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RETIRE BETTER®

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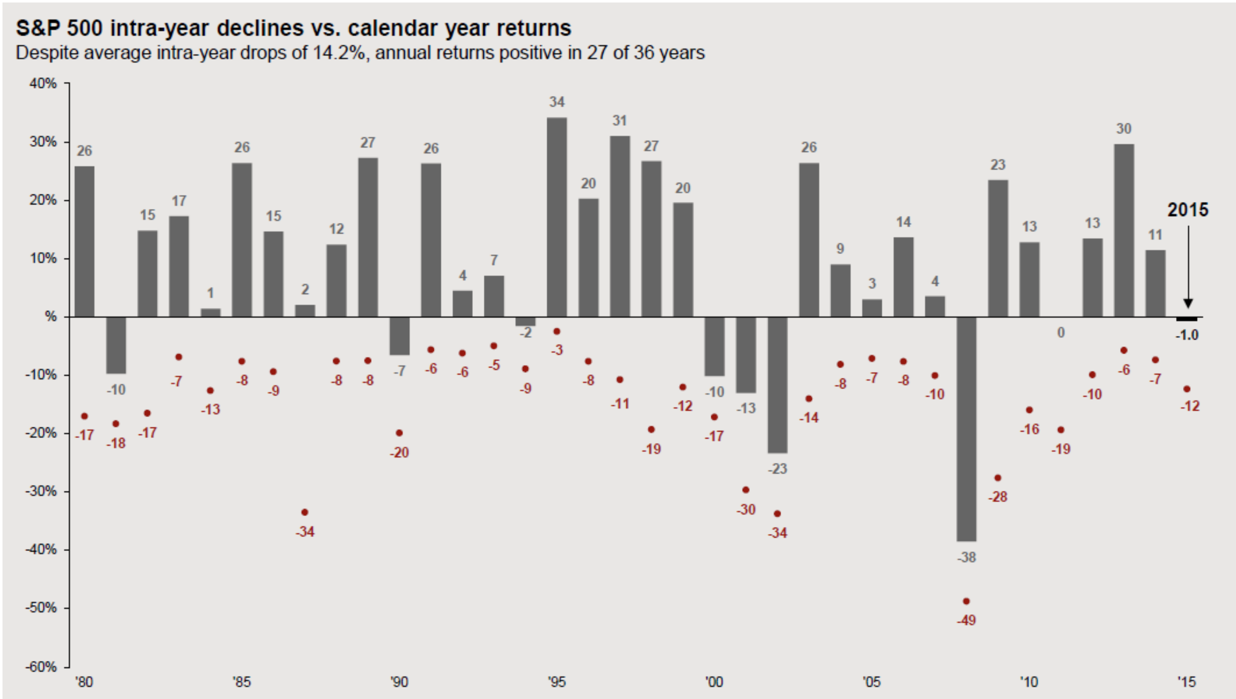
Dear Client:

If the stock market ended 2015 with a thud, then 2016 has begun with a crash and then a "Crud!" when looking at January account statements. We have just lived through one of the worst opening months in stock market history, and if it hadn't been for a couple of up days at the end of the month, it could have been the worst January ever. None of this helped the values of portfolios in this first month of a presidential election year, and we are as disappointed with the results as our clients are.

So is it time to panic?
Amazingly, we are technically still in the bull market that started almost 7 years ago. That seems strange after we just saw the market decline over 10% in 3 weeks, but a downturn doesn't actually qualify as a bear market unless stocks are down 20% or more. So presently, we are experiencing a correction (10%+ decline) in a bull market. We won't know whether things will worsen to become a bear market until we get there or the market moves back up again.

As an investor, though, what's important to keep in mind while watching stocks and portfolios suffer is that these types of pullbacks are very typical in the history of the stock market. In fact, since 1980, the average pullback during a calendar year in the S & P 500 has been 14.2% (see chart from JP Morgan below). This means that at some point during a single year, the S & P 500 has declined on average 14.2% from its high. But in 27 out of 36 of those years, the total return for the year has still been positive. In 1980, the biggest decline during the year was -17%, but the total return for the year was 26%. In 1982 we had the same sized decline during the year, with a total return of 17% at year's end. In 1998, we had a decline during the year of -19%, but ended the year with a total return of 27%. In 2003, we had a decline of -14% but ended the year up 26%. And there are other examples, including some where there were big declines during the year *and* negative total return for the total year as well. The point is we won't know what this January means for the year until we've gotten to the end. And to answer the question, *it's never a good time to panic*.



