

INVESTMENT UPDATE

THE MUNCY BANK & TRUST COMPANY

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Points of interest:

- U.S. stocks lost 57 percent by their low point on March 9 from the previous high.
- During the Great Depression bear market of 1929 through 1932, stocks lost 80 percent.
- Deflation and dividends meant that it really took only four years and five months to recover from the 1932 low.

RECOVERING FROM A MARKET ROUT DOESN'T HAVE TO TAKE DECADES

The U.S. stock market dropped 57 percent from its peak in late 2007 through March 9 of this year, making this the second worst bear market since the Great Depression.

Investors, quite naturally, want to know how long a recovery will take. We are constantly reminded of an ominous precedent: the Dow Jones Industrial Average hit a high in 1929, plunged, and then took 25 years to recover. Will today's market behave in similar fashion?

The premise of a long recovery, however, may be a straw man: it really only took the broad stock market about 4½ years to recover from the 1929 crash if dividends and deflation are taken into account, says Mark Hulbert of The Hulbert Financial Digest.

Real vs. nominal
Investors have a bad habit of looking at nominal numbers over time without adjusting for inflation. But that's just wrong: \$1 received in 1975 was worth a lot more than \$1 received today due to inflation over the last 34 years.

In the Great Depression the country suffered from deflation, so that \$1 received in 1936 was worth 18 percent more than \$1 received in 1929. So although the stock market had not hit its former high in nominal terms, even at a lower nominal level it was worth more than in 1929 due to deflation.



Investors who have been stung by the bear market want to know when the bull will reassert itself.

Another consideration is dividends: market averages like the Dow merely look at current and historical stock prices and do not take into account all the dividends paid over time, which have a real effect on an investor's wealth.

By the time the Dow hit its Great Depression low in mid-1932, its dividend yield was 14 percent. An investor who reinvested dividends over this period recovered more quickly than did the Dow average.

The IBM effect

The big question is whether the Dow is a good representative for the U.S.

stock market, back in 1929 or even today. The index consists of just 30 large stocks. Its makeup changes periodically based on the judgment of a committee at Dow Jones & Co., which publishes *The Wall Street Journal*.

Up and comer IBM was a member of the Dow average until it was inexplicably deleted by the Dow Jones committee in 1939. It was restored to the index 40 years later.

It has been estimated that if IBM had stayed in the index continuously over that period, the index would have

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IT TOOK FOUR YEARS AND FIVE MONTHS TO RECOVER AFTER 1932

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been twice as high in 1979.

IBM was one of the best performers of large stocks in the 1940s, and its inclusion most likely would have sent the Dow's nominal number well above the levels it actually reached.

1938 recovery

The market hit its Depression low in mid-1932, three years after the 1929 crash. Ibbotson Associates has estimated that in real terms, the market probably

had fully recovered just four years and five months after that low.

Other bear markets have shown similar trends: the average recovery since 1900 is just two years. The big exception was the recovery from the 1973-74 bear market.

The low in that market was December 1974 and U.S. stocks did not fully recover for eight years, when, in 1982, the Dow rose higher than the previous high in 1972.

Investors who bet



Market crashes are not permanent.

against the market now could be right for several years yet, but they will eventually be disappointed if the market follows its historic pattern.

SOCIAL SECURITY IS STILL VITAL TO RETIREES

Some younger workers discount the relative importance of Social Security in their retirement planning, yet it remains a major source of income for most retirees.

Social Security benefits currently represent about 40 percent of all income received by the elderly, says the Social Security Administration.

For some, Social Security represents an even greater source of retirement income. About half of married retirees and three-quarters of single retirees derive 50 percent or more of their income from the government program.

And the benefits provide 90 percent of retirement income for about a third of all retirees.

Average benefits

Those are sobering statistics, especially given that the average benefit paid to a retiree is \$1,153 a month, or just \$13,836 a year.

That means those beneficiaries who derive half of their income from Social Security are living on \$27,672 a year.

The Social Security Administration also warns that workers who are planning their retirements should be ready to go a longer distance than in the past.

In 1935, when Social Security was founded, the average life expectancy for a 65-year-old was 12½ years.

Today that average life expectancy is 18 years. Also, that is only an average expectancy: retirees who never smoked and are generally healthy most likely will be looking at an even longer period in retirement.

Here is another sobering statistic for those who want to relax in retirement: earnings from working account for 28 percent of all retirees' in-

comes and it is the second largest income source after Social Security.

Savings are important

The third-largest source of retirement income is money earned on assets, i.e., interest from bank accounts and bonds and capital gains from stocks and other investments.

Pensions account for only 8 percent to 10 percent of retirement income, depending on whether you have a private or a public employee pension.

This supports the need for workers to build up the largest retirement ac-

counts possible.

Regular contributions to 401k accounts and other retirement savings accounts are a must, with annual increases in contributions recommended. Some of that savings should be put into high growth assets.



The average retiree relies on Social Security for at least 40 percent of his retirement income and might not survive without it.

