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Market Turbulence Reveals A Tale Of Two Markets

During the autumn of 2008, the stock market most people knew vanished without a trace. For years, most trading days had been uneventful, with only occasional spikes higher or lower. As the financial crisis took hold, however, extreme ups and downs became commonplace. It was as if this was an entirely new market, and all of the conventional investment strategies seemed powerless against it.

It *was* a new market, says Mark Kritzman, president and CEO of Windham Capital Management, which manages more than $30 billion in institutional portfolios, and a senior lecturer at the MIT Sloan School of Management. According to Kritzman, there are really two kinds of markets—the usual, average sort that holds sway during long periods, and a different market during compressed times of turbulence. Understanding what happens during turbulent periods could help in constructing portfolios that hold up better when the going gets rough.

Today's markets are some of the most turbulent in history, says Kritzman. They're also quite volatile, though volatility and turbulence aren't the same thing, according to Kritzman. He defines the latter as a "measure of statistical unusualness" marked by two things: investment returns that are either far above or below their long-term averages; and returns in different asset classes that interact in a strange or uncharacteristic fashion. Two asset classes that normally have a very high positive correlation—that is, their performance tends to track each other closely—may instead move in opposite directions during a turbulent period.

Kritzman and his research team have developed a quantitative measure of turbulence and a turbulence index, which hit record highs in October. From February 2008 to February 2009, the index more than doubled its long-term average. Now that markets have become turbulent, says Kritzman, they're likely to stay that way. "During the weeks and months following the first appearance of a turbulent day, turbulence is much greater than average. And it persists." Knowing those tendencies is important, he says, because it enables investors to respond.

"Suppose we understand that correlations between certain asset classes increase when markets are stressed—so that just when you most need diversification, it goes away," says Kritzman. "But there may be other assets whose correlations go down during stressed markets, and if you incorporate those assets in your portfolio, you may increase diversification during those markets."

According to Kritzman's research, as you shift from quiet to turbulent periods, the correlations *within* asset classes but *across* countries increase.

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WMN Experiencing Busiest Summer In Our History

Happy Summer!! Hope you've been enjoying some leisure time with family and friends...'tis the season! Speaking of seasons, the summer months are usually the slowest time of year in the investment business. More often than not, a phenomenon known as "Summer Doldrums" results from slackened trading volume and heightened travel.

But this year has been different, as investors continue to repair the damage wreaked on their portfolios by the violent "Storm of '08." Many have come to the conclusion that the "Investment Game" is not as easy as they once thought, and they are seeking out professional guidance. Also, a lot of people have decided to stay closer to home this year, a logical response to feeling poorer and fearful that this recession might last longer than normal.

Another factor contributing to our "busy-ness" is the success of our May 13th Forum, attended by over 200. Thank you to all who attended and brought friends, neighbors and business colleagues. Everyone seemed to enjoy hearing Jim Owen present his ideas, slides and books on the cowboy lifestyle and value system.

In keeping with the season's theme, it won't be long before the year-end holidays are upon us. Plans are already underway for another Wealth Management Forum, probably the first or third week in November.

Meanwhile, best wishes for continued summer fun and good health...and thanks, again, for all of your thoughtful referrals!

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A Walk Every Day Can Keep Aging At Bay

It's much easier to talk the talk about staying young than it is to walk the walk. Starting in our 20s and 30s, we commence a long, seemingly inevitable physical deterioration. Our maximum heart rate declines, and with it the amount of oxygen-bearing blood the heart can pump. Muscle is gradually replaced with fat and weight edges upward. And decade by decade, as oxygen intake drops, it becomes a little harder just to get around. Eventually, in our 70s, 80s, or 90s, most of us lose our "functional independence," the ability to live on our own. We move to assisted-living or nursing homes because, literally, our living needs to be assisted.

But what if there were a simple way to turn back the clock? In a recent article in the British Journal of Sports Medicine, Roy Shephard, a physician at the University of Toronto, reports that for people 64 and older, a vigorous, hour-long walk five days a week cuts a dozen years from their biological age. In a review of other published work on the subject, Shephard found that such an exercise program could also extend a person's functional independence, which tends to be lost when maximal oxygen intake falls below 18 milliliters per kilogram per minute in men and 15 ml/kg/min in women.

Without this kind of exercise program, about 10 years of physical aging normally corresponds with a loss of about five ml/kg/min. But Shephard found that beginning a program of vigorous aerobic exercise could restore about 25% of maximal oxygen intake within three months, raising that essential level by an average of six ml/kg/min and decreasing biological age by 12 years.

Shephard also found that regular exercise provides other benefits, helping prevent conditions that may hasten aging including obesity, high blood pressure, diabetes, heart disease, osteoporosis, and even some kinds of cancer. And the improved muscle tone that comes with brisk walking, swimming, or other aerobic activities may help older people avoid falls.

