SPRING 2011

in Context

WEALTH STRATEGY FROM A DIFFERENT PERSPECTIVE

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Investing Internationally

Recent events such as the crisis in Japan and political unrest in the Middle East and northern Africa have left many investors wondering if investing internationally is a good idea. Rather than interpret these events as a reason to abandon international diversification, we should take them as a reminder of why we own a diversified portfolio in the first place.

Investing in non-U.S. stocks delivers expected returns similar to U.S. stocks, but provides the benefit of diversifying the economic and political risks of investing solely in U.S. stocks. There have been long periods when U.S. stocks have performed poorly when compared with non-U.S. stocks, and vice versa. This diversification benefit is especially important for those employed in the United States, because their future earnings may be affected by events in the United States.

Japanese equities play a role in the portfolios we recommend, although the amount of exposure to Japan varies from client to client. To get a rough idea, Japan represents less than 8 percent of the world's market capitalization.

Any country or region can experience a financial or economic crisis, and any country or region can suffer a natural disaster. Investors would be wise to have an investment plan that takes these possibilities into account by diversifying across countries and asset classes.

All Around the World

The relationship between markets and world events is different than many would expect. The following article addresses some of the questions investors have been asking.

1. When will things return to normal?

Although it can be difficult to accept, what we experienced these past few months may be what normal looks and feels like. Many people may look back at 2010 as normal, but memories of that time may be altered because of what we experienced in late 2008 and early 2009.

Even though the S&P 500 Index returned 15.1 percent for the year in 2010, bad news in the way of high unemployment, numerous bank closures and a struggling housing market were just a few of the hurdles we faced last year.

It's common to hear people say, "Just when things were getting back to normal." This suggests they were on the verge of normal, but not quite there yet. More often, we find ourselves looking back, identifying normal only after it has passed but rarely talking about things being normal in the moment.

2. What is the market's relationship to crisis events in the United States and overseas?

Since 1973, there have been at least 16 significant financial crises in the United States or overseas. We have watched some crises turn from isolated situations to global events. The market has had a history of rebounding from crisis events.

Consider the past five financial crises and the S&P 500 total return for the following 24 months:

September 2008 (Lehman Brothers fails): 2.55 percent
March 2000 (Internet stocks drop): –21.49 percent (This period includes September 11.)
August 1998 (Russian stock market crashes): 62.64 percent
July 1997 (Asian contagion begins with Thai baht devaluation): 43.38 percent
December 1994 (Mexican peso experiences devaluation): 69.17 percent

3. What about gold?

Until gold hit $900 an ounce at the beginning of 2009, not many people were thinking about it, much less as an inflation hedge. Gold has had good returns in recent years. However, from 1980 to 2008, the annualized real return (the return adjusted for inflation) of gold was –0.54 percent per year. Over this time period, gold would have been an insufficient inflation hedge.

Those who seek protection against future inflation should consider owning Treasury inflation-protected securities. Investors can also consider an allocation to commodities through fully collateralized commodity futures to provide some protection from inflation. Commodities tend to have their best performance during periods of rising inflation.

4. In light of recent events, what is a prudent annual withdrawal rate?

In 1998, Trinity University in San Antonio published a paper regarding a prudent withdrawal rate from a retirement portfolio. This paper became known as the "Trinity study," and its conclusions still are widely referenced in financial planning.

Based on historical data, the Trinity study calculated safe withdrawal rates for various portfolio allocations. It found that a retiree with a 25-year distribution time frame could safely withdraw 4 percent of his or her initial portfolio value each year, adjusted for inflation. At a rate of 4 percent for a portfolio with an allocation to both stocks and bonds, there would be no chance of running out of money.

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In the Face of Adversity

By Vladimir Maşek

On March 11, eastern Japan was devastated by the most powerful earthquake in the country's recorded history, followed by exceptionally destructive tsunami waves. The magnitude of the humanitarian impact (more than 13,000 deaths, more than 14,000 people missing, more than 300,000 refugees at the time of this writing) and the economic loss (estimated at more than $120 billion) are hard to fathom. The impact of the nuclear breaches is still unfolding. However, there is hope. The Japanese society has a well-deserved reputation for resilience in the face of adversity, and it may yet emerge from this calamity stronger than before.

