

February 10, 2009

Email Update

In This Issue

- Introduction
- Our Approach - Buckets
- Current Environment
- Conversation with Portfolio Managers
- Wrapping It Up

www.FinancialPlanningForLife.com

As many of you know, we do a weekly radio show. You can listen to past shows [here](#). You can also visit the Learning Center, which has a variety of educational audio and video presentations designed to educate you. Revisit often, as we are constantly updating content.

Michael Rogan, President

mgr@roganfinancial.com

Introduction

Predictably, it seems as if there is no end to the bad news you hear on TV or read in the papers. As we often say, the media lives to rub salt in wounds. Just as they are intent on doing their job of keeping everyone as nervous as possible, we are intent on doing our job of providing perspective and trying to keep our friends and Clients focused on the big picture. With that in mind, I thought this would be a good time for an update.

First, I want to revisit the "bucket" strategy we utilize since that will help to set the tone for the rest of my note. While this is something we have discussed (on more than one occasion for some of you), I realize that the basics are often forgotten after a meeting ends or we hang up the phone.

Next, I want to provide some perspective on the current environment.

Finally, as part of our ongoing due diligence, we participate in conference calls with senior portfolio managers at fund companies. I would like to summarize a few of the highlights of a recent call and then tie everything together.

Overall, the goal of this note is to address concerns you might have, give you some perspective and allow you to take a deep breath and go on about your life - something that the media really would prefer you not do!

Our Approach - Buckets

For some of you, this will simply be a review. For others, it is a timely reminder of why we do what we do. As you may recall, your portfolio has been divided into 3 "buckets":

Bucket 1 is designed to address your spending needs for the next 12 months. Since these are funds we know you'll need soon, this bucket is primarily invested in cash, CDs and/or money market accounts. It is not subject to any stock market risk or fluctuation.

Bucket 2 is designed to address your spending needs for years 2-5 (or longer, depending on your particular circumstances). Like bucket 1, these are funds that we know you'll need within a reasonable time

horizon, so we generally do not want to expose these funds to much risk, but we do seek a modest level of growth to account for near-term changes in the cost of living (i.e., inflation). Typically, these funds are invested in a combination of money market funds, CDs, bonds, conservative funds or other investments that have traditionally exhibited lower levels of volatility.

Bucket 3 is designed for longer term growth. As such, this is the portion of your portfolio that will likely have the most significant exposure to stocks. Of course, this exposure is diversified among a number of different industries, geographies (US and foreign) and company sizes (large and small). As you may recall, exposure to stocks is important because of their ability to help us deal with the ravages of inflation over time. If you are entering retirement, this bucket might have to help provide for a 30-year retirement. Due to the impact of inflation over that time period, the amount of income you'll need in 30 years will likely be substantially larger than the income you need today. If you are still accumulating for retirement, this bucket should be designed to grow until your retirement and then provide for a retirement that can be 30 years or longer (life spans are increasing). So, the time horizon for Bucket 3 is very long in most cases.

In addition to being an effective planning tool, the buckets are also designed to help you address the emotional reactions that all of us have to the market. During difficult times like this when the markets are exceptionally volatile, our "fear" response usually kicks in and tells us we have to sell -- we have to protect ourselves. However, if we think about things rationally, which is difficult (but easier if you have someone counseling you), we begin to realize a few things:

- Buckets 1 and 2 are like an "insurance policy" for at least the next 5 years. Knowing that at least 5 years of spending have been accounted for helps to prevent knee-jerk reactions, which might feel good now, but which will likely prove to be very costly over time;
- Likewise, the majority, if not all, of the stock investments are in bucket 3, which likely isn't even needed for 5 or more years;
- Usually, when things go on sale, we get pretty excited. Also, we have all heard the adage "buy low and sell high". Stocks are, in many cases, much lower than they were a short time ago, so does selling when they might be on sale make sense? When a TV (or shoes, car, etc) that we want goes on sale, we tend to jump on it - we don't sell all our other TVs (or shoes or cars) - why should things be different with our investments?;
- We know that the stock market has had difficult times in the past, but it has *always* recovered. Moreover, there has never been a time where it hasn't reached new highs eventually.
- Even if the stock market (the Dow) doesn't get above its old

high (around 14,000) any time soon, a move to even 10,000 is close to a 20% increase, and a move to 12,000 is close to a 50% increase. So, we don't even need to make new highs to potentially benefit from these levels.

There are plenty more things your "rational" mind (or advisor) might tell you, but I think you may be getting the picture. While none of us can guess when the market will improve, we have time on our side because of Buckets 1 and 2. Importantly, there has NEVER been a time in history when the markets didn't eventually improve. We'll come back to this, but first let's review where we are and how we got here.

Current Environment

According to government statistics, we entered a recession in late 2007, which means that we have been in a recession for some 13 months or so. The average recession in modern times has lasted about 11 months, with the longest being about 16 months. That doesn't mean that we can expect this recession to be over in a few months, but it may suggest that we are closer to the end of this recession than the beginning.

