BEYOND THE HORIZON

HORIZON FINANCIAL ADVISORS NEWSLETTER

July 2015 Issue

MARKET OUTLOOK

In our last issue of "Beyond the Horizon", we reported that many prognosticators were forecasting 2015 to be another positive year for stocks, possibly gaining another 6%-10%. By late June, U.S. stocks overall are up over 3% year-to-date, outpaced by the international stocks. Bonds, other than the high yields, are showing negative returns year-to-date, as are commodities and real estate. Therefore, portfolio returns so far this year have been minimal.

It's not surprising that the markets are losing steam. This current bull market is now more than six years old (or 2,268 days as of May 22, 2015 when the S&P 500 hit its all-time high). A "bull market" can be defined by the S&P 500 gaining 20% or more without a decline of 20% in between. Of the 11 bull markets that have occurred since World War II, only four (including the current one) have made it through a sixth year. That is why this current upward trend in stocks is due for a reversal.

At this point, we don't anticipate a significant or sustained market downturn in the foreseeable future. A correction, however, defined as a decline in stocks of 10% or more, would not be out of the question. Historically, corrections occur about once a year and last an average of 114 days. Yet the S&P 500 has not experienced a 10% or more correction since October 2011.

One thing that has fueled this bull market and sustained the equity markets is the continuation of low interest rates. Going into 2015, many expected the Federal Reserve to begin raising interest rates, possibly as early as this summer. But the Fed has postponed making any moves as it continues to keep its eye on the economy. It has stated, however, that when it does begin to raise rates, it will do so at a slower pace than it did with previous rate hikes.

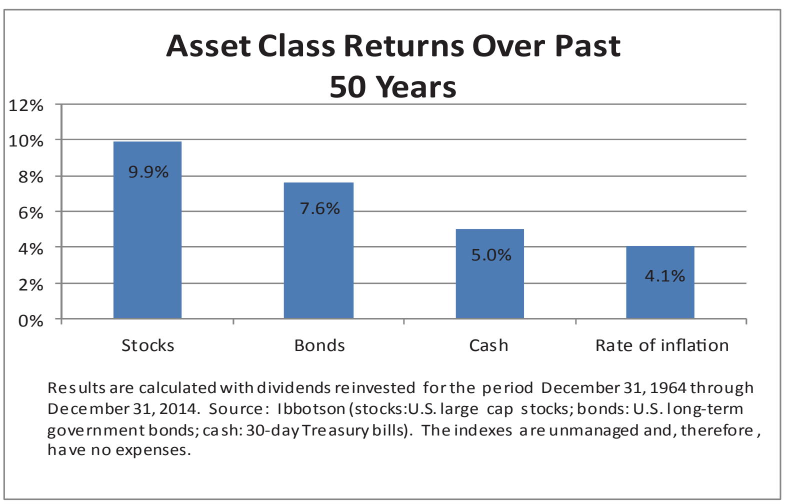
What effect, then, might rising rates have on stocks when the Federal Reserve begins raising rates? Fortunately, rising rates don't necessarily kill bull markets. They do, in the short run, make for a bumpier ride, but historical data shows that bull markets in stocks usually continue once the Federal Reserve goes into a tightening mode. The most recent analysis by Nuveen Asset Management going back to the early 1980s shows that, in most cases, equities performed well prior to Fed rate increases, then struggled or declined slightly after the onset of rate hikes, only to recover and outperform in the two years following the first rate increase.

With a market that's overdue for a correction, does it mean it's time to sell stocks? Not necessarily. It depends on your goals, risk tolerance, and investment time horizon. For example, if you have money in stocks or stock funds that will be needed in the near future, such as for college tuition, perhaps liquidating might be the best option. Conversely, if stocks or stock funds are held in a retirement account that won't be needed for five or more years, selling may not be recommended.

Trying to time the market or guess its short-term moves can do more harm than good. American Funds addresses the subject in their "2015 ICA Guide". They compared making investments at market highs (the worst day of the year) versus during market lows (the best day). Beginning with an annual investment of $10,000 in December of 1995 and each year until December of 2014, the average annual return having invested on the worst day of each year (at the market high) was 7.30%. Conversely, the average return having invested on the best day of each year (at the market low) was 9.00%.

Investors also tend to change their investments and get in and out of the market based on short-term market conditions. There is a cost to getting it wrong. When timing the market, you not only have to get out at the right time but then get back in at the right time, as well. Here is an example that shows why timing can be detrimental. We'll compare two investors who hypothetically invested $100,000 on January 1, 1992 and reinvested all dividends and capital gains along the way. The first investor was very wary. He moved out of stocks and into U.S. Treasury bills on October 31, 2002, shortly after the market reached its low, following the burst of the Tech bubble. By December 31, 2011, that investor accumulated $310,851, for an average annual return of 5.83%. Another investor, who we would consider disciplined, invested the same amount of money at the same time. However, she maintained a diversified portfolio consisting of 60% stocks and 40% bonds. Her only move was to rebalance her portfolio holdings each year to maintain that allocation. By December 31, 2011, she accumulated $445,579, for an average annual return of 7.76%. This proves the point that it's time, not timing, that really matters.

