Weiss Wealth Management Group of Raymond James®

# The Weiss Report

Smart and Steady

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## Difficulty of Thinking Long-Term

Most investors acknowledge their overarching goal is to develop a long-term plan for college costs and or retirement income. This sounds like it should be an easy thing to do. However, too often the investor's viewpoint becomes skewed towards the short term by news and data that takes one off their original long-term path. Most investors, when acting on their own instincts, act in ways counter to that goal. We believe there are two important reasons why this happens.

The first reason is the financial media industry. Consumers are bombarded by opinions and information that many think will help an investor see the next move in the market. Unfortunately, even if the media could foretell the next move, there is little value in their reporting as what is about to happen in the next few weeks will unlikely determine long-term results. Generally speaking, professional media members have one goal and that is to attract and keep the largest audience that they can.

The second reason is the inability to conceptualize large numbers. We believe that we are not calibrated to understand long periods of time or very large numbers. For example, try to picture the difference between what happened 150 years vs. 1,500 years ago. Now, do the same thing with picturing what a pile of $30 million dollars looks like vs. a pile of $4 billion.

When we say long term, we do not mean one, three, or five year periods of time. These time frames may seem long-term to an individual, but market time is measured much differently. When we look at markets in a 75+ year context, all of the particulars of daily, weekly, or monthly news become irrelevant, and a clear picture emerges.

One cycle that seems to repeat itself in the long term is called a Secular Market. While this term may sound like a contrast to a "religious market", it actually is defined as a market driven by forces that could be in place for many years. A Secular Market can be either a Bull market or a Bear market. We use this definition in the context that these long-term cycles repeat over many years, but for an indefinite time span.

We have included a view of these long term Secular Markets in Enclosure #1. The first is a bar graph of the Standard and Poor's 500 Stock Index (S & P 500) from 1927-2013. The data seems to tell a clear story. Once a market declines, it takes several years of sideways trading until the prior market peak is exceeded. The periods of 1929-38, 1970-82, and 2000-09 represent the Secular Bear Markets.

The periods of 1938-69 and 1982-2000 represent Secular Bull Markets. The 2007 peak in the S & P 500 occurred in October 2007 at 1,577. It stayed below this level until April 2013.

When using the secular approach to evaluate long term cycles in the stock market, it can be said that a Secular Bull Market began at that time. History details that these cycles last for several years in a particular direction. Using this template as a guide, we view a Secular Bear Market as a headwind for stocks. Flipping the same coin over, we view a Secular Bull Market has a downwind effect on stock valuations and prices.

IN SUMMARY: The stock and bond markets have been more volatile than not for most of the last nine months, after an almost 18 month steady rise. During these times, various news stories pull at the individual investor to use these day-to-day and week-to-week events to make investment decisions.

In the context of the longer view, which is supposed to drive investor's goals and decision-making, none of the short-term focus changes the history of stock trading. We are very comfortable with the conclusion that markets rise and fall for many years at a time. And, as of April 2013, we have entered a Secular Bull Market.

WHAT DO WE EXPECT AHEAD?

Long-term unemployment is still at 11% (BLS U-6), but this calculation was over 15% at the recession's low point. Wages may be more stagnant then robust, but the American consumer has much less debt than in 2008 while disposable income has been increasing somewhat. Consumer spending, which comprises approximately 70% of the domestic spending, has been rising steadily for some time now. We don't see the economy's growth soaring anytime soon, but with that said, we see little chance of another recession too. Steadily rising earnings should lead to steadily rising stock prices.

More market specific, we thought we'd share some of the notes from Raymond James Chief Market Strategist Jeff Saut. He attended and spoke to the recent 36th annual Raymond James Institutional Investor Conference. Below were the most asked questions, with his answers in parenthesis:

1) Is the U.S. Dollar going to stay strong? ("yes")

2) Is that going to hurt large cap companies' earnings? ("yes, marginally")

3) Are earning estimates going to come down? ("I think they already over-reacted")

4) Are small/mid-caps better than large caps? ( "they are more expensive")

5) How about value vs. growth? ("Value is less expensive than growth...")

