INVESTMENT UPDATE

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THE MUNCY BANK & TRUST COMPANY

INSIDE THIS ISSUE:

Are variable annuities viable alternatives to the stock market for retirement income?

The experts cannot predict the future. Why should you?

Social Security is still a significant income source, wealthy and struggling, and more.

A 401k account is the sole savings vehicle for many workers.

Points of interest:

- Common flaws in memory lead to investment errors.
- We don't always store information properly.
- Upon recall, past events are rewritten by current beliefs and knowledge.
- The transience of memory and inattention to current information can magnify investment risks.

INVESTORS CAN IMPROVE DECISIONS BY FIXING FLAWS IN THEIR MEMORY

If it is true that you can improve your performance by learning from the past, then the weak link in this process is our memory, the findings of recent neuroscientific research assert. Investors should heed these research findings before going on to repeat past mistakes.

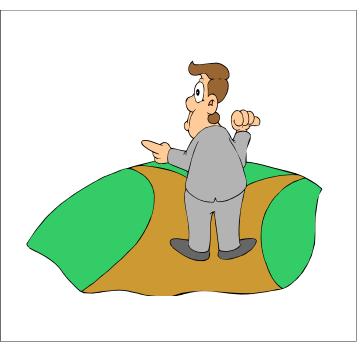
A bad memory will distort our recollection of our past financial decisions and outcomes, making it likely we will not be able to learn the proper lessons from them.

Neuroscience experiments have identified two memory flaws. First, we often do not properly store information. Second, the stored information is often distorted by common cognitive biases when it is recalled.

Too much information
Research has shown that
our brains simply do not have
the capacity to hold in longterm memory every detail of
every event we have experienced.

Much detail can be held in short term memory, but after a while only a general outline—including perhaps a few specific details—of events and facts remain in our memory.

Then, when we recall those memories, our brains reconstruct them based on what it has stored. But it also fills them in with information from our current set of beliefs and knowledge, a process that often distorts the



Our capacity to make informed investment decisions based on our past actions can be diminished by the flaws in our memory.

memory of the actual event.

Transience, a memory phenomenon where information is lost the longer it is stored in memory, may explain why stock market participants who have experienced long periods of calm markets are shocked when a crisis period ensues: the vividness of their memories of previous crisis periods has faded. They may panic and sell their investments because they don't fully remember how quickly markets recovered after past crises.

Absent mindedness can also affect your memory: you may hear a long detailed rec-

ommendation about an investment, but miss the warnings of potential risks.

Blocking the bad
Researchers also say we
often block salient information with other information,
making it difficult or impossible to retrieve. For instance, it
is more common to remember
pleasant experiences than
unpleasant ones. For investors, that can mean recalling
our winners but not fully remembering our losing decisions.

However, highly traumatic memories seem to persist in our memory more than

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INVESTMENT POLICIES AND DIARIES OVERCOME GAPS IN OUR MEMORIES

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others. The Depression generation, for instance, never got over the stressful memories they had of the 1930s, and were generally more risk averse when investing than were subsequent generations.

Overcome your limits

Investors can overcome these memory flaws by using written investment policies and keeping investment dia-

An investment policy documents your goals, risks, and rules and limits for investing. Frequent consultation with it can prevent you from making shortterm investment decisions that conflict with your longterm goals.

An investment diary should include all of your reasons for making decisions to buy or sell. They can help you learn from past mistakes.

They can help you avoid the bias of hindsight and correct any overconfidence.

You should note all of the reasons for a trade, your



An investment diary is a helpful tool.

goals, and then the outcomes. Such a record will help you find out whether your wins are due to skill or just plain luck.

ARE ANNUITIES THE ANSWER FOR RETIREES?

The volatility of international financial markets since the recession of 2008 scared some investors into considering old-fashioned, lifetime income annuities for their retirement incomes.

These are essentially guarantees from insurance companies: you give the insurer a lump sum of money and the insurer in turn pays you a monthly income, guaranteed to last throughout your life or that of your life and a beneficiary's life.

In the simplest version, a retiree gives up a fixed sum of money for a fixed benefit. For instance, a 65-year-old man would pay \$500,000 in New York to get a lifetime monthly benefit of \$2,926, according to Immediateannuities.com.

Increasing the benefit

A more complicated version has been popular among Insurance agents and stockbrokers dealing with investors made uneasy by the markets: variable annuities linked to stock market investments that guarantee a minimum

monthly payout, but that increase the payout if markets go up.

This concept has appealed to nervous investors who want stock market performance but don't want to risk a decline in their retirement income. Research indicates that this type of guaran-

tee may not be a panacea for investors.

For instance. Wade Pfau, who teaches at the National Graduate Institute for Policy Studies in

Tokyo, argues that the extra internal costs of this type of annuity tend to erode the invested balance, meaning that it is less likely that the payout to a retiree will be increased during his lifetime.

He notes that this would

be especially true during those periods when the retiree would be most in need of increased income: periods of high inflation and low stock market performance.