Another study, from Texas, further highlights what exercise can do. In 1966, five healthy 20-year-olds were kept in bed around the clock for three weeks—and suffered many of the ills normally associated with aging. They gained weight, their heart rates and blood pressure rose, and their hearts lost pumping capacity. Then, an eight-week exercise program more than reversed the effects of inactivity. In a follow-up with the men 30 years later, actual aging had imitated the effects of the forced bed rest. But here, too, an endurance exercise regimen undid most of the damage, restoring all of their lost aerobic capacity.

The moral? Exercise always helps, and it's never too late to start pushing back the hands of time. ●

Six Ideas For Frightened Retirees

The economic meltdown has vaporized more than $2 trillion in retirement assets—at least on paper—and more may disappear during the coming months.

Of course, "retirement assets" means one thing when you're decades from leaving the work force with ample time for your 401(k) to recover. It's something else if you're already retired and drawing on your portfolio for living expenses. Still, the situation may not be as dire as it seems. These six ideas could help keep you afloat until conditions improve.

Avoid panicking and pulling the plug on your investments. Moving money now from stocks into money market funds and CDs will guarantee losses and leave you battling to keep up with inflation. However, it could make sense to shift to a more defensive portfolio. We can advise you on how much of your portfolio should remain in stocks, based on your age, goals, and risk tolerance.

Shift the source of investment withdrawals. As much as possible, take money from cash and bond accounts to avoid locking in losses in stocks that still look fundamentally sound. That's a good idea even if you're drawing income from retirement accounts—mandatory if you're at least age 70½. Note: Congress has eased the rules on required minimum distributions from 401(k)s and IRAs for 2009 only.

Cut spending 5% to 10% for the next year or two. Pulling out less from a depleted portfolio can have a very positive impact. So consider putting off travel plans, delaying vehicle purchases and home improvements, and trimming outlays on entertainment and restaurant meals.

Put off collecting Social Security payments as long as possible. If you don't absolutely need this income now, a delay could mean more cash later—8% more for each year you wait between your "Full Retirement Age" and 70,

Five Retirement Tips For Every Business Owner

Entrepreneurs enjoy some unique opportunities when it comes to preparing for the golden years. But with all of the pressures of running a business, many owners neglect personal planning—and delays can be costly. For example, saving the same amount annually for 20 years will produce a nest egg 60% smaller than if you'd saved for 30 years (assuming a hypothetical 8% annual average investment return). And starting early isn't the only path to a more secure retirement. Consider these five tips.

Think about owning. Many arguments for buying a personal residence make just as much sense where business property is concerned. In both cases, the chance to build equity usually beats shelling out rent you'll never get back. In terms of retirement planning, if you own business property, you could hold onto it even after you sell the company, thus enabling you to collect rent from the new owner. Or if the property has appreciated significantly, you could sell it and use the after-tax proceeds to brighten your retirement.

Make the most of tax-deferred plans. It's your company, so install the retirement plan that best suits your needs. For many businesses, that's a 401(k). It lets you save more tax-deductible dollars than many other plans do, and it doesn't oblige you to contribute for workers—or even for yourself.

For 2009, individuals may contribute up to $16,500 to all 401(k) plans (including any at other companies), although if you'll be at least age 50 by year-end, you can put in an additional $5,500—and you should. Saving that extra amount each year from age 50 through 65 could boost the retirement kitty by more than $135,000, again assuming an 8% return.

But the story gets even better if you combine your company's 401(k) with a profit-sharing plan. Under such an arrangement, your 2009 contribution could be as high as $49,000, or $54,500 if you're at least 50. Profit sharing requires contributing on behalf of workers, but only during profitable years, and vesting requirements could slow those payouts. And if you have no staff? "Solo" 401(k) plans for owner-only enterprises (including sole proprietorships) incorporate profit sharing and let any family members who work in the business participate in the plan. That could help you channel more money for retirement to your spouse.

Build yourself a pension. If your goal is to put away the absolute maximum every year and you don't mind contributing for workers (or don't have any), a defined-benefit pension plan could be right for you. You choose the retirement income you want, based on your earnings history and the current $195,000 IRS maximum (adjusted for inflation). Then an actuary determines how much you need to save each year to meet that objective, based on factors including your age and a projected investment return. For a successful middle-aged entrepreneur—the primary user of this plan—that amount is often measured in six figures.

Deducting a contribution of that size obviously produces mouth-watering tax savings. But there is a drawback. Contributions are essentially required every year (for workers, too), although you may be able to make a reduced contribution, or none at all, in lean times. Still, you should adopt a defined-benefit plan only if you expect to be able to afford hefty contributions for several years. (This vehicle, too, can be customized for owner-only businesses.)

Diversify properly. Your retirement investments should complement, not duplicate, the wealth in your business. If you invest in different industries than those your company and its customers are involved in, you'll reduce the chance that a downturn in a single sector could wreak havoc on both your business and your portfolio.

Plan your exit. Experts generally advise getting ready to divest your business as early as 10 to 15 years in advance. Getting out is complicated, and it's likely to affect every kind of tax imaginable—income, capital gains, gift, estate. It also requires answering tough questions, such as whether a family member has the skill and interest to take over the company, and if so, when?