While markets were generally weak from October 2007 through August 2008, something changed in September/October 2008 (and it wasn't the election). We experienced the first financial crisis in a considerable amount of time. Note that I did not say "**economic**" crisis. Without going into excruciating detail, the most immediate root of the crisis can be traced back to securities created during the real estate boom and accounting rules imposed by the government to value those securities. Suffice to say that these two issues resulted in a situation where banks were worried about lending to one another. That fear of lending to one another caused the entire system to seize - - companies began experiencing very real difficulties in financing their businesses. There were fears articulated by some that the entire financial system would collapse.

You may remember the "bailout" (it would take another lengthy note to explain why this wasn't really a bailout -- we can save that for some time in the future). Well, you may also remember the failure of our government to approve the "bailout" for a week or so. This delay resulted in the stock market experiencing tremendous losses as there was true panic selling. At the same time, due to the lack of lending, companies that needed money were being forced to begin paying very high interest rates. Since interest rates and bond prices move in opposite directions, this resulted in the prices of outstanding bonds coming down. *It is very important to realize that none of these things were happening as a direct result of the quality of the companies -- these were happening to companies across the board.* So in essence, we had a situation where the proverbial baby was getting thrown out with the bath water, and there was truly nowhere

to hide – both stocks and bonds went down (coincidentally, commodities also experienced sharp declines). It is important to understand that this was still primarily a financial crisis. To be clear, a recession is not a crisis; however, the financial crisis has had the obvious effect of exacerbating what would likely have been a fairly manageable, normal economic event.

Unfortunately, this started a spiral...people continued to panic so they began redeeming their mutual fund investments, hedge fund investments, etc. The professional managers saw opportunity and wanted to buy since good investments were suffering alongside more questionable investments, but they had to sell to raise cash to meet the redemption requests. Given the nature of the panic, these managers were often forced to sell investments in very good companies because that is where the most trading volume was. Hopefully, you can see where this is heading -- this forced selling caused additional price declines in some of the very best companies. Once again -- *this was not a reflection of the quality of the underlying companies.*

So, where does that lead us to today?

The government has and continues to throw quite a bit of money at this problem (the total amount is in the trillions of dollars). Barring unforeseen policy decisions, this response all but guarantees that we will not enter another "Great Depression". The stock market is at valuation levels not seen in decades, which suggests attractive returns may be in store for investors with a long-term time horizon. Non-government bonds are paying yields that are excessive given pricing on government bonds, which may provide savvy investors with the ability to get paid while they wait for more "normal" conditions to return. Finally, there has been more money in money market funds and the like (as compared to investments in equity funds) than at any point in history, which means that there is plenty of pent-up demand once the masses feel that "things look better".

On the last point, there are plenty of people that are waiting for "things to get better" before they do anything. While I don't want to be Pollyannaish, the stock market has historically been a predictor of events, not a follower. In other words, it is likely that the stock market will improve dramatically before any of us feels like "things are better". To that end, a well-allocated portfolio and a well-designed plan will require some exposure to stocks (as well as bonds and other assets), so that you will be in a position to participate when the market improves – regardless of whether or not "things" seem better.

Conversation with Portfolio Managers

As part of our ongoing due diligence process, we recently had a telephone conference with a number of the portfolio managers at

one of the fund companies that we deal with. Since this is not a “sales piece”, we’ll leave the names omitted; however, we did feel as if some of the information was worth sharing to help provide you with some perspective on what the managers are thinking (note: the questions and answers have been paraphrased/condensed).

Q: When will this end?

A: There is really no way to predict that. There are signs that stability is coming back into the market; however, we believe that volatility will remain a feature.

Q: It seems as if there has been no place to hide.

A: Since much of this situation has been driven by forced selling, good stocks got thrown out with the bad. People are selling the good companies because they need to raise cash, not because there are problems. At times like this, correlations rise, and the market doesn’t differentiate between good and bad.

Q: Are there opportunities?

A: You do not often get opportunities to buy high quality companies at current valuations. Forced selling has given us that opportunity.

Q: Confidence is low – why should people stay invested?

A: Unfortunately, there has been no place to hide. We can’t say when the economy or the market will respond [to the stimulus packages]. You need to be cautious, but invested for the rebound. Based on usual measures of valuation, one would predict decent upside. While there is quite a bit of near-term uncertainty, we are focusing on opportunities, which are plentiful.


Q: What have you changed in your investment process?

A: At the end of the bull market, we were taking some flak for not being risky enough. We think our process, which emphasizes fundamental research and a long-term approach, has been reaffirmed by these markets. There are a lot of long-term opportunities.

Wrapping It Up

So, where does that leave us? While we cannot predict whether or not we have seen the lows for this cycle, there are a few things we can say:

- Valuations are currently as attractive as they have been in decades, suggesting positive results for investors with a long-term time horizon.
- Based on historical precedent, it is likely that we are closer to the end of the recession than the beginning of it.
- The stock market is a forecasting machine and will likely show marked improvements before “good news” starts to appear.
- Our portfolio managers are finding “a lot of long-term”



opportunities.

- While we don't know whether the "market" will give us lemons or lemonade over the short term (i.e., the next year or so), buckets 1 and 2 give afford us with the ability to ignore the short-term moves in the markets so that we can be positioned to take advantage of the recovery when it arrives...*this is why we plan!*

As always, we are here for you. Please do not hesitate to call or email if you have any questions. Also, please feel free to forward this to friends or family members who might benefit from some of the information or perspectives.