this case that has meant buying government bonds from the United States, Germany, Australia, the Netherlands, and other countries considered safe havens.

Panic buying has pushed yields in some cases to negative levels, meaning investors are willing to pay a small amount of money in order to park their money in a government bond.

Is this rational? Probably not: investors seem to be guaranteeing themselves a negative real return after inflation. The only way to make money on such an investment would be to live through a depression with accompanying massive deflation.

### High risk premiums

Investors are also ignoring the market’s mechanisms for dealing with risk. All the risks that investors are worried about today—financial

troubles in Europe, slowing economies in the United States and China—are already priced into the market.

Investors have pushed down prices of volatile investments such as stocks and commodities, and at the same time have pushed down yields on less-volatile government bonds.

What does that mean? It means that the risk premium investors now demand for putting money into a risky asset has

gone up. Investors are pricing stocks, for instance, at a price that expects higher returns sometime in the future, says Jim Parker, a vice president of Dimensional Fund Advisors, a Santa Monica, CA-based investment firm.

If the market’s risk appetite revives in the future, owners of risky assets will be paid “a very substantial return,” Davis writes.

### Safety’s cost

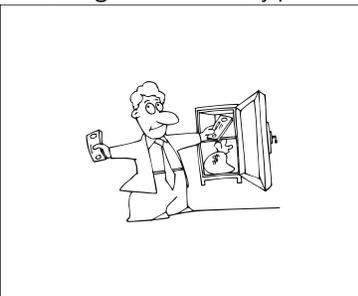
“The takeaway is that sheltering in what are perceived as the safest government bonds may provide certainty for a

time, but also comes at the cost of foregoing the significant increase in risk premiums that may be available,” he writes.

He notes that yields approached zero back in early 2009 after a brutal bear market, but just before

world stock markets staged a sharp recovery.

Investors who had bought government bonds at that time may have felt ok for a while but they gave up a stretch of gains that reached nearly 100 percent over the next few years.



Stashing money in zero-interest government bonds for safety may mean giving up on big potential returns in stocks.

*“Panic buying has pushed yields in some cases to negative levels.”*

## INVESTORS AREN'T HAVING 'FUN' ANYMORE. THEY MISS THE POINT

A recent survey by the research firm Spectrem Group found that well-to-do investors say investing isn't as fun as it was a few years ago.

Only a third of investors with \$1 million or less to invest said they enjoy investing these days. About 43 percent with \$1 million to \$5 million say investing is enjoyable, while 52 percent with \$5 million to \$25 million are having fun.

In a survey a few years ago about two-thirds of wealthy investors said they enjoyed investing.

### Fatigue factor

Spectrem's director of business development said "investor fatigue" from recent volatile markets plus concerns about personal finances may be the cause of the bad feelings.

"Investors have almost become tired of the constant worry that comes from being so involved, and many just can't seem to find strategies that they're happy with," said Randy Wostratzky.

It's undeniable that markets have been volatile since the 2008 bear, but are investors missing the point? Is investing supposed to be "fun?"

It's apparent that some of these investors are confusing investing with speculation.

It can be fun to buy a hot stock and reap a quick, large profit, just as it is fun to hit a slot machine for a big payoff.

But that is not investing. It is short term speculation, and, just as in Las Vegas, it is as easy to lose money as to win it.

Certainly many speculators have lost money in recent years as they were whipsawed by up and down markets that ravaged individual stocks and market sectors.

### Get used to boring

Investing, on the other hand, is a long-term process of continually adding to a portfolio and leaving it alone



Now that investors aren't making money easily, they don't find investing to be fun.

to grow when markets move ahead. It may take many years of small and some big losses before a portfolio even shows a profit.

But an investor who is patient, maintains a diversified exposure to markets, and keeps adding to their portfolio usually comes out ahead.

As Nobel-prize-winning economist Paul Samuelson once said, "investing should be more like watching paint dry or watching grass grow. If you want excitement, take \$800 and go to Las Vegas."

*"It can be fun to buy a hot stock and reap a quick, large profit, just as it is fun to hit a slot machine for a big payoff."*

## LUNAR INVESTING, RETIREMENT, & MORE

Here is some more proof that astrology belongs only on the comics pages of your local newspaper and not in your investment accounts.

The Securities and Exchange Commission says broker Gurudeo "Buddy" Persaud of Palm Beach Gardens, Fla., ran an illegal Ponzi scheme that lost over \$400,000 for 14 investors by trading securities based on lunar cycles and gravitational forces.

Persaud made up phony statements to hide the losses



and some \$415,000 he diverted to cover his own expenses, the SEC said. Persaud promised safe 8 percent returns and used money from some investors to pay off others, it added.

### College lessons

Parents from affluent families say the best way to get college-age children to appreciate their education is to make them pay for part or all of it themselves.

Some 72 percent of parents from affluent families said that it helps their chil-

dren learn responsibility and financial skills, found a survey conducted for the Legg Mason Inc., a Baltimore-based mutual fund company.

### Retirement dreams

Rather than dreaming about retirement, many working Americans think their chances of retirement are just a dream, found a survey for St. Louis stockbroker Edward Jones.

Some 72 percent of workers said they weren't saving enough for retirement, while a third of investors said the burden of immediate expenses kept them from saving.

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## THE KIDS MAY BE GROWN UP, BUT MOM AND DAD ARE STILL HELPING

Baby Boomers are helping their grown children financially at greater rates, show surveys in 2007 and 2011 for Ameriprise Financial.

A survey the firm did last December of 1,006 affluent Baby Boomers found some 93 percent provided support to adult children in the previous year.

Almost three-quarters of those who are still helping grown children said they are paying off their college loans. Fifty-five percent have allowed adult children to move back home without charging rent. And 53 percent have helped them buy a car, while about half have helped with car insurance.

The survey covered Boomers who make more than \$100,000 per year. It also surveyed 300 adult chil-



Even though the children may have graduated, they remain a financial burden on their parents.

dren of affluent boomers.

Ameriprise did a similar study in 2007. The results for financial support of adult children were similar, but at that time more Boomers—44 percent—said they were trying to increase their savings. Now only one in four said they were putting money away for the future, while a quarter were just trying to maintain what they had.

“In many cases they’re sandwiched between children who are unemployed or struggling to pay down their student loan debt and aging parents who are facing complex health and financial issues,” said Suzanna de Baca of Ameriprise.

“At the same time they’re trying to prepare for their own retirement. The demands on their time and money can feel endless,” she added.

Although few reported taking money from retirement accounts to help their kids, many said they slowed down their savings rates and failed to make catch-up contributions to retirement accounts.

De Baca warned that “unconditional financial support can threaten or even sabotage retirement goals and security.”