6) Have oil prices bottomed? ("yes")

We have included Jeff Saut's answers to the above investor questions because they mirror many of the questions we are receiving from our clients.

We expect the next few months will see markets to continue to be volatile with an upward bias. Talk of oil prices and when the Fed may raise rates will dominate the news, but we think we're in a Secular Bull Market and that is most important.

PORTFOLIOS:

When we construct portfolios, we try to put risk analysis ahead of opportunity for gain. We believe the investment with the highest risk given its potential of returns is bonds, especially long term bonds.

We have been waiting for conditions to improve in the economy that would justify interest rates in general to rise. We saw a false start to this trend in the summer of 2013. The 10 year T-Bond rate rose from 1.6% to 3% within a few months. While the rate did back down at year's end, the long term T-bond indices were down approximately 10% for the year.

When interest rates rise, the prices of existing bonds must decline. This is not attitudinal, its simple arithmetic. Because the amount of income from a bond is fixed, the only way for a bond to adjust its yield upward to match rising rates in general is to fall in price.

In Q1 2015 we have adjusted accounts we manage by discretion to reflect our expectation that rates are set to rise later this year. We have trimmed our longer term maturities for shorter maturities and cash. This action alone will reduce the risks of principal values once rates rise.

In appropriate accounts, we have researched an investment that we think rises in value as rates rise, and declines in value if rates fall. While not a perfect hedge, we would like to have something appreciating because interest rates are rising. This should also offset some of the damage that falling bond values bring to our monthly statement.

In equities, our portfolios have not changed much in 2015. In November 2014, we reduced exposure to energy, and replaced those monies with allocations to traditional growth sectors. We purchased a new mutual fund, added sector ETFs, and purchased a few individual stocks.
We are pleased to report that the new allocations are doing very well, in some cases appreciating significantly this year while general market indices have been near unchanged.

While we reduced energy investments in Nov 2014, we still have a meaningful allocation to the sector. The last 90 days have been rocky for the energy sector, but we see some stabilization in oil and gas prices. We also note that the overwhelming number of holdings in the energy infrastructure subsector raised their distributions in Q1 2015 despite such a pressured price environment. We view continued distribution growth as a sign that while the subsector has had a major correction, the overall thesis of rising income is still viable.

ENCLOSURES:

Enclosure #1 is a graph depicting secular markets. In this graph, secular bull markets are in green, and secular bear markets are in red. What this graph does not show is how a secular markets shift. After a secular bull market, the market rolls over and begins to decline. The decline and consolidation takes several years. When the new rising market exceeds its prior market peak, the market moves from secular bear to bull.

