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Email Update

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Introduction

If you're like most people these days, your feelings about our country, your investments, and the stock market in particular run somewhere between complacency and resignation to downright fear. It's understandable. The news cycle today, in a rare show of diversity, spouts out two stories over and over (as opposed to the usual one story at a time model). These days it's the bad economy and the gulf oil spill - **24/7/365!** There's quite literally no good news to be found - at least in the media.

In this note to you, we will make no attempt to convince you that you shouldn't feel fear, apprehension, or complacency. Rather, we hope simply to keep you from acting on those feelings by providing a little perspective. It is precisely at times like these, when virtually everyone - your friends, neighbors, and colleagues - is throwing in the towel (or have done so long ago) that it is most important for you to stay the course. But we won't ask you to have blind faith. Instead, we'll provide you with positive facts that will contradict the media's "story".

How'd We Get Here?

The past decade hasn't just been a bad one for the US stock market - it was the second worst ever. It followed the 1990's, which was the best decade for stocks in US history. So, just as the pendulum swung extraordinarily far in one decade (the 1990's), it swung back just as far in the following one (the 2000's). In fact, as we write this, the S&P 500 would need to rise more than 40% to reach a level it first reached more than 10 years ago. How could one possibly feel optimistic in light of those stats? Why use stocks at all? What's wrong with other investments?

As a recent article we sent stated, if you invest in stocks or stock mutual funds, you aren't just "in the stock market"; you are actually an owner of hundreds of the best corporations in this country and around the world. As our clients and friends, you're not "gambling" in the stock market any more than you are "gambling" in the real estate market by owing your own home,

you are quite simply invested in an area that has historically provided the best chance for your long term financial success.

History as a Guide

Since the last decade was so lousy for stocks, history suggests the next decade should be above average. (Regulators want us to tell you that past performance doesn't guarantee future results, but you already knew that.) History is supported by the fact that based on some measures, stocks may be cheaper today than at any time in the last 30 years.

Sometimes history can provide a good roadmap. Flash back to the early 1980's. America had been battling a lousy economy with big government being the answer during several presidential administrations, which is pretty similar to recent events. Back then it resulted in persistent high inflation, which has not hit us yet, but is a fear expressed by many. The stock market had first peaked in 1968, then again in 1973, and by the early 1980's everyone was fed up. The stock market, they said, had "gone nowhere" for more than a decade (once again pretty similar to this past decade). Gold was more popular than it had ever been, like today. The US was widely believed to be on the decline. It was the Japanese who knew how to run an economy in that new era. Today, the sentiment is the same, there's just a different player - China.

Then, like now, bonds were popular and considered safer than stocks. Of course, back then due to the high inflation, bonds paid historically high interest rates. Today, interest rates are about as low as they've been since Eisenhower was president. As mentioned, gold was also very popular given the belief it acts as a hedge against inflation; despite the fact that since then - even with the recent historic gold rally - it would still need to double simply to keep pace with rising prices. In the early 1980's, it was widely believed that the stock market no longer worked and gold, bonds, and alternative investments were the only solutions. Sound familiar?

Today, we find ourselves with stock prices nearly as cheap as they were then in terms of relative valuations. Gold and bonds are very popular, and the stock market is once again as unpopular as it's been in a long time.

From that point until now - for nearly thirty years - bond yields have declined steadily. Gold has now risen almost 50% in the past three decades, after first losing about two-thirds of its value. Stocks? After this second worst decade ever? Stocks are up about

10-fold during the same period. That's right – 1,000%. And that does not even account for dividends that may have been earned.

We could tell you that relative to earnings and competing bond yields, stocks may again be cheaper than any time in the past thirty years. Or that corporate balance sheets are healthier than they've been since perhaps World War II. We could also suggest that corporations having nearly \$3 trillion in cash sitting in accounts earning nothing right now may be tempted to deploy that cash in the form of higher dividends, stock repurchases, and a mergers and acquisitions boom, all of which would be great for stock prices. But we'd rather have you look back into your own memory to decide.


The Takeaway

Sir John Templeton, a renowned international investor, was known to have said the following about bull markets (rallies). “They are born on *pessimism*, grow on *skepticism*, mature on *optimism*, and die on *euphoria*”. While this could be summed up by saying you should simply do the opposite of what the crowd is doing, we'd rather go farther.

In late 2005, around the time that the proverbial last person who could be convinced to buy a condo on the beach in Florida made his purchase, condos were more popular than they had ever been. People had been buying them at any price – many collected several – certain that they could be flipped at a future date to someone else at a higher price. But when they reached peak popularity, when condo euphoria had swept the land, there was nearly literally no one left to buy them. The condo bull market died.

The same could be said about tech stocks in the late 1990's. Or, perhaps gold today. Can you ever remember a time when more people were encouraging you to buy gold? Or a time when more of your friends and neighbors owned gold? As of this writing, gold is trading at nearly twice the price of its normal range relative to other commodities for the past 40 years. Surely people have gold euphoria.

The same could be said for bonds, especially treasury bonds. And while the popularity of bonds may not feel like bond euphoria, the fact that people are willing to lock up their money for 10 years to receive a paltry 3% is definitely evidence of understandable but excessive fear. Which brings us full circle back to the beginning point - all of the stories in the news today are bad. People are pessimistic about the economy and, by



extension, the stock market. As we head into the midterm elections, “experts” from both political sides need you to believe that absolute disaster lies ahead unless their candidates get elected. You can expect this rhetoric to continue to get worse until November.

Economic data shows the economy recovering and productivity soaring. America’s GDP is already at record highs, and corporate profits are close to all time highs, despite being only a couple of years removed from the “Great Recession”. It’s just going to take a while for people to notice (and much longer for the media to report it).

In the meantime, if your long term financial plan calls for exposure to stocks, you can take comfort in the current stock market pessimism. When euphoria returns, that’s the time to get worried!