

# INVESTMENT UPDATE

## THE MUNCY BANK & TRUST COMPANY

### INSIDE THIS ISSUE:

- Low bond yields have not deterred investors from buying them. Where will it lead?* 2
- Diversification without bonds was a failure in the last bear market.* 3
- The most tax friendly states for retirees, investment lessons from 9/11, and more.* 3
- Our abilities to make financial decisions fade as we age.* 4

### Points of interest:

- Some 46 percent of retirees have less than \$10,000 in assets at death.
- Single retirees generally have less assets at death than do married retirees.
- Retirees with higher incomes and wealth tend to be healthier.
- Loss of a spouse can lead to a big drop in retirement income.

## MARRIAGE AND WEALTH DETERMINE WHETHER RETIREMENT IS A SUCCESS

**W**hat's the secret to leading a financially successful and healthy retirement?

Accumulate wealth while you are working and stay married in retirement. And, for the best individual outcome, die before your spouse does.

Those are some of the findings of a study done by three economics professors at MIT, Dartmouth, and Harvard.

It seems obvious that accumulating wealth is one of the keys to retirement success. The finding that being married at retirement and staying married leads to a healthier, wealthier retirement is novel.

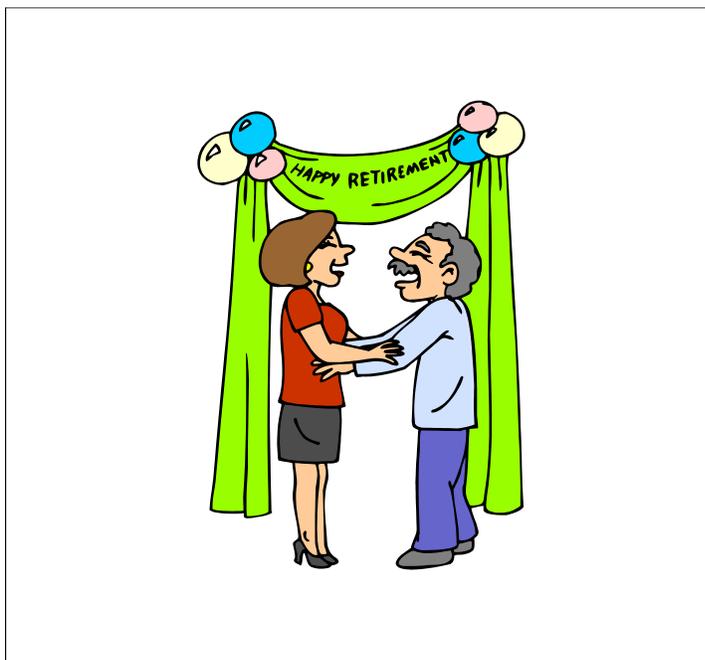
The study also uncovered some dismal statistics: Nearly half of retirees are virtually wiped out of financial assets at death, with \$10,000 or less, including home equity.

### Studying the end game

The study by James Poterba of MIT, Steven Venti of Dartmouth, and David Wise of Harvard, started with a unique premise: instead of focusing on the assets and income retirees had at the start of retirement, they looked at what was left at death.

They used statistics from 1993 through 2008 gathered by the Health and Retirement Study at the University of Michigan, which regularly surveys 26,000 people over age 50.

Retirement studies usu-



Having a spouse throughout retirement may lead to more wealth and better health, a new study says.

ally focus on income replacement rates at retirement. They look at income and assets to determine if the retiree can replace enough of his or her income to support themselves in retirement.

Poterba and his co-authors found that many of the households with less than \$10,000 in assets at death appeared to be financially healthy on a replacement income basis, because "their income in their final years was not substantially lower than their income in their late 50s or early 60s." Many still had pensions and Social Security benefits to carry them through.

However, reaching old age with virtually no assets leaves them with "little capacity to pay for unanticipated needs such as health expenses or other financial shocks or to pay for entertainment, travel, or other activities," they wrote.

### Marriage equals wealth

On average, retirees who were single in 1993 died with the least average wealth—\$142,000, the survey found. Single retirees who had lost a spouse in subsequent surveys had an average of \$253,000 in assets, while married couples where a spouse had just

*(Continued on page 2)*

## SURVIVORS FACE A LOSS OF RETIREMENT INCOME WHEN THEY LOSE A SPOUSE

(Continued from page 1)

died before the 2008 survey had an average of \$692,000 in wealth.