Meanwhile, although the initial fixed payout may look attractive, their value will gradually decline over the years as

inflation eats at their purchasing power.

An illusion "I remain concerned that prospective retirees may be overvaluing the guarantees in their minds because they are not properly considering how inflation will erode

their real value over time," he

some cases the guaranteed spending amounts after 30 years may be as little as 20 percent of the initial level after adjusting for inflation.

"The extra internal costs of this type of annuity tend to erode the invested balance."



Even annuities that promise increasing benefits may not be able to keep up with the erosion of purchasing power caused by inflation.

> wrote. His research found that in

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THE EXPERTS HAVE DIFFICULTY PREDICTING MARKETS ONCE AGAIN

It's pretty common knowledge that predicting the future is impossible. Yet each year perfectly sane and rational experts go on record telling investors how things will go in the year ahead and where to put their money for the best results.

And every time that year ends, we have another good example of the futility of making predictions.

Consider the annual Barclays Capital Global Macro Survey of over 2,000 institutional investors. These are the cream of the crop in the investment world: the professional managers who are entrusted with hundreds of millions of dollars of other people's money.

Forecasting 2011 When Barclays asked professional investment managers back in late 2010 for their views on 2011, many were bullish on the stock mar-

Forty percent said stocks would be the best asset class to own in 2011, while 34

percent voted for commodities. Only 10 percent argued that bonds would do the best.

The cover of *Pensions & Investments*, the major trade publication for professional investors, proclaimed "For 2011, It'll Be All About Equities."

Fast forward to the end of 2011: U.S. bonds were the best performers by far during the year, with a gain of 8.7 percent in 2011.

Meanwhile, the Standard & Poors 500 Stocks Index went nowhere, and certainly did not realize the consensus prediction among the experts for a gain of 15 percent.

Commodities were miserable performers in 2011, losing nearly 10 percent.

Eastern promises Meanwhile, prestigious investment publication Barron's recommended that stock investors go east and invest in China and other fast growing Asian countries.



Even the experts have great difficulty seeing the future.

Unfortunately for anyone who followed that advice, they ended up getting into one of the worst markets of the year. The Hong Kong Hang Seng index and the Shanghai Composite index were each down by almost 17 percent.

The best antidote for all of these shoddy forecasts is an investment portfolio that is diversified among all major asset classes and then rebalanced regularly to its investment policy, without regard to predictions. After all, the future will take care of

"Commodities were miserable performers in 2011, losing nearly 10 percent."

SOCIAL SECURITY, WEALTHY WOES, & MORE

Social Security makes up the majority of retirement income for 60 percent of retired Americans, the Social Security Administration says.

And for retirees in the top 40 percent of house-hold income it still accounts for almost half of their retirement income, it adds.

Current projections by the Congressional Budget office show that Social Security can meet all its obligations through 2038. After that it will collect enough money from payroll taxes to

pay 80 percent of promised benefits.

Even the rich struggle Some 14 percent of workers who earn \$100,000 or more say they are living

from paycheck to paycheck, says Career-Builder, a job search firm.

Its survey found that upper income workers last year either stopped participating in, or reduced contributions to, their 401k and other employee savings plans. However, 56

percent of those surveyed

said they would not give up their internet connections, despite financial troubles.

When a spouse dies Some 58 percent of parents with children under 19 said the loss of a spouse had significantly impacted their standard of living, according to a survey conducted for the New York Life Foundation.

Two-thirds of those surveyed had difficulty saving money after a spouse died, while 60 percent said it was much harder to manage household finances and harder to finance a child's education.

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401K ACCOUNTS ARE THE ONLY SAVINGS MANY WORKERS HAVE

When it comes to retirement savings 401k accounts have become vitally important for more than half of those preparing for their golden years, says Fidelity Investments.

It conducted a nationwide survey of workers enrolled in workplace savings plans and found that without 401k plans many workers would not have saved a dime for retirement.

Some workers were supplementing their 401k accounts with other sources of retirement income: 37 percent also had individual retirement accounts, 28 percent had significant bank accounts, and 28 percent had investments in stocks and bonds, Fidelity said.

Only one third of those surveyed were also going to get a traditional employer-



Money saved in 401k accounts is a significant source of many worker's retirement income.

sponsored retirement plan.

However, saving for retirement remained difficult even for workers with access to a 401k.

The survey found that 23 percent of workers had borrowed from their 401k accounts, while 25 percent said they had recently decreased their contributions to their accounts.

If you are a 401k contrib-

utor, consider increasing your contribution level at least annually until you reach the maximum allowed contribution. The maximum contribution limit in 2012 is \$17,000.

Remember that if you are age 50 or older you can contribute an additional \$5,500 per year to your account.

If you are married with household income less than \$173,000 or single with income under \$110,000 you can also supplement your retirement savings by contributing to a tax-free Roth IRA account. Although you won't get a deduction for the contribution, you will never be taxed on any money withdrawn from the account, if you meet withdrawal rules.

You can contribute up to \$5,000 to a Roth IRA, or \$6,000 if age 50 or older.

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