The Financial Navigator – April Newsletter

In this issue of the Navigator we discuss some of the issues associated with owning significant amounts of your employer's stock, and we discuss worldwide stock market returns during the first quarter of 2012. Please feel free to forward this newsletter to any individuals that you think might be interested or call if you have questions on the information provided.

Sincerely,

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Loading Up On Your Employer's Stock

I recently met with a prospective client who had diligently saved for retirement and had succeeded in amassing a considerable portfolio as a result. However, half of his money was invested in his employer's stock. When asked why he was so heavily invested in the company stock, he told me he really trusted and admired the management team. Unfortunately, in meeting with prospective clients over the years I often find this situation when employees have accumulated significant sums of their employer's stock in their 401(k) plan, in restricted stock, and or company matches to employee contributions.

In 2006 a friend who worked for a major financial firm asked me for investment advice. His investable assets were about $1 million which was pretty good for someone in their early 40s; but it was 80% invested in the firm's stock. I explained to him the additional risk he was assuming by having the majority of his total portfolio invested in one company, and I recommended a more diversified portfolio. He agreed with my recommendation but said he wanted to wait for the company stock to hit $55 per share again: he is still waiting. 2007 hit and the stock crashed from its high of $53 to $2, and adding insult to injury he was laid off.

Unfortunately this scenario is repeated over and over again. It was reported that WorldCom employees lost over $1.1 billion in 401(k) assets when the company declared bankruptcy in 2000. Just a year earlier, *Fortune* ranked WorldCom 60th on the list of "Most Admired Companies," which may say more about *Fortune* than WorldCom. Enron ranked 25th on the same list; Enron employees held about 62% of their 401(k) assets in company stock and lost an estimated $1.3 billion when the company collapsed in 2001.

Do you think the company you work for is well run and immune to a significant change of fortune? So did many employees at Lehman Brothers, Bear Stearns, Wang Laboratories, Bethlehem Steel, Polaroid, Circuit City, Blockbuster Video, Countrywide Mortgage, Washington Mutual… and the list goes on. Each company went bankrupt, but at one time had been lauded in the media for their growth rate, management team, and investment prospects.

The average life expectancy of a multinational corporation is 40-50 years. Considering that your work life and retirement are likely to be more than 50 years, do you really want to risk your fortune in one company's stock? Consider allocating maybe a maximum of 5% of your portfolio to your employer's stock to maintain a diverse portfolio, and perhaps avoid the fate of Lehman Brothers employees.

Out of the Blocks[1]

"And you thought 2011 was tough?" So went the headlines in December as media and market pundits reflected on a miserable year, and foreshadowed the same for investors in 2012. But markets have a funny way of confounding expectations.

To be sure, the reasons to be anxious were piling high as the year turned, with European politicians dithering over how to tackle a tottering mountain of sovereign debt, policymakers in the US running short of options, and emerging markets not providing the cushion that many investors had hoped for. The general view, as expressed through the media, was that there would be more muddling through in early 2012. "Buckle up!" warned the respected Barron's magazine. "For investors frightened by the stock market's volatility in the past six months and tired of worrying about places in Europe once given little thought, 2012 promises scant comfort—at least in the first half."[2]

As an investor, if you had taken that advice, you might be ruing it now, as global equity markets—as measured by the MSCI World Index—have registered their best start to a calendar year in twenty-one years. The index was up by just over 10% in US dollar terms as of the end of February. You have to go all the way back to 1991 to find a better start.

Added to that is that much of the leadership for the turnaround is coming from the US, an economy that many observers just two years ago were writing off in favor of the emerging powerhouse economies in Asia. The US benchmark S&P 500 was up by 9.0% at the end of February. This is also its best start since 1991 and returns the index to the levels of June 2008, before the Lehman Brothers collapse.

Even Europe, the epicenter of concerns for much of the past year, has exploded out of the blocks in 2012. The Euro Stoxx 50 was up by nearly 12% over the first two months of the year, with the German market rising by close to 20% in US dollar terms.

The renewed buoyancy extended to Asia, where the MSCI Asia Pacific Index has registered ten consecutive weeks of gains, its longest uninterrupted winning streak since 1988. Why the change in mood? There are several catalysts for the turnaround in markets so far in 2012.

First, by the end of last year, market participants were discounting a lot of bad news, including a couple catastrophic scenarios. Fears of mass defaults in Europe and a possible breakup of the euro were seen as entirely possible. While Europe can hardly be described as being out of the woods yet, the agreement by creditors on a new round of official funding for Greece has eased nerves, as has the European Central Bank's (ECB) provision of another half-trillion euros in cheap funding to financial institutions.

Second, there have been signs of a turnaround in the US economy, at least compared to the view the market was taking a few months ago. At that time, another recession was seen to be in the cards. Since then, data has shown an improvement in the labor market, a rise in manufacturing orders, and a climb in consumer confidence.

Third, central banks are pumping out massive amounts of cheap cash—essentially printing money—to provide liquidity to the financial system and to support the recovery. As well as the ECB's latest cash injection, Japan and Britain have recently extended their so-called "quantitative easing" programs, while China has cut the reserve requirements for its banks.

Of course, just as it was wrong to extrapolate the pessimism of last year into 2012, it would be foolish to forecast that the rest of this year will resemble the first two months in tone. No one knows how markets will perform going forward, because that requires an ability to forecast news. You can always guess, of course, but we tend to think that's not a sustainable investment strategy. The point of this is to highlight the virtues of discipline and the tendency of markets to absorb news very, very quickly and to look forward to the next thing. Unless you know what the next thing will be, you are wise to stay in your seat.

1. Jim Parker, Outside the Flags, Vice President, Dimensional Fund Advisors

2. "Buckle Up!" Barron's, December 19, 2011.

For more information on these topics and more contact Azimuth Financial Planning at (603) 373-8793.