

Quarterly Insight

Wolf Financial Management LLC

Investment and Retirement Plan Services

Summer 2009

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Markets Often Rebound Before The Economy

Given the extreme recent volatility of the stock market and the worsening economy, it's no wonder investors are on edge. Most have suffered significant setbacks during a recession that is already at record length and could continue for another year or more. It hardly seems like the right time to buy stocks. Yet while no one can know for sure when markets will turn around, that typically happens well before the economy gets going again.

The numbers don't lie.

One recent study examined nine recessionary periods defined by the official arbiter, the National Bureau of Economic Research (NBER). According to NBER data charting recessions from 1953 through 2001, the stock market typically declines until sometime during the middle of the downturn and then begins to strengthen.

Starting at the low point of each recession and continuing until six months after its official end, the Standard & Poor's 500 stock index averaged a gain of 36%. That compares with an average decline of 21% for the S&P during a period starting six months before the official onset of each recession and ending at its low point. The average return for an entire recessionary period, including the six months before and after the actual recession, was 8%, and the average recession lasted 11 months.

The positive return is due to the role of the markets as a leading

indicator, meaning that by the time the recession grips the economy, the markets are already looking forward to the eventual recovery. Similarly, much of the drop in the markets occurs in anticipation of the recession, many months before it is made official.

Throwing in the towel. Despite the hard data showing its benefits, buying stocks during the depths of a recession is bound to feel counterintuitive, particularly if you've spent months watching current holdings steadily lose value.

Psychologically, it feels better to jump into the market after prices are already surging and getting out when they're falling. But it's exactly when most investors have finally given up on stocks—a situation market pros call capitulation—that the market is likely to bottom out and start climbing. Capitulation tends to happen when economic news is most dire.

Indications of things to come. In the end, of course, market movements are driven by supply and demand, and stocks won't improve this time just because they've risen under similar circumstances in the past. Still, history can provide important clues about where the economy and markets are likely to go, and economists consider the stock market a leading indicator—a preview of what may be to come for the economy.

Other lagging economic indicators
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Financial Advisors Provide More Than Investment Advice

Choosing investments is only part of our job as financial advisors. Just as important is helping you separate emotion from investing.

Everyone aims to buy low and sell high. Yet, as the dot-com bubble inflated in the late 1990s, investors piled into stocks even as valuations grew to unsustainable levels. What they should have done was shift allocations to bonds or other underperforming asset classes. After the bubble burst, many investors bailed out—selling low—and then avoided stocks for years, missing the bull market of 2002 to 2007.

Last year's market crash again caught investors (and many advisors) by surprise, as the inflation of the housing bubble wasn't recognized until it burst, causing a sharp recession that cut many portfolio values in half. So what are investors doing now? They're cashing out stocks in 401(k) and brokerage accounts in favor of bonds and money market funds yielding next to nothing. They're selling at the bottom of the market, instead of taking this opportunity to replenish stock allocations at low prices.

Doing the right thing as an investor often means ignoring your emotions, and that has never been more difficult than it is today. But as professional investors, we have studied the long-term financial and economic movements that influence markets and investors. We view the current market as an opportunity for long-term investors, and we're here to help you stay focused on your goals.

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. ●

The Cost Of Missing A Market Rebound

Amid the recent stock market carnage and the severe downturn in the economy, the natural inclination of many investors has been to run and hide. But that kind of emotional reaction could work against your own long-term interests. Historically, the best time to invest in the stock market has been when the economy is in the dumps. Investors who wait for conditions to improve before buying stocks are likely to miss the first leg of a bull market—and that, over the long haul, could be extremely costly.

Past performance is no guarantee of future results, and this recession is already one of the worst in history. So it could be

that this time will indeed be different. But during the past nine recessionary periods, beginning in the 1950s, the stock market has staged rousing comebacks that started while the economy was still struggling. If you pinpoint the statistical low point of each of those recessions and measure the performance of the Standard & Poor's 500 stock index until six months after the downturn's end, you'll find returns averaging 36%. And several rallies significantly exceeded that average. During and after the recession of 1953 to 1954, the S&P gained 51% in a little more than a year, and coming out of the recession of 1981 to 1982, the market surged 59%. It's too early to specify this

recession's low point—that will be possible only in retrospect. Still, it officially began in December 2007, and so has already exceeded the average 11-month length of those previous post-World War II recessions.