Though past performance is no guarantee of future results, stocks historically remain the best asset class for beating inflation and other asset classes in terms of return over the long term. Over the past 50 years (the period of 12/31/64 through 12/31/14 with dividends reinvested), U.S. large cap stocks have averaged 9.9% per year, as depicted by the chart below, compared to 4.1% for inflation. Conversely, bonds, Treasury bills, and cash have provided lower returns but have been accompanied by lower risk.



In the end, the best asset allocation is the one that suits the client's goals, risk tolerance and time horizon, as well as addresses the current and anticipated market conditions. Over the past year, we have been adjusting our clients' portfolios to reflect what our models suggest as the appropriate asset allocation.

Sources: Hays Advisory; CNN Money; MarketWatch; Nuveen Asset Management; American Funds.

How Much Is Enough?

How much do you need to retire comfortably? If you're already retired, is what you have saved enough? Some say you need $1 million to retire comfortably. Other sources, such as T. Rowe Price, advise you should have 12 times your final pay saved to retire, while Fidelity advises to have saved 8 times your pay. There are plenty of calculators and Monte Carlo simulators that can be found online to help you crunch the numbers. However, there is no magic formula that will work for everyone. Determining how much you need to live comfortably during retirement is a function of many variables, such as guaranteed sources of income, investment return and inflation, spending habits, and life expectancy. We will examine each of these variables further.

When we prepare a financial plan for a client, we show them the ***total*** amount of resources needed to fund retirement, which comes from both income sources and assets or capital saved. Guaranteed sources of income could include pensions and Social Security benefits. It is also a function of when retirement begins versus when those income benefits begin. If one retires early, say age 60, and retirement income benefits don't begin until age 62 or 65, then more assets will be needed to fund the gap until those benefits begin. When the guaranteed sources of income are greater, the need for available assets is lower. Therefore, a husband and wife who both retire with a pension and their own Social Security benefit shouldn't need as much saved (i.e. assets) as a couple without pensions. Many workers today, however, do not have pensions. As of September 2007, as reported by U.S. News & World Report, approximately 80% of state and local government workers had access to a traditional pension, according to the Bureau of Labor Statistics. Most government, teaching, and union jobs came with pensions. But only 21% of all private-sector workers were offered traditional pensions, most of which came from larger companies. Today that number is likely lower. With changes also predicted for future Social Security benefits, the burden will be on the younger generations to fund their own retirement by saving and creating their own resources.

The rate of return on your assets will also impact the amount accumulated by and maintained during retirement. The investments of a more conservative investor will likely not grow as fast. However, it's not just about maximizing return. More aggressive investors run the risk of losing principal due to market volatility. That is why investors typically should take a more conservative approach the closer they get to retirement or needing to draw on their assets. But it's "real return", not nominal return, that matters. Real return takes into account the effect of taxes and inflation on overall return. Therefore, the real rate of return of a taxable investment earning 3.00%, adjusted for taxes and inflation, may in fact be 0% or less. That is why holding stocks or stock funds in a portfolio invested for longer-term growth can be essential, as evidenced by the previous article.

How much you need to fund retirement is largely a function of your spending habits. Some say you will need 70%-80% of what you needed while working to cover expenses during retirement. However, that might not take into consideration big ticket items such as health care and housing. In most cases you will need less income in retirement. After all, you will no longer be paying wage taxes or making retirement plan contributions (i.e. into your 401(k)). But retirement prior to age 65 and Medicare eligibility may mean you pay more for health insurance. As for housing costs, they are usually the largest line item in the budget. That is why it is recommended that mortgages be paid off before retirement to further reduce the amount of income needed.

Lastly, life expectancy or longevity will play a big part in determining how much you need to fund retirement. Without factoring in a possible long-term illness, how long will you need your money to last? How many years will you be retired? According to the CDC, the average life expectancy for women is now 81.2 years and for men is 76.4 years. The answer also depends on whether or not you plan to spend down your assets or leave money behind.

In summary, there is no quick calculation to determine how much money you need to comfortably retire. Therefore, ask yourself these questions: Have you already considered and addressed the above issues? Have you discussed these issues with your spouse, significant other or family? Are you prepared for retirement, whether or not retirement has already begun? After all, planning doesn't stop when you retire. Have you ever had a financial plan prepared? If you answered "no" to many of these questions, and would like to discuss them with us, call our office.

Sources: Time.com; Centers for Disease Control and Prevention

ON THE HORIZON

Throughout the remainder of this year, we will continue to celebrate 25 years since we became an independently-owned and operated financial advisory and investment firm. Our practice has grown and thrived over the years thanks to your business and the referrals of your family and friends, which is very much appreciated. We will continue our anniversary raffle every month through the end of the year. We've given away Kindle Fires, Pirate tickets, golf passes, restaurant gift certificates, and more. If your name hasn't yet been pulled as a lucky winner, there are still six monthly drawings remaining.

We also want to remind you of the newest member to join the Horizon team, Mike Satler. Mike joined us in January and has already passed two of his three exams to be an advisor with our firm. As our new apprentice, he may be calling you from time to time on our behalf.

One last reminder - our newsletter is now being published on a semi-annual (versus quarterly) basis. You can elect to receive it electronically instead of by mail, if not yet doing so, by calling our office and speaking with Darcy. You can also opt to view it on our website and share it with family and friends by visiting www.horizonfinancialadvisors.com.

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