The Financial Navigator - June Newsletter

Welcome to the June edition of the Financial Navigator, in this edition we discuss two topics that have been in the financial news lately:

1. The US investor experience - buy high/sell low.
2. Target Date Funds - do you know what is in yours?

As always, please feel free to forward this newsletter to anyone you think may be interested, or to unsubscribe follow the link at the end of this email.

Sincerely,

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The US investor - buy high/sell low

Each year a Boston research firm, Dalbar, conducts a study of US investor returns by comparing mutual fund investor behavior with an appropriate set of benchmarks over a rolling twenty year period. The results for the twenty year period ending in December 2008 are in, and as in every year since the study was started 15 years ago, investor returns are disappointing. In the period of 1989-2008 US investors earned the following returns with the respective benchmark returns shown for comparison:

- Equity => 1.87% vs. S&P 500 Index => 8.35%
- Fixed Income => 0.77% vs. Barclays Aggregate Bond Index => 7.43%

The approximately 6.5% underperformance experienced by investors is actually on the low side of what the study has found each year, many years it has been in the 8% range.

The results for 10, 5, 3, and 1 year periods are no different, which begs the question: **why has the average investor continuously underperformed the index?** Dalbar's conclusion is a rather simple one: **'When the going gets tough, investors panic.'** In other words, it appears the majority of US investors buy high and sell low.

The long-term implications of this consistent underperformance could have serious future consequences. Not only have individual investors underperformed the indexes, they also earn less than the 3% average rate of inflation. The potential result is a decreasing standard of living during the retirement years.

What you should do – Don't be average, consider setting up a portfolio allocation based on your individual goals and risk tolerance, stick to it, rebalance it periodically when it is out of balance, and do not try to time the market climbs and dips. And ignore the 'noise' such as CNBC, Jim Cramer, and the rest of the talking heads and *Fast Money* crowd as their approach and views have no relevance to long-term investors.

Target Date Funds – do you know what is in yours?

The popular retirement plan investments called ‘target-date’ funds have come under a barrage of criticism recently due to their poor performance during the recent bear market. Target-date funds hold a blend of asset classes such as stocks and bonds, and fund managers automatically shift the asset allocation to a more conservative portfolio as the ‘target’ date is approached. These funds are often the default choice for many 401(k) plans, and are quite popular with investors as they make retirement investing easy; the fund does all the work of allocating the money, picking the investments, and rebalancing the portfolio. The funds usually have a name with a year in it such as the Fidelity Freedom Fund 2025.

The criticism has come after target-date funds designed for those near retirement were hit with significant losses last year. According to investment research firm Morningstar, funds with 2010 as the target date suffered losses ranging from 3% to 41% in 2008. Many of the funds were aggressively invested in stocks and other highly volatile asset classes, which may or may not be appropriate for each investor.

Other criticisms stem from the fact that some fund companies layer target-date fund management fees on top of the individual mutual fund fees, which can take a sizable bite out of the portfolio return. In addition, the one-size-fits-all approach doesn’t allow individual investors to synchronize their risk tolerance with their retirement portfolio.

Fund industry representatives have defended the funds saying they generally performed as expected and are not risk-free funds, nor are they guaranteed to produce a certain level of income. However, many investors have major misconceptions concerning these funds. According to a survey conducted by Behavioral Research Associates LLC, most people who were shown target-date fund marketing material came to the conclusion that the funds offered some sort of promise, a guaranteed retirement date, or a guaranteed rate of return.

What you should do – If you are investing in a target-date fund through your retirement plan take a look under the hood. Review the mix of stocks, bonds, and other asset classes within the fund, how this mix changes over time, and ensure it is consistent with your risk tolerance. If it isn’t, consider creating your own portfolio using individual funds in the plan, or choosing a more or less aggressive target-date fund that is more suitable for you.

If you have any questions on these topics, or need some help assessing what you risk tolerances is and designing a retirement portfolio, give me a call at (603) 373-8793. Ask about the Rapid Assessment, a financial plan targeted specifically at your retirement and investment goals and focused to get you back on track.