Most of the market's best days, in fact, have occurred during economic downturns. The accompanying list of the top 10 one-day gains in percentage terms all came while recessions raged. You'll notice that most of those spikes came in late 2008, amid extreme market volatility, and while the broad market was losing almost 40%. Again, to judge by past events, missing the market's sharpest rallies could put a major dent in long-term

What Else Should Be In Your Will?

When writing a will, most people focus on big assets—real estate, securities, and bank accounts. Often overlooked are smaller items, such as jewelry, paintings, and family heirlooms, as well as other instructions that have nothing to do with assets—whether you want to be buried or cremated, for example, or who should clean out your house after you're gone. This begs the question: Exactly what, beyond the obvious, should be in your will?

According to Mary Randolph, author of *The Executor's Guide: Settling a Loved One's Estate or Trust* (Nolo, 2006), "you can do pretty much whatever you want in your will." The question is, will what you want benefit your descendants—or only add to the confusion?

Many people writing wills indicate exactly who should receive specific big-ticket items—a car, a boat, the summer house—then stipulate that the rest of the estate be divided equally among all heirs. That's nice and simple, says Randolph, but it could spark family disputes. "Even in families in which everyone gets along fine, in times of stress, disagreements can bubble up," Randolph says.

Your goal should be to leave specific instructions without getting too complicated. Attaching conditions to a gift, for example, can be problematic.

performance.

Given that accurately timing market moves is virtually impossible, the best way to avoid missing out on a market rebound is to have a sensible, long-term investment plan that keeps you invested throughout the market's ups and downs. By staying invested, you will undoubtedly suffer on the down days, but you'll be sure to enjoy a share of the 80% to 90% of market gains that occur over less than 10 percent of the trading days.

During those aforementioned nine recessionary periods, looking at the performance of the stock market from six months before the recession until six months afterward, stocks averaged a gain of 8%*. So, as painful as it is to watch the value of your holdings tumble, you can

Suppose you'd like to provide your daughter with a financial reward only if she attends college—but what does "going to college" really mean? Does she have to attend full time, or can she take night classes? Does she have to enroll in a four-year university, or is a community college or unaccredited online program acceptable? And is there a specific time frame? What if she attends college in 50 years—does the estate have to reserve enough money to pay her then?

Randolph recommends you think about what material goods are particularly important to your family—your grandmother's china, a favorite painting, an 18th century armoire—and make specific bequests of those items. But those instructions don't necessarily have to be in your will. About half of U.S. states accept a "property memorandum"—a list, outside your will, of personal items you want to leave to certain people. If you choose this route, your will can simply indicate that you wish your personal effects to be divided according to the attached memorandum. This approach saves you the hassle of rewriting and re-notarizing your will if you acquire additional items you want to give away or change your mind about

take comfort in the fact that, over the long haul, the market recovers and moves higher than it was before the economy tanked. ●

***Past performance is not a guarantee of future return.**

A Burst Of Sunshine In A Cloudy Economy

These are the 10 best days, measured by percentage gains, for the Standard & Poor's 500 stock index. All came during recessions.

DATE	PERCENTAGE CHANGE
Oct. 13, 2008	+11.6%
Oct. 28, 2008	+10.8%
Oct. 21, 1987	+9.1%
Nov. 13, 2008	+6.9%
Nov. 24, 2008	+6.5%
Nov. 21, 2008	+6.3%
July 24, 2002	+5.7%
Sept. 30, 2008	+5.4%
July 29, 2002	+5.4%
Oct. 20, 2007	+5.2%

who gets what.

For the remainder of your personal effects, try to come up with a way for heirs to divide things up among themselves. For example, you might let each descendant pick one item and then another, until everything is accounted

for. Or, you might assign everyone a certain number of points, which can be used to bid on individual items. "That way, your children can decide what's important to them," Randolph says. "John may want to spend his

100 points on furniture, while Mary prefers to spend hers on a snow globe."

You can also make specific instructions in your will—for example, that your son gets the job of cleaning out your house, or that you want to be cremated, not buried. But here you may find yourself in tricky legal territory.

