



FINANCIAL PLANNING *Outlook*



2ND QUARTER, 2011

Who Needs Fixed Income?

For decades, the financial services industry has been pushing the idea that stocks are the way for savvy individual investors to make serious money. As the bull markets of the mid-1980s and late 1990s roared, it became an article of faith that only the timid would resort to buying bonds. Now, with the bear market of 2008-2009 still fresh in our memories, the financial services industry has swung fully to the other direction, pushing the supposed reliability of annuities as the new salvation product.

In both scenarios, a well-constructed bond portfolio gets short shrift. The fact is that a fixed-income strategy can have immense power in any kind of investing environment. There's no doubt that in the short term, stocks can give you much more punch than bonds. Bonds have never had the kind of year that stocks had in 2009, when the S&P 500 returned 26 percent. A bond portfolio also avoids the dips that stocks are subject to, and over the long term, that makes a huge difference.

Barclays Capital has tracked the U.S. corporate bond market over the past couple of decades and compared it to the return from equities. For the 10 years that ended in 2008, bonds actually came out ahead, returning an annual average of 2.3 percent while stocks lost an average of 2.7 per-

cent per year. That includes the crash of '08, of course, but even if you extend the time frame further, stocks don't come out strongly in front: Over the 20-year period from 1988 to 2008, stocks inched ahead, 5.6 percent to 4.9 percent.

For the risk that stocks involve, that's a poor tradeoff for many people, especially given the aging of the American population. The demographics forecast a generation that will be seeking less-risky investments. In 1970, there were about 20 million Americans aged 65 and older. Today, there are roughly 40 million, and by 2040, there will be more than 80 million Americans of retirement age. That's an awful lot of people who will need a reliable source of income to keep them in a comfortable lifestyle after their careers have come to an end.

That combination of a need for a steady retirement income and a desire to reduce the risk of equity investing has helped fuel the popularity of annuities. In a sense, annuities have taken the place of the old defined-benefit pension plans, which have dropped precipitously since the advent of the 401(k). The number of Fortune 100 companies offering defined-benefit plans fell from 89 percent in 1985 to just

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You don't have to decide between the potentially lofty returns from equities and the reliability of an annuity.





Reading the Yield Curve

By Craig Carnick, CFP®

As part of its efforts to jump-start the economy without touching off a round of hyperinflation, the Federal Reserve has kept the interest rates it charges to member banks—the Fed Funds rate—at near-zero levels, which in turn has kept interest rates charged to people like you and me very low as well. The prime interest rate sits right now at 3.25 percent, which is the lowest it's been since 1955.

The other side of this coin is that people who issue debt can pay very low premiums to the people buying that debt. The U.S. government is foremost among these issuers, and as of the beginning of June, it was paying just over 3 percent per year to people who bought its benchmark 10-year notes. Normally, issuers have to pay much greater interest to people who are willing to hold longer securities—the longer the time frame, the greater the risk. However, the 30-year Treasury was yielding just over 4 percent, giving long-term investors a bonus of just over one percentage point. Meanwhile the 5-year was returning about 1.6 percent.

You can graph all those points to see the yield curve, which is currently some-

what flat in historic terms but has been getting steeper. Why does this matter? Because the slope of the yield curve is one of the most powerful economic predictors we have. It's so strong that one measure of the yield curve slope—the spread between 10-year Treasury bond rates and the Fed funds rate—is part of the official Index of Leading Economic Indicators.

When the yield curve has a positive slope, as it does now, it's a sign of growth and, potentially, stronger inflation. An inverted yield curve—when the longer-term bills yield less than the shorter ones—is a strong indicator of a recession: every U.S. recession since 1970 has been preceded by an inverted yield curve.

The yield curve also helps to forecast interest rate movements as well. Basically, if long-term investors aren't demanding a great premium in exchange for holding a security for 30 years, we can deduce that they don't expect interest rates to rise sharply in the near future. Remember, interest rates are historically low at the moment, so there's not much room for them to drop, either. All told, this particular set of tea leaves would seem to indicate that interest rates will rise, slowly and gradually, over the next few years. ■

There Are Still Positives Out There

By William Van Keulan, CFP®

As you may have noticed, at times the market can face headwinds. Gains can become hard to come by and the majority of stocks can be headed in a downward trend. As reality starts to set in, it's understandable that investors will become overly negative, especially with global news reports of Japan's earthquakes, the debt situation and the Middle East unrest. What we must remember, however, is there is always something working in the market. Even in difficult markets, there can be small pockets of stocks catching the attention of investors even though the market as a whole refuses to cooperate. We call this market environment "A Thinning Market". And as the name implies, there are a fewer opportunities to choose from.