Higher wealth also predicted a longer life: Those with a higher income in the 1993 survey tended to live longer.

“We find a very strong relationship between health ... and the level of assets just before death,” they wrote. “Those in poor health have much lower assets than those in good health.”

**The income cliff**  
Married couples and those who entered retirement single had stable incomes during retirement, while those who lost a spouse saw a drop in income of up to 75 percent.

This was probably caused by the loss of one Social Security benefit and/or the loss of a pension that did not include survivor's benefits, the study found.

Spouses can guard against this by making sure one survivor will not suffer



Wealth increases retirement health.

financially when the other dies, usually by selecting a pension with survivor's benefits or by using life insurance to replace lost income.

## LOW BOND RATES CLOUD INVESTORS' FUTURES

Even though interest rates on bonds are at rock bottom, investors keep pouring money into them because they are spooked over high stock market volatility.

They should be asking themselves what the future holds for their bond investments: will it be like the United States in the 1950s through mid-1960s, or will bonds behave like they did in Japan from 1994 to the present?

In the U.S. scenario, low interest rates led to a stock market boom and a bond market bust; in Japan similar conditions were followed by a long-term decline in stock prices and gradual gains by bonds.

**Rates are the key**  
The key to judging the future course of the bond market is the current interest rate, says Joe Davis, chief economist at the mutual fund company Vanguard.

“Arguably the best predictor of the future return on a bond portfolio is its current

yield to maturity,” he wrote in a recent analysis.

Bond yields in the 2-3 percent range imply that this is the best investors can hope to get in the near term. Of course, bond yields could rise rapidly and cause big losses for investors, but that is not expected to be the case, because the Federal Reserve Board and other central banks have pledged to keep rates low for an extended period in order to spur economic growth.

In the post-World War II United States, government debt climbed, bond rates were very low at the beginning of the period but rose slowly throughout, and the stock market soared, rising nearly

10 times, Davis noted. Bond investors made almost nothing over this period.

### Stagnation in Japan

Facing similar conditions in the mid-1990s, the Japanese stock market declined and today remains lower than it was in 1994. Bonds, meanwhile, climbed slowly, offering modest

returns.

Davis says investors should not count on one scenario or another because the future is unpredictable.

He notes that in both the U.S. and Japanese scenarios a balanced investor with money in stocks and bonds

came out ok. Bond investors, meanwhile, should prepare for low returns and stay diversified in case stock returns are good; stock investors should be prepared for the worst by continuing to hold some bonds as an insurance policy.



Interest rates on short-term bonds are near zero and on long-term bonds are modest. Investors are guessing when and how far they may increase.

*“The key to judging the future course of the bond market is the current interest rate.”*

## BONDS MAY BE THE MOST IMPORTANT PROTECTION IN A FINANCIAL CRISIS

A lot of investors with diversified portfolios were surprised and unhappy with their dismal investment returns during the bear market that began in October 2007 and ended in March 2009.

Diversification across a wide variety of assets whose long-term returns had low correlation should have protected them from more of the downside, they thought. Some even expected that diversification should have helped them avoid all losses. After all, it meant that if one asset class went down, another went up, right?

### Risk asset meltdown

Unfortunately, that wasn't what happened. Virtually all risky assets, even those that had in the past often moved in different directions, fell sharply. In fact, when measured against the returns on U.S. stocks, most other risky assets fell more.

"Investing over the long term will almost inevitably include short-term periods of (sometimes severe) market stress, during which the value

of diversification for risky assets is less evident," says the *Journal of Indexes*.

It looked at the returns of a simple 50 percent U.S. bonds/50 percent U.S. stocks portfolio, and compared it to a more diversified portfolio that included four additional risky but non-correlated asset classes.

The simple portfolio produced an average annual long-term return of 9.9 percent. The more diversified portfolio beat it, returning 10.9 percent per year on average, with hardly any added risk.

### Flight to quality

But during the last bear market, the diversified portfolio did much worse than the simple 50/50 portfolio.