The aftermath of the disaster raised a number of interesting questions for economists, investors and other observers. There is no doubt that the devastation will create significant hurdles in the short run. After the very serious problems at the Fukushima I nuclear power plant, power shortages are possible. This will affect industrial production in general. Damage to the infrastructure is enormous. One can only imagine the losses to insurance companies. What will all of this mean for the Japanese and global economy, stock markets and the yen?

According to classic Keynesian theory, despite the human tragedy, the earthquake may actually help the economy. Facing a severe economic crisis caused by a significant drop in aggregate demand, Keynes argued that "pyramid-building, earthquakes, even wars may serve to increase wealth." The economic profession is deeply divided over the applicability of Keynes's observation. For the benefit of the Japanese people, we should hope that Keynes was at least partly right.

Many investors expected the Japanese yen to lose value, in view of the calamity's impact on the Japanese economy and finances. They were shocked to instead see the yen reach a post-World War II high against the U.S. dollar. As an export economy, Japan holds huge amounts of foreign-denominated assets. To assist in rebuilding, Japanese investors (including the Japanese government) are expected to repatriate assets, creating significant demand for the yen and supply of foreign currencies.

In the immediate aftermath of the disaster, the Nikkei 225 Index dropped 18 percent, from 10,500 to 8,600 — although it has since recovered, up to 9,700 a month after the earthquake. This doesn't mean, however, that we know what the effect has been, or will be, on the Japanese stock market or economy. There is no way to know where the index — or the economy — would have been without it.

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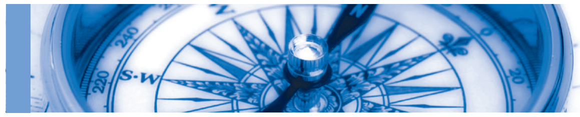
The Trinity study was updated in 2011 to include data through 2009, and the authors found that 4 percent is still a safe withdrawal rate. The authors noted that adaptive withdrawal plans can also be implemented when markets make significant moves. Bull markets might allow for a higher withdrawal rate, and bear markets might force a reduced withdrawal rate. Alternatively, if time horizons are significantly reduced, a retiree may be able to increase the withdrawal rate.



Perspectives

Perspectives features different topics of interest that offer viewpoints on improving quality of life. This quarter, we focus on a topic that affects everyone: transition. The following article discusses the true nature of transition and why understanding more about the transitions we experience can bring positive change in everyday life.

Understanding Transition

By Marilyn Wechter, MSW, BCD

Our lives are constantly in transition. Transition can be defined as going from one state to another. We may think of big events, such as marriage, birth of a child, moving or a taking a new job. In reality, we go through multiple transitions every day, such as going from waking to sleeping or from home to the office.

Large transitions tend to throw us off balance because they upset our routines, even if it is a transition to something that we desire. But there are actions an individual can take to move forward with less disruption.

Recognize that a change is happening. Sometimes, those around us do not understand why we are off balance, especially if we wanted or previously welcomed the change. When we find it difficult to adjust to what is new, it can be helpful to acknowledge what we are experiencing to ourselves as well as to others.

Consider what elements you can control. Quality of life can improve when we focus on the parts of life we have influence over, while at the same time being gracious about the parts we cannot control.

Engage in behaviors and rituals that provide comfort. When we take part in familiar activities that are pleasing to us, such as taking a long walk or visiting a favorite restaurant, we re-establish balance to our routine. It reassures us that everything is not new and unfamiliar.

Reach out and connect. When transition is difficult, we tend to feel isolated. Sometimes, it is helpful to connect with those who remind us we are not out there alone.

Very often, our connections with others are what get us through large transitions. It is natural to strive to control our environment. But we struggle when we try to exert control over things we cannot affect. When we allow for the possibility for something good to happen, we find the confidence to face whatever comes our way next.

Marilyn Wechter, MSW, BCD is a psychotherapist and wealth counselor. She has been in private practice in St. Louis for more than 30 years working with adolescents, adults, families and couples. In addition, she works with estate lawyers, investment advisors and executive coaches. She has taught courses on normal and abnormal development at Washington University in St. Louis, and courses on images of women in film from a cultural and psychological perspective at Webster University in St. Louis.

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