“Workers who are planning their retirements should be ready to go a longer distance than in the past.”

ADDRESS ISSUES YOU CAN CONTROL WHEN DOING ESTATE PLANNING

The future of federal estate taxes remains up in the air. No one is certain whether the Obama administration will offer a new taxation plan when current regulations expire after 2010.

In the meantime, anyone doing their own estate planning should focus on the important issues that are in their control. It also helps to set up a record-keeping system for executors and trustees that will make it easier to turn over your assets and take care of your dependents and beneficiaries.

Consider scenarios

You have to plan for several eventualities, and all should be addressed in your will or trust.

For instance, if both spouses die simultaneously, at what ages should property be available to children? Who should be the guardian of children? Who would succeed that guardian if he or she became unable to serve?

How should property be distributed if you die before

your spouse? What if your spouse dies before you? What if you die before a financially dependent parent or child?

Physical stuff too

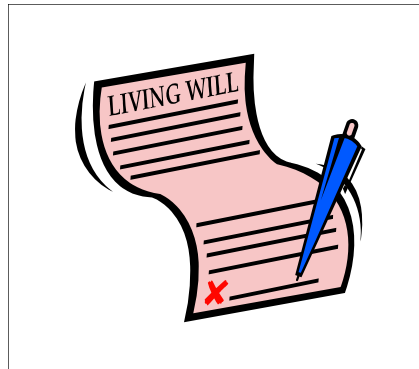
Too often personal property is forgotten in estate planning. Simply saying that heirs "will sort things out" is not the best way to handle things. Sometimes this can lead to family feuds over emotionally-loaded items.

Discuss with family members and friends their desires to have items of sentimental and monetary value, and include written instructions to your executor or trustee.

Leave good records

Don't leave your executor, spouse, children, or trustee scrambling to put together the jigsaw puzzle of your financial life.

Provide them with an annually updated list of all assets and liabilities complete



You have control over how your estate is passed on.

with account numbers and custodian names.

Provide information on real estate, boats, cars, and other major physical items, along with deeds and other ownership papers.

Make sure information on employee benefit plans is available. Executors and lawyers also need copies of all gift tax returns ever filed.

Also leave good information on any charitable organizations that are due to receive a bequest upon your death.

"How should property be distributed if you die before your spouse? What if your spouse dies before you?"

LOVE AND MONEY, YOUNG INSURE, & MORE

When it comes to love, money can be a relationship killer.

A survey by PayPal found that 43 percent of couples in the United States said the stress of the recession had caused them to argue more, mainly about finances.

The online payment service said money is the number one source of couples' arguments, with sex finishing as a distant second. Its international survey found that 10 percent of couples worldwide



said they had ended a relationship over money, and that more couples hid purchases from partners in 2008.

Long term buyers

When long term care insurance is offered by an employer, younger buyers are interested, says the American Association of Long-Term Care Insurance.

The insurance provides benefits for those who are in a nursing home or need nursing care at home.

One third of group insurance buyers are ages 35 to

44, while only 5 percent of private purchases are in that age group, the association said.

Financial illiteracy

Even with financial news on the front page during a recession, Americans remain financially illiterate, says the Center for Economic and Entrepreneurial Literacy.

Its survey found that two-thirds of Americans cannot calculate 25 percent of 8 and a third did not know what 1 percent of 50,000 amounts to. A third said they had no notion how to eliminate their credit card debt.

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DID INVESTMENT DIVERSIFICATION FAIL DURING THE 2008 BEAR MARKET?

Investment pundits have been harping on a popular theme lately: the great market sell-off of 2008, they say, proves that diversification “doesn’t work.”

How’s that again? The pundits say virtually every investment market fell during the year, including parts of the bond market. Worldwide stock markets fell pretty much in concert, with little difference between big stocks in the United States and tiny stocks in Malaysia.

Peng Chen, president of the investment analyst firm Ibbotson Associates, disagrees.

“People need to understand that diversification didn’t fail; it’s what you invested in to diversify that failed,” he said in a recent interview. Yes, it is true that most stocks



Diversification at minimum requires holding stocks, bonds, and cash.

fell during the year, but an investment in stocks, no matter how many held, does not provide true diversification.

“In the most basic form, there are three asset classes: stocks, bonds, and cash,” he said. “Two of those asset classes held up relatively well. Bonds and cash both had a positive year, while stocks were demolished, proving again that diversification

worked.”

For instance, the U.S. Standard & Poor’s 500 Stocks Index fell by 37 percent in 2008, while the international EAFE Index fell by 43 percent. Even high-flying emerging markets stocks fell by 53 percent as measured by the MSCI Emerging Markets Index.

But cash investments in money markets had a positive return of 2 percent, and five-year U.S. Treasury Notes earned 13 percent. One Merrill Lynch index of short-term bonds gained almost 5 percent.

A balanced portfolio of 60 percent stocks and 40 percent bonds operated by Dimensional Fund Advisors lost 24 percent during the year, considerably better than the S&P 500’s loss of 37 percent.