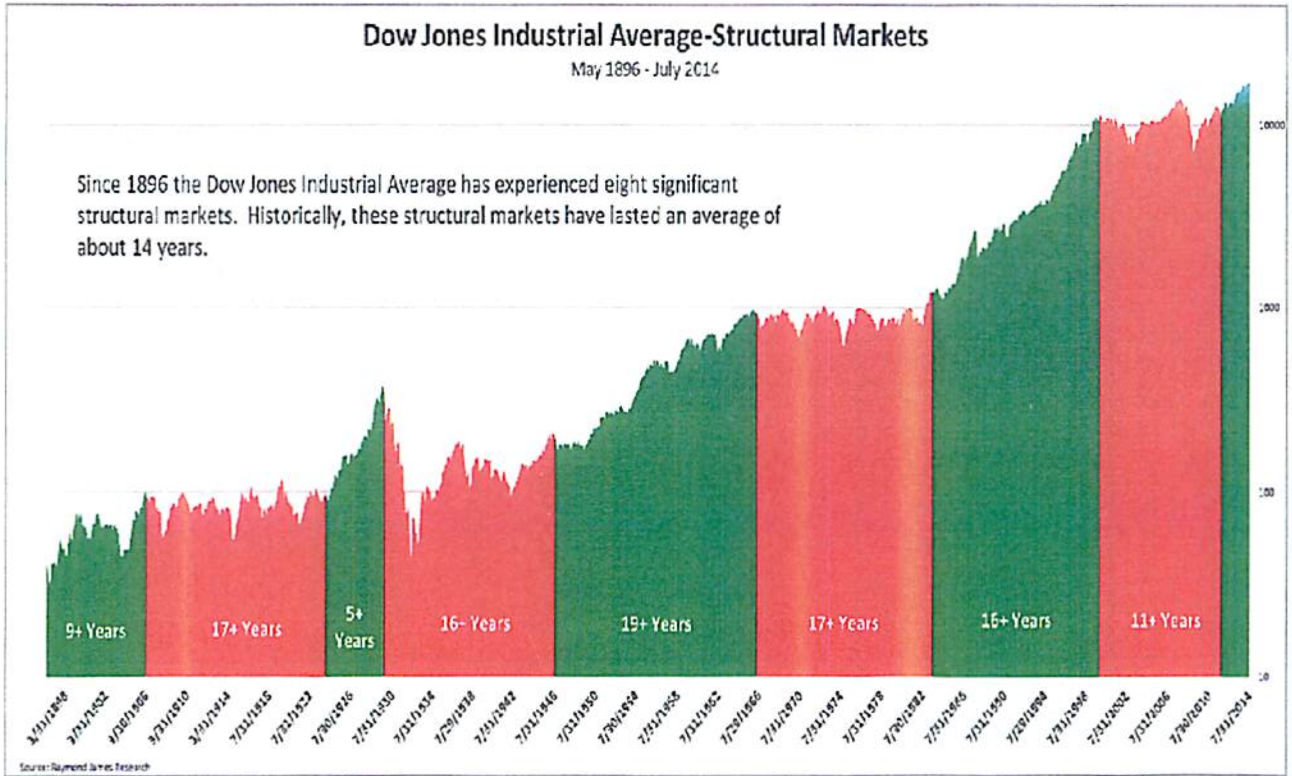
Enclosure #2 is a breakdown of the 2014 performance of the Standard and Poor's 500 Stock Index (S&P 500) courtesy of American Century Investments. Many investors calibrate their opinions of their portfolio returns to this index. It turns out that almost half the increase for the year was concentrated in 25 stocks or just 5% of the Index. At the same time, 108 stocks or 21.6% were actually down for 2014.

Enclosure #3 is a recent interview with one of Lenny's most important business influences, Nick Murray. Over 20 years ago, Murray had the vision to preach that advisors needed to take a holistic view of client relationships. That in the future, advisors need to do much more than just make stock and bond recommendations. We think he was dead on. We feel his opinions are as important today as they were over 20 years ago.

## Jeffrey Saut

# "Valuation" Low in October 2011

I maintain that the bull market began in October 2011 at the "valuation" low, or the cheapest the S&P 500 would get on forward earnings estimates, and not at its "nominal" price low of March 2009. Nobody measured the 1982 to 2000 secular bull market from its "nominal" price low of 1974, but rather the "valuation" low of 1982.



## S&P 500 Performance in 2014 Driven by a Narrow Set of Stocks

- The S&P 500 returned 13.7% in 2014. But that performance was largely driven by a small group of stocks.
- The top 10 contributors accounted for 29% of the S&P 500's gain.
- The top 25 contributors accounted for 47% of the S&P 500's gain.
- Apple Inc., which is the largest position in the S&P 500 (3.3%), was also the greatest positive contributor to performance for the year (1.2%). So one stock out of 500 accounted for nearly 9% of the gain.
- Microsoft, Berkshire Hathaway, Intel, Wells Fargo and Facebook, all among the 20 largest holdings in the S&P 500, together contributed another 1.8% to the index's performance. That equates to 13% of the index's performance last year.
- So just six stocks out of 500 accounted for 22% of the S&P 500's 2014 gain.
- In fact, nearly a quarter of the companies in the S&P 500, or 108 of them, had negative returns in 2014.