First, you need to make such a request in language suggesting it is legally binding. "Saying, 'I want my son to clean out my house,' is not binding," says Randolph. "But saying, 'I appoint my son as executor and direct that he shall sort and divide my personal belongings as he sees fit'" is.

Next, consider when your will is likely to be read. If you want to be cremated, it's better to make that request in a final arrangements document or a similar form, because your will probably won't be reviewed until after the funeral.

Finally, realize that whether you make such requests in your will or another document, they may not have the weight of law. Most state laws don't say anything about how to make final instructions legally binding. Those that do require a form that must be witnessed and notarized—and even then, the instructions have to be followed only if they're reasonable. "You probably can't say you want to be buried in a Cadillac," says Randolph. "Your best bet is to write down what you want according to the laws of your state, and hope for the best." ●



Key Questions For Those Nearing Retirement

Life may begin at 40, but the countdown to retirement starts at age 55. Now is the time to take stock of your savings, goals, and timetable for moving into a phase of life that may last 30 years. These questions can help you gauge how you're doing.

When do you want to retire?

This is a crucial variable. If you're planning to retire early—say, at age 55 instead of 65—you'll not only have to save more, sooner; you'll also need to have the money last an extra decade. On the other hand, if you expect to work well past normal retirement age, that reduces the burden on your nest egg. Another reason to keep working: While you normally can begin penalty-free withdrawals from an employer's qualified retirement plan at age 55, distributions from an IRA before age 59½ may result in a 10% penalty.

How is your money invested?

Though there are no guarantees, a portfolio with most holdings in stocks holds the potential to grow more quickly than one emphasizing bonds or cash. But at this point, you won't have much time to recover from market losses and may need to

reduce your allocation to equities.

That, in turn, could affect when you'll have sufficient savings to leave the work force.

What will you get from Social Security? Government payments may make up only a small percentage of your retirement income, but this variable, too, needs to be part of your retirement calculations. How much you receive depends on several factors, including when you were born and when you apply for benefits. Payments could start as early as age 62, but if you begin then, your checks will be smaller. Wait a couple more years (if you were born between 1943 and 1954, full retirement age is 66), and your checks will be larger. If you live a long time, the bigger monthly checks will more than make up for the few years you did not collect up front.

How's your contingency planning?

An unexpected job loss or serious illness could hurt your retirement plans,

draining savings just when you need to be putting away as much as possible. If you have a cash cushion you can draw on in emergencies, it could stem the damage—but if you don't, build your reserves now. And you may want to invest in long-term care insurance.

How much will you need during retirement? Though rules of thumb suggest you'll need 70% to 80% of your current income to live comfortably after you leave the work force, the amount you should set aside depends on several factors, including the age when you expect to retire, your anticipated housing costs and other living expenses,

and how healthy you are. To be effective, your retirement plan needs to take into account many interrelated variables.

We can help you evaluate many possible scenarios, and if you're in danger of falling short of your goals, we can work with you to get on track before it's too late. ●



Markets Often Rebound

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reflect what has already occurred. For example, a higher unemployment rate typically develops because the economy is struggling; when demand for goods and services slackens, companies often respond by reducing their payrolls. Similarly, inflation may keep rising for months after upward pressure on prices, reflecting an economy at its peak, has already largely dissipated.

Stock prices, in contrast, are based on what investors consider to be a company's prospects. When the economy is at its worst, the road

ahead may begin to seem comparatively bright, and company earnings could start to rebound even while current statistics continue to paint a gloomy picture. And when investors finally stop selling and start buying, rising demand for stocks will push up prices.

Chances are that this time, as in the past, the stock market will strengthen well before the economy and point the way forward for investors. But keep in mind that the sample size of this study is very small; only nine recessions

occurred between 1953 and 2001. Also, the current economic crisis is largely viewed as the worst since the Great Depression, so the rebound may take longer than past recessions.

As always, it's crucial to stick with a long-term investment plan that reflects your goals, timetable, and risk tolerance. We are closely following developments in the economy and investment markets and would be happy to discuss whether any adjustments to your portfolio might be in order. ●

Average return from six months before recession starts until recession low point

-21%

Average return from recession low point until six months after recession ends

+36%

Average total return from six months before recession until six months after recession

+8%

Source: "A Historical Look at Recessions and Stock Market Returns," JennisonDryden, Prudential Insurance Company of America