January 2015

"Surviving 2015"

By Craig Pulliam, CFP® and Michael Comstock, CFP®

It's the middle of December 2014 as we sit down to write this, and we already have a pretty good idea of some of the financial issues we'll contend with in 2015, and a few things you might do to stay ahead of the game.

Bad News is Coming but Won't Stick For Long: Just in the last year, we've seen stocks dive temporarily because of reports of the Ebola virus in Texas, terrible terrorist acts by ISIS in the Middle East, poor sales for Black Friday (of course three days later Cyber Monday was better than 2013), and oil that's becoming too cheap, too fast. These are not issues that have had (nor are likely to) a lasting effect on the stock market, but news outlets would have you believe that they might have done so. In 2015, we'll see more provocative news bites, but you should probably stay the course.

The U.S. Economy is Strong and Likely to Get Stronger in 2015: It's sad that almost 50% of the non-investor public thinks we are still in a recession (we are not). Which probably accounts for the fact that these people have been on the sidelines while the S&P 500* is up close to 200% in the last 5 ½ years. Unemployment is down, housing has rebounded, economic growth is up, and –overall- consumer confidence (which impacts spending) is higher. You will hear anecdotal reports that seem to call all this into question . . . a friend who still hasn't found a job or a small business having trouble getting a loan. Even in rebounding economies, there will be pockets of misery.

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The Federal Reserve Has Got to Raise Rates: Presumably not by very much at all, but they are probably going to do so. And while the markets may react negatively at first, it will signify the confidence that the Fed has that the economy is finally strong enough to weather the needed rate increase. Know, too, that an increase in borrowing costs – which a rise in rates would surely bring- need not have a negative effect on your portfolio. As a matter of fact –over the last 50 years- gradually rising rates (from the current 2.10% to about a 5% yield on the 10-year Treasury) are generally associated with rising stock prices (JP Morgan). So don't despair when interest rates eventually start to rise, as they must.

<u>TIP- Review Your Life Insurance in 2015:</u> It may sound crazy for a financial advisor to say this, but not everybody needs life insurance. An even greater number have the wrong types of policies, don't understand them, or are paying too much. In 2014, as Kim Weimer took over the role of Insurance Coordinator, we've helped a number of you review your coverage and some of you to make changes that upgraded your coverage and even saved you a lot of money. If you haven't done so, please let us help you have a closer look in 2015. For some of you, having proper long-term care insurance coverage is the most vital insurance.

<u>Bond Prices Must Go Down:</u> When interest rates go up (they should, they will) bonds will be hit. A 1% increase in interest rates can cause a 17% reduction in the price of a 30-year Treasury bill (U.S. Treasury, Barclay's, FactSet) and a drop of almost 7% in high-grade corporate bonds. Almost no one believes rates can go any lower, as they are nominally at "0" now. So it's important to know that your bond allocation *–and we believe it's critical to have a bond/fixed income allocation-* can have very muted returns. Rates will not jump to 1% overnight, so you can gradually adjust. What this means is that it's important to look at a variety of different fixed income instruments that may provide ballast for your portfolio and also a modest return (returns are never guaranteed, even on most fixed income investments).

<u>TIP- Save, Save, Save:</u> For those who are working, nothing –nothing at all-will put you in better position for college funding, retirement, or that wonderful cruise than saving as much as you can. What *you* save is the single most important component in building a large portfolio. We can pick great investments, and help you through the rough patches . . . but do you really want us to take the risks inherent in trying to make you 15% annual returns? No, it wouldn't be prudent or realistic. But you have a chance of 15% growth annually (that's contributions *plus* investment return) if you do a lot of the heavy lifting yourself, and save as much as you can. While we think a 15% or greater annual increase is achievable, it is not guaranteed, of course.

<u>Volatility is Back in 2015 –Its' Frightening, but it's Normal:</u> Even though 2014 showed a few more tentative market swings, we've not seen normal volatility for years. We've been about 40% below the average volatility as measured by the DOW* over the last 80 years; and almost 20% below the average as measured by the VIX* over the last 25 years. If we begin to move toward the norm, and we probably will, it will be harrowing for some investors. Yet market swings, sometimes violent, are a normal part of the investing landscape, so don't get thrown by this. On average, we see declines of 5%+ about 3 times a year; declines of

10%+ once a year, and bear market declines of 20%+ about every 3 ½ years (Capital Research and Management). Since 1980, the average intra-year drop has been over 14% (JP Morgan, FactSet). Yet, the S&P 500 averaged 9.94% per year over that period. Stay on track and history tells us you should be fine.

TIP: Your Home Isn't as Good an Investment as You Think: So don't convince yourself that the upgrades you're planning will multiply in value when you sell the house. Very few of you have seen your home values grow appreciably over the long haul (on an annualized basis) . . . and for most of us, the growth of home values is more like 2-3% per year over the long term (Federal Housing and Finance Agency). Sure, you'll hear people tell you about how their parents bought a home for $75,000 in 1975 and sold it for $300,000 just weeks ago!! Impressive? That's about a 3.5% rate of return over 40 years, and don't forget the property taxes paid, the mortgage interest paid, the new roof, the landscaping, etc. No, a home is not comparable to saving in an investment account or your company 401(k), and don't let anyone convince you otherwise. A home should be a nice place to live. Period. Regardless of the attestations of a friend who says he made a bundle flipping a house.

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We think 2015 is going to be one of those years that will test us all. There are going to be some legitimate economic issues to deal with. What will the Fed do? Will Russia's economic and currency woes infect the global markets? Will China's growth slow dramatically? And will Congress be able to get anything done?

While a strengthening domestic economic climate will likely rule out a recession, it does not preclude emphatic fluctuations in markets, or even an overdue correction. The best you can do is to rein in expectations for account growth, accept that there will be months when your values dip temporarily and to take care of business on the home front (the Tips above): save as much as you can, review your insurance with us, and spend very wisely on your home. Maybe the very best move is to lean on us and let us help with these and other issues, and to let us help those you care about. We'll always do our best.

**All indices are unmanaged and investors cannot actually invest directly into an index. Unlike investments, indices do not incur management fees, charges, or expenses. Past performance does not guarantee future results.*

Craig Pulliam and Michael Comstock are CERTIFIED FINANCIAL PLANNER™ professionals practicing at 112 Westwood Place, Suite 310, Brentwood, TN. They own Premier Asset Management and are registered representatives and investment adviser representatives with/and offer securities and advisory services through Commonwealth Financial Network: A Registered Investment Adviser, Member FINRA, SIPC. Fixed Insurance products and services offered by Premier Asset Management are separate and unrelated to Commonwealth.

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