Source: Morningstar Data as of 12/31/14



American Century Investments

FINANCIAL ADVISOR



# A Talk With Nick Murray

MARCH 2, 2015 • EVAN SIMONOFF

*Editor's Note: Editor-In-Chief Evan Simonoff sat down last month with author and advisor Nick Murray to talk about the retirement income challenge. Murray will be a keynote speaker at the upcoming [Financial Advisor Retirement Symposium] in Las Vegas.*

**Q. It's widely accepted that most baby boomers have undersaved. Even among advisors' clients who are savers, there is a gap between the perception and reality of the amount of retirement income their savings can buy. Global monetary policy isn't helping. Some think we are headed for a train wreck as big or bigger than the financial crisis. Others say humans have remarkable abilities to adapt. What say you?**

*A. First of all, undersaving isn't a baby boomer phenomenon. It's a human phenomenon. Fifty percent of all Americans over the age of 65 are living entirely on Social Security. Undersaving (and underinsuring) are why the financial advisor was sent into the world. Second, I don't see what "global monetary policy" has to do with anything; Americans save and spend in dollars, and the dollar is far and away the most credible currency in the world, not that that's saying much. Third, some people are always predicting a train wreck to dwarf all other train wrecks; history counsels otherwise. And history has to become our investment philosophy. Our only other choice is chaos theory, and I don't know how to make investment policy out of chaos theory.*

*Failing to plan is planning to fail. For people in the accumulation phase of life, that means a written, date-specific, dollar-specific retirement accumulation plan, premised on long-term historical returns. Once in retirement, it has to become a retirement income plan which, at historic returns, defends and even accretes purchasing power. We financial planners know how to craft such plans, and they should always be our focus. The rest is noise.*

**Q. We are six years into the most unloved bull market in most Americans' lifetime. According to some measure, only one bull market since 1873 made it to seven years and that was from 1897 to 1903. Should that be a source of concern?**

*A. I guess if you torture the data long enough they'll confess to anything, but it really depends in part on how you define a bull market. We had one from 1946 to 1968, by my reckoning—albeit one interrupted by three relatively brief and relatively shallow (i.e. less than a 30% decline) downturns. We had another from August of 1982 to March of 2000, interrupted essentially by one day of horror in 1987 and a couple of blips in 1990 and 1998. And in the largest sense, we've had one since those guys met under the buttonwood tree; it is quite wonderfully ongoing, as how could it not be?*

*But beyond all that, I don't see how this line of inquiry gets us anywhere, inasmuch as the market can never be timed. Peter Lynch said it best: "Far more money has been lost by investors preparing for corrections, or trying to anticipate corrections, than has been lost in the corrections themselves."*

**Q. The biggest risk facing recent retirees in the last 15 years, according to experts, is a phenomenon defined as sequential risk, or retiring just before a bear market begins. Millions of Americans experienced this when they retired in 2000–2001 and in 2008–2009. So some like Wade Pfau and Michael Kitces have proposed standing the traditional 60% equities-40% fixed income on its head, and moving to 70% fixed income-30% equities and not rebalancing, but instead just letting the equities ride over the remainder of their lives.**

*A. After observing that whatever the biggest risk was over the last 15 years won't be the largest risk over the next 15 (during which we seem unlikely to have the two biggest market declines since 1929 all over again), let me acknowledge that placing 60% and 70% of one's portfolio in bonds may be a way of managing sequence-of-return risk, but so is shooting oneself in the head. Both are fatal; one is just more sudden.*

*There are any number of ways to manage sequence-of-return risk while maintaining a preponderantly equity portfolio. One is to start with two years' living expenses in a cash equivalent, so that if the market goes south early you can moderate or stop altogether your withdrawal plan and live off the side fund. Another is to work part time and/or a couple of years longer. Another is to start a planned 4.5% withdrawal program as 2% the first year, 3 the next, 4 and then 4.5. Moreover, all these tactics can and in many cases should be combined. Finally, there are the so-called "living benefit" riders of variable annuities, which may very well have a place for some portion of the portfolio.*