Source: FactSet, Standard & Poor's, J.P. Morgan Asset Management. Returns are based on price index only and do not include dividends. Intra-year drops refers to the largest market drops from a peak to a trough during the year. For illustrative purposes only. Returns shown are calendar year returns from 1980 to 2015. Guide to the Markets – U.S. Data are as of December 31, 2015.

Oil Prices

Oil prices have dramatically declined in the last two months, and the stock market has fallen almost in lock step with these prices. You might think that falling energy costs would be good for the economy, and therefore the stock market, but there are several other factors at work.

First, oil prices often fall when the economy slows down. In this case, oil prices were reacting mostly to the slowdown in the Chinese economy and increases in inventory of oil around the world. So there is a concern that the Chinese slowdown could have a big enough effect that it might harm other global economies. Oil prices, then, are a symptom of a bigger concern about economic slowdown.

Second, there are a lot of oil companies and companies that profit from the oil business in the stock market. When oil declines, the stocks of these companies decline as well, and during January these stocks were hit very hard, which brought down the overall stock market indexes and investor sentiment generally. Oil prices have recovered somewhat, and seem to have stabilized for the time being, but every day could be different.

At some point, there will be an upside from lower oil prices when companies that consume oil are able to realize savings from lower costs, and these savings should be reflected in higher profits. Therefore, if oil prices stay low for an extended period of time, there should be a positive effect on company profitability and price for these oil consuming companies. It also should have a positive effect on consumer spending, as less money will be used to fill gas tanks and more money will be available for consumer spending and saving. This should also be good news for the economy and corporate profits in general.

Hedges?

We have multiple ways we hedge risk in our strategies. The investments that are specifically designed for this purpose are up over 11% since they started adding return in the middle of January. However, since the market has risen 4% since its low, they are no longer actively protecting. Should things start moving badly again in a sustained way, I would expect them to start helping once again. We are also in the process of improving these investments, so you may see some activity in that space shortly.

We also created several investments that have partial principal protection on them. For all three of these investment notes with some principal protection, if they matured today they would be fully protected for 100% of their original issue price of 100. Two of these notes are currently being valued by Schwab at substantially less than 100, so if these notes were to mature at current market levels, their actual values would be 9% higher in one case and almost 25% higher in another versus what Schwab has them priced at. While we don't ever expect to actually need the principal protection when we create these notes, it's times like these that add an important reminder of how valuable principal protection can be.

Finally, we hedge risk by diversifying across multiple asset types and multiple countries from around the world. When the stock market is underperforming, we can rely a bit more on the fact that we have investments in cash and bonds as well. As you'll recall, our asset allocation design creates a five year buffer of withdrawals needed and places that buffer in non-equity investments. So even if you are currently retired and withdrawing money from your accounts, we are not forced to sell any of your equity investments into this downturn. This means that these investments can have the time they need to recover, even if we end up in bear market territory.

Once more, why shouldn't I panic?

The only time you are guaranteed to lose during a bear market, or even a bull market correction like we're in now, is to sell equities when the market is down. No one has a crystal ball that allows them to see the future. The market could be on the way to new highs or new lows on Monday. But for the investor with a total investment horizon of more than 5 years, it doesn't matter what direction the market is moving over the near term. In retirement, no one ever spends ALL of their money in one year (at least not people who planned for retirement). At most, you should be planning on spending around 4 – 5.5% of your portfolio each year. So even if someone had done no asset allocation and had 100% equities, they still would only be selling and consuming a small portion of their portfolio in any given year. And because of our asset allocation design, our clients aren't selling equities to fund their needs during a down market. Therefore, even if the equity part of our portfolios decline during a bear market, as long as we don't have to sell those equities because we have a 5 year cushion of cash and bonds, there is no damage done to the long term growth of the portfolio. The damage only happens when equities are sold, and the losses are realized, during a downturn.

So don't panic. The sun will surely shine again.

Our best regards,

Tony Steve

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