And if no heir will succeed you? Figure on spending at least three years preparing your company for sale. That's how many annual financial statements prospective buyers typically examine. Streamline operations beforehand so you can present the strongest possible profit-and-loss picture on the way to getting the most for your enterprise and making your retirement truly golden. ●

according to the U.S. Social Security Administration. If you've already started drawing benefits, you could pay back that money and still get the higher payments.

Consider taking a part-time job. The notion of a completely idle retirement has faded in recent years, with many retirees preferring to keep working even when money isn't an issue. If it is an issue now, look for something you'll enjoy that will also help you preserve your savings and give your investments time to recover.

Weigh the costs and benefits of a reverse mortgage. Tapping the equity in your home in this way, though often not as ideal as refinancing at a lower interest rate, could help you weather the economic storm. You'll get monthly income or a line of credit with repayment delayed until you sell the home or die. But interest rates and closing costs can be high, so please let us help you evaluate this or any other financial moves you're considering. These are scary times for retirees, but together we can come up with a plan to minimize the impact on your long-term goals. ●

A Better Estate Plan For Business Owners

If you own a small business, you're likely working around the clock to build your company. But you still need to find time for estate planning. Despite recent tax-law changes, federal estate tax remains a prime concern for successful business owners. For someone who dies in 2009, the federal estate exemption can shield from tax up to $3.5 million in assets going to non-spouse beneficiaries (up from $2 million for 2008). But any excess is taxed at the top 45% estate tax rate.

While the estate tax is scheduled to vanish in 2010, it is likely that Congress will not let that happen, as current legislation proposes retaining the current $3.5 million exemption, with a maximum tax of 45 percent. And whereas heirs currently can "step up" the tax basis of assets for capital gains purposes—calculating subsequent gains or losses based on the assets' value on the date of death of the person who bequeathed them—that provision is due to change in 2010, at which point there will be a limited step up in basis.

However, estate tax minimization is only one aspect of estate planning. Financial planners offer many other services to help clients meet their estate planning goals. Here are four estate-planning tools a business owner might put to good use.

Buy-sell agreement. This legal document can establish the value of your business for estate tax purposes while ensuring there will be cash for your family upon your death. A buy-sell agreement spells out arrangements for purchasing shares from a deceased co-owner or partner. Typically, the buyout is funded with life insurance on the owners or partners.

Section 303 stock redemption. Under Section 303 of the tax code, your family can remove cash from the business with little or no tax liability by redeeming company stock. This special provision may provide funds to pay funeral costs, estate and administrative expenses, and federal and state estate taxes. To be eligible, the value of the company stock held by the estate must exceed 35% of the estate's total value.

GRATs. With a grantor retained annuity trust (GRAT), you transfer company stock to a trust that pays out annual income for a specific term, with the assets ultimately going to the beneficiaries you designate. This planning technique enables you to freeze the current value of the business in your estate. The amount of associated gift tax depends on the value of the stock transferred, the term of the GRAT, and the Section 7520 interest rate at the time of the transfer.

Installment payments. Another tax code provision allows your executor to spread out estate tax payments over 15 years. Among other requirements, the business interest again must comprise more than 35% of your overall estate.

Of course, every business owner's situation is different. One important thing to remember is to always ensure liquidity or these techniques will not be successful. Therefore, adequate life insurance is essential. We can work with you to discuss strategies to best address your unique planning needs. ●

A Tale Of Two Markets

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This means that geographic diversification doesn't provide as much benefit as you'd like. "When stocks go down in the U.S., they go down everywhere," says Kritzman. "But we also noticed that within countries, as you change from quiet to turbulent periods, correlations between stocks and bonds go down—so that asset class diversification within countries is actually more beneficial during turbulent periods." In other words, U.S. bonds diversify U.S. stocks during turbulent periods better than foreign stocks diversify domestic stocks. Kritzman's research has also shown that the correlation between financial assets as a group and real assets such as commodities is lower during turbulent periods than when calm markets prevail. So, increasing a portfolio's exposure to commodities could make it more turbulence resistant.

Kritzman isn't suggesting most investors try to time the market by moving to a different portfolio mix when turbulence seems imminent. "But you can prepare a portfolio for turbulent times—possibly by increasing allocations to certain asset classes, such as bonds, or by relying less on geographic diversification," he says. "If a portfolio is based on what we know happens during turbulent periods, rather than on what occurs on average over all markets, it may perform better. You may not be able to know when turbulence will come, but you know it will come, eventually."

And what about this turbulent period? When is it likely to have run its course? "What has been happening recently is completely unprecedented," Kritzman says. "But the silver lining for investors is that the market, historically and fairly reliably, leads the economy. I think there's a strong likelihood that the market will rebound."

Before you decide to participate in commodity trading, you should carefully study the disclosure document provided by the commodity pool or trading manager. You should pay particular attention to the description of the principal risk factors attendant to any investment before you invest.

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