The 50/50 portfolio lost 26 percent during the bear market, while the diversified portfolio lost 38 percent. Why? This financial crisis caused a flight to quality,



Diversification among assets helps, but bonds provide the most downside protection.

where investors dumped anything that was even slightly risky and stashed their money in government bonds.

This demonstrates why investors should hedge their bets with an allocation to bonds, the *Journal* said.

"Investors should recognize that low historical or estimated correlation does not ensure against loss, particularly in times of stress, and that bonds and other low-risk assets can provide valuable protection during such periods," it said.

*"Virtually all risky assets, even those that had in the past often moved in different directions, fell sharply."*

## RETIREE HAVENS, A 9/11 LESSON, & MORE

Those who have a choice of where to live in retirement may want to take a look at the states that are most friendly to retirees.

Research firm Commerce Clearing House recently said that Alaska, Nevada, South Dakota, Wyoming, Texas, Florida, and Washington offered the best tax breaks to retirees.

The study looked at taxation of retirement income and

Social Security, property taxes, and sales taxes. Those states without an income tax rated the best.

### A lesson from 9/11

Eleven years after the terrible attacks on the World Trade Center and the Pentagon, investors can at least learn one investment lesson: Don't sell in a panic during a geopolitical crisis.

Although the attacks caused a 5 percent drop in

stock prices the day the market reopened, investors were in the black just two months later. In previous crises the market had gained ground within six months.

### Better prospects

Retirement savers are being more diligent and market returns are up, and that has improved retirement readiness, says research firm Aon Hewitt.

Its latest annual survey shows that the average employee using an employer savings plan was on track to replace more income at retirement than in previous years.



Investment Update is published monthly by OBS Financial Services, Inc. © 2012 All rights reserved. Information has been obtained from sources believed to be reliable, but its accuracy and completeness, and the opinions based thereon, are not guaranteed and no responsibility is assumed for errors and omissions. Nothing in this publication should be deemed as individual investment advice. Consult your personal financial adviser and investment prospectus before making an investment decision. Any performance data published herein are not predictive of future performance. Investors should always be aware that past performance has not been shown to predict the future. If in doubt about the tax or legal consequences of an investment decision it is best to consult a qualified expert. OBS Financial Services, Inc. is a Registered Investment Advisor.

---

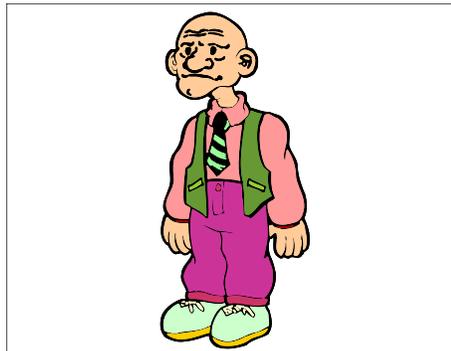
## AGE MAY BRING WISDOM BUT NOT WHEN IT COMES TO YOUR FINANCES

As we age and gain experience we should get wiser, right? We've learned a lot from our mistakes and those of others and we gain a sense of calm and deliberation that we may not have had in our younger years.

When it comes to finances this may be true only up to a point, the latest cognitive research shows.

*Research Magazine* recently noted that scientists who study cognitive aging show that a decline in old age is "natural and inevitable... our brains, like the rest of our body, lose their ability to respond quickly and precisely over time."

Research at the University of Virginia Cognitive Aging Laboratory, for instance, has looked at how people of dif-



Cognitive abilities related to financial decision making begin to decline in our late 50s.

ferent ages do when trying to come up with a synonym to a random word, how well they detect patterns, and how well they recall lists of words. These tasks require the ability to process a stimulus and relate it to an item in memory.

Research shows that the ability to do that tends to peak in a person's late 50s. Studies by the Federal Reserve show that financial be-

havior, such as limited credit fees and interest rates paid on home equity loans, tends to peak in the late 40s or early 50s.

Another study by two professors at the University of Miami shows that risk adjusted investment returns decline with advanced age.

They found that investors over age 70 underperform by about 2 percent a year compared to investors who are younger.

Other studies from Texas Tech show that the ability to understand financial concepts and apply them appropriately declines by about 2 percent per year after age 60.

Unfortunately for older investors, studies show that while cognitive decision making abilities decline, their confidence in their ability to make good decisions does not.