*Chuck Yeager termed ejecting from a supersonic aircraft "committing suicide to keep from getting killed." That applies equally well, it seems to me, to trying to fight off three decades of rising living costs with a 60%–70% fixed-income portfolio.*

**Q. You are known for having a low opinion of bonds. Given their yields, your opinion isn't the only thing about bonds that is low. But the vast majority of retirees need both an element of risk control and a source of income in their portfolios. A look at the options—high-yield bonds, real estate, high-yield munis, dividend paying stocks, MLPs, annuities and other instruments—reveals that each vehicle has its own set of issues and each has also been influenced by global monetary policy. How do you evaluate the choices embedded in this conundrum?**

*A. What conundrum? Nothing has provided greater risk control over the long term than equities, which are historically without principal risk over 30-year periods (unless you're mistaking volatility for loss, in which case you're already doomed). And there has never been a source of increasing income as powerful or reliable as the constantly rising dividends of the Great Companies in America and the world.*

*Today's retirees will average age 62, which means they were born in 1953. If they were born in February 1953, the S&P Index was at 26, and the dividend at $1.40. The relevant numbers as I write are 2,000 and $39. Again, as long as you don't mistake temporary decline (volatility) for risk/*
*loss ... what conundrum?*

**Q. Debt, the demographics of aging, and large budget deficits are global problems. The IMF and the World Bank say the U.S. economy is one of the few bright spots in the world but most Americans think our economy is mediocre at best. Should we accept this as the New Normal?**

*A. No. We should enact pro-growth fiscal policies, including but not limited to tax reform and entitlement reform, to begin with. When, as and if we get our fiscal situation rationalized, our economy can and will grow at superior rates.*

**Q. In the past, you have argued that optimism is the only rational outlook for the future. That flies in the face of the current mood in America and elsewhere. Do you still believe that and why?**

*A. That optimism flies in the face of "the current mood" is almost reason enough to embrace it, all by itself. But I carry in my back pocket more computing power than existed on Earth when I started kindergarten in 1949, and a million times more than E. F. Hutton had when I joined that firm in 1967. I have been almost effortlessly cured half a dozen times in my life of illnesses which, had I been born 50 years earlier, would have killed me. Both these staggering improvements in the quality of life are compounding exponentially, as indeed is all information technology—and all technology is information technology.*

*As the developing world continues to adopt free market principles, it continues to pull tens of millions of people a year out of poverty—first to become producers and then consumers. America remains the most entrepreneurial, flexible, transparent economy in the world. We virtually own science. Nearly all (if not all) of the revolutionary global companies started since the advent of the microprocessor are ours; this country throbs with opportunity for the path-breaking technologist.*

*We're one of the richest countries in mineral resources, and the only one which vests the mineral rights in the landowner—just when we've perfected the synthesis of horizontal drilling and hydraulic fracturing. We may very soon be an exporter of hydrocarbons—a major boon to Americans and a source of strength for the dollar. Cheap natural gas is bringing manufacturing back home. I can go on and on like this. I've never been more optimistic in my life than I am today.*

**Q. If an advisor wanted to focus his or her practice on just one idea for the foreseeable future, what would it be?**

*A. That when an American (or an American couple) steps across the threshold of retirement, they find themselves facing two doors. Door Number One says, "The money outlives the people." And Door Number Two says, "The people outlive the money." And the newly minted retirees must pass through one door or the other. It's as stark and as simple as that. Forget debt, the demographics of aging, unfunded entitlements, global monetary policy, and all those other amorphous imponderables we can't predict, much less control. Focus on what we may be able to control, if and only if the client will let us: whether the money outlives the folks, or they outlive their money. There is treasure on Earth and in heaven for those advisors who make it their mission to help people plan their way through Door Number One.*