LFM&P

LINNARD FINANCIAL MANAGEMENT & PLANNING, INC.

Registered Investment Advisor, Wealth Management & Financial Planning

October 1, 2016

Outlook & Trends

The central banks' response to Brexit gave the markets a lift early in the 3rd quarter, providing most, if not all, of the return we have realized this year. Now we move on to the US Presidential Election and beyond. The events themselves will be lost in the sweep of time. Most important for us, are the strategies we use to work with these events and to prepare for our own futures.

The Economy

Economic growth maintained snail speed in the 2nd quarter, registering a 1.4% annual rate. The Federal Reserve reports "modest" growth in their regional survey. Apparently quite modest. The current 3rd quarter estimate expects improvement to 2.8%. Looking forward, the recent Leading Economic Index declined after a rise in the prior two months. Corporate profit growth, the lifeblood of the stock market, remained negative for the 5th straight quarter.

The official unemployment rate remains low at 4.9%, Homeowners continue to see improvements in the value of their properties, especially in the South and West. The inventory of unsold homes is less than last year at this time, which is positive for sellers. Overall, one could classify this economy as lethargic, but holding its own.

The Markets

Central bank support, after the Brexit vote, stimulated a market rally of 8%. The following pullback has brought the S&P 500 index back to just above the peak of July 2015. Given the lackluster economy and high valuation, central bank (US, ECB, and Japan) policy and intervention appears to be the primary support. No one knows (probably including the bankers themselves) how long it will last, but the risk / reward ratio remains high.

A major question on the minds of many is how will the presidential election affect the markets. We are the first to admit that our crystal ball is broken on this topic. Nevertheless, in response to popular demand, we will hazard a guess. We expect that at some point, regardless of the election, the stock market will return to its average value, so the election may not really matter in time. Donald Trump has been critical of Fed Chair, Janet Yellen, so we might expect that his election would precipitate that return (by falling) sooner rather than later. On the other hand, Hillary Clinton is more likely to continue current policies, which could extend the market's lethargy, continue to build economic imbalances, and intensify the eventual correction.

The Retirement Predicament

If you were alive in 1850, the concept of retirement did not exist. 80% of 65-year-old men were still working. The idea of a public pension was introduced in 1881 by Prussian president, Otto von Bismarck, and was expanded by Social Security in 1935. Through the years up to 1980, employers also offered retirement pensions. By the 1990's the percentage of employed 65-year-old men had dropped to 17%. At that point, many companies replaced their pension plans with 401ks, and people, who had not grown-up with the concept of being responsible for their own retirement, found themselves bearing the risk and coming up short. Since then, the 65-year old participation rate has climbed to 31% for men and women, as the baby-boom generation makes up for lost time. Increasing life expectancy adds to the problem. The life expectancy of a 60-year old has increased by 8 years since 1850. Half of that increase has occurred since 1980. This acceleration is likely to continue as medicine advances. While longer lives are a benefit, the longer retirement withdrawal period adds to the financial shortage.

"Saving for retirement" is actually new concept. It is slowly being ingrained into the society's thinking, but too late for many retirees. As the baby boom generation went through the accumulation phase of life, the financial community developed the conventional wisdom of buy-and hold, set and forget, and dollar-cost averaging -- a good strategy for young and middle-aged savers. The industry has not really addressed the strategy of retirement, other than by selling annuities. In past issues of *O&T*, we have discussed how retirement is the opposite of accumulation, and how strategies and mindset should change.

One retirement strategy that has gained traction is the “4% rule”, which states it is safe to annually withdraw 4% (adjusted for inflation) of your starting principal. You might ask, "Isn't 4% very conservative? Doesn't the stock market average a 10% return?" Conservative, yes, but not necessarily unrealistic, particularly now. It is probably not coincidental that the economy and stock market have been in the doldrums for the last five to ten years, as the baby boom generation retires and there are fewer productive workers relative to the size of the economy. More and more people are beginning to withdraw retirement investments instead of adding to them. That effect may continue until the boomers have retired and the generation-x and millennials predominate. Perhaps, not so coincidentally, some observers are predicting low investment returns (<4%) for the next 10-15 years, based on current market levels. This low potential return may be a double-whammy for catch-up retirees. The investment markets are providing lower returns, just when their balances need to build.

LFM&P’s financial planning process often includes a "stress test", a historical series of real returns starting in 1967. The table below shows the results of a hypothetical buy-and-hold stock portfolio from 1972 to 1982, withdrawing $40,000 (4%) per year. You can see in the leftmost columns that the value drops over the 10-year period. You can also see that the sequence of returns is also important. Reversing the order of the same annual returns produces a 29% higher result at the end. It is far better to retire when market values are low and good returns occur early. Right now, market values are high, and the more likely sequence resembles the columns on the left.

1972		$1000000		$1000000
1973	-16.8%	798,993	20.7%	1,158,538
1974	-20.3%	605,025	-7.1%	1,039,537
1975	31.0%	740,302	13.5%	1,134,285
1976	1.2%	708,426	14.2%	1,250,111
1977	-12.5%	584,701	12.0%	1,354,918
1978	12.0%	609,882	-12.5%	1,150,215
1979	14.2%	651,033	1.2%	1,123,093
1980	13.5%	693,407	31.0%	1,419,080
1981	-7.1%	607,257	-20.3%	1,099,323
1982	20.7%	684,572	-16.8%	881,658

It is easy for people to look at the current economy and market and either opt out completely, or continue to follow a familiar "buy and hold" strategy. Either may be fine if they are situated well enough to live comfortably well into their nineties, regardless of investment performance and inflation. For others, it would have been a mistake to avoid the positive return years in the example above, just as it would be counterproductive to be fully exposed during the worst years. Although returns cannot be predicted, risk can be managed. We suggest that people should actively engage in the process of managing their future, altering strategy and consider moving away from avoidance or "set and forget". We suggest developing and maintaining a plan to clearly visualize potential outcomes, actively manage investment risk, and just as importantly, actively manage expenses to be consistent with income.

If you would like help looking into your financial future, evaluating your risks, managing your investments, or planning to manage your income effectively, please call or e-mail. We invite you to visit our website.

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