In this type of market, gains often come from niche areas you'd least expect. Last year, the consumer stocks in footwear, restaurants and retail helped us deliver 60% gains while the market as a whole returned less than 1/3 of that performance. In 2007, education, agriculture, and select industrial areas delivered 40-80% gains while the broader market tended to take a breather. The point is, that after great stock market runs, there tends to be

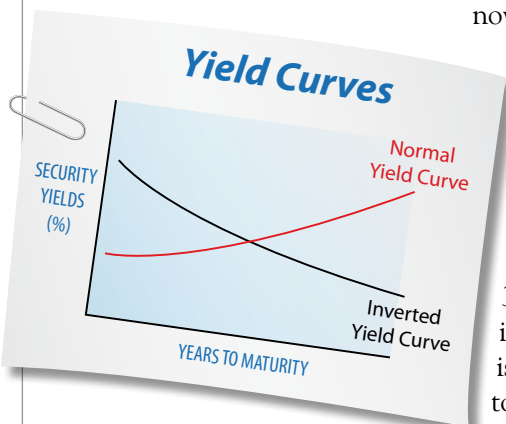
a lull during which only a thin portion of the market is performing.

The key is to pay attention to where those areas are and that is our forte'.

Currently, only healthcare, technology and consumer staple stocks, such as distillers, software and media, are showing positive signs. For example, Herbalife, in the nutritional supplement area, returned a 62% gain so far this year. It could be due to a health conscious baby boomer trend or simply a mad rush to drug alternatives. We generally don't care why, we care "what is" and that we migrate to "what is" working.

So what about the stocks trending downwards? As always, our strategy is to sell weak stocks and either hold cash or purchase stocks from the areas moving upwards. Yes, this does raise the cash levels in accounts, but sometimes it's prudent that we keep our proverbial powder dry and live to fight another day.

Overall, we keep away from trying to figure out how world events are affecting the market and simply try to recognize our situation. For now, we are seeing a narrow market and that means it is a stock pickers environment where active migration into what is working can help returns tremendously. ■



REAL ESTATE PROBLEMS HIT CLOSE TO HOME

By Clarissa Hobson, CFP®

"Today's buyers are also today's sellers". Herein lies a major problem inherent in our current real estate market. While many potential buyers want to take advantage of the still historically-low interest rate environment and the glut of bargain-priced homes for sale, a large portion of these buyers must first sell their own homes before purchasing another. According to the Pikes Peak Association of Realtors, there were 4,866 new listings from January to April 2011, but only 2,252 sales, representing a decrease of 4.2% compared to 2010. Adding to this problem, the Denver Post reports that Colorado is one of two

states leading the nation in increased foreclosures, with Colorado Springs foreclosures up 7.7% from April to May 2011. With tighter lending standards and crackdowns on lenient appraisers, this remains a very difficult market.

So what does this mean if you are trying to buy or sell a home? Buyers remain at a significant advantage. With the average home in Colorado Springs sitting on the market for 94 days, buyers will be able to negotiate on price, closing costs and extras, such as having appliances included in the sale.

For sellers, the market will remain challenging for the foreseeable future. Sales prices will continue to be depressed, particularly with the volume of foreclosed properties coming on the market. The keys to selling quickly include:

- **Pricing your home correctly from the beginning.** Work with a real estate agent or appraiser to obtain a market analysis for comparable recent home sales. For a speedier sale, list your home in the lower range compared to these comparable sales.
- **Make sure your home is in tip-top shape in terms of curb appeal and necessary repairs.** A professional stager can help de-personalize your home and ensure maximum appeal to buyers.
- **Be flexible and willing to negotiate.**

In the heady days of the real estate bubble, homeowners considered their homes investments. Today's reality is that a home is primarily a place to live, the chance of the value increasing as it did in the past is slim to none, and sellers must be patient and flexible. ■



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28 percent in 2007. Annuities have a similar construction: At their most basic level, you deposit money into one over the course of many years, then the annuity provides you with regular payments for the remainder of your life. There are variations on this theme, but for the most part, once you've bought an annuity, you're at the whim of the person managing it.

However, a fixed-income portfolio can meet those needs as well, while affording much more flexibility. A bond portfolio can be tweaked and rebalanced, changing along with your needs and with the larger changes in the economic environment. You can withdraw less or more from the account as needed. Unlike with an annuity, you retain complete control.

That's not the only option for retirement planning. For younger investors, a portfolio with more dividend-paying stocks can be another way to generate income without locking oneself into a single strategy. The idea is the same as with a fixed-income portfolio: The stocks throw off regular income via their dividends, with the potential to also provide steady returns over time. For retirees, whose immedi-

ate need for income is stronger than their desire for long-term growth, that's a very desirable balance. With the American population heading into retirement in swiftly increasing numbers, we expect to see these types of instruments only gain in popularity.

Best of all is a combination of these tactics, working together to provide you with diversification, income, and the promise of a golden retirement. Including a bond strategy and dividend-paying stocks in your overall portfolio may make your investment planning more complicated, but it is likely to pay dividends – literally – for years to come.

The point is, you don't have to decide between the potentially lofty returns from equities on the one hand and the reliability of an annuity on the other. There are avenues to pursue that can give you flexibility, the potential for solid returns, and a steady stream of income as well. While the financial press seeks out the next hot product, you can benefit from turning to the boring old reliables. In retirement planning, slow and steady really does win the race. ■



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