Beacon Investment Management
The Friday Brief

Distributed to our clients and friends weekly

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Is it Time to Get Back In?

The S&P 500 index rose 10% in April, for its largest monthly increase since 2000, despite a steady stream of negative to mixed economic data. Its near-two-month rally has added 29% to the index's value. The story was more mixed for bonds as short term rates fell and long term increased. But the clear message is that both the bond and stock markets are positioning for recovery. Even Thursday's announcement that Gross Domestic Product fell by a whopping 6.1% had no significant impact on the markets.

The Federal Reserve on Wednesday expressed mild optimism on the economy as they refrained from increasing purchases of Treasuries and mortgage securities. Following their two day meeting, the Fed said: "The economy has continued to contract, though the pace of contraction appears to be somewhat slower. "Household spending has shown signs of stabilizing, but remains constrained by ongoing job losses, lower housing wealth, and tight credit." Regarding debt purchases they said: "The committee will continue to evaluate the timing and overall amounts of its purchases of securities in light of the evolving economic outlook and conditions in financial markets." Their optimism was guarded as they said the economy "is likely to remain weak for a time," but they do expect "a gradual resumption of sustainable growth in a context of price stability."

Lower interest rates are showing glimmers of hope for the housing market. Efforts by the Fed and Treasury to lower rates began to take hold in March. The Case-Shiller composite-10 home price index which gives a very accurate picture lags other indicators. The Case-Shiller reported a 2.1% decline in February prices, but sales of existing homes in March hovered near their four-month average and new home sales slipped only .6% in the same month.

Confidence among US consumers rose in April to 65.1 from a 57.3 reading in March, more than forecast. It is the highest level since the collapse of credit late last year, according to Reuters and the University of Michigan. The index reached a three-decade low of 55.3 in November.

Consumer spending rose at a 2.2% pace in the first quarter following its longest slump in nearly three decades. However, economists surveyed by Bloomberg in the first week of April forecast spending will slump at a 0.5% rate in the second quarter before picking up in the second half.

Manufacturing is showing signs of improvement as the rate of decline slows. The Institute for Supply Management's factory index rose to 40.1 last month, higher than forecast, from 36.3 in March. Readings less than 50 signal contraction. Businesses are replacing inventories they allowed to reach extremely low levels in order to sustain current sales. Manufacturing employment showed some signs of life as well, increasing more than 6 points, though still to a very weak 34.4.

As we say over and again, it is corporate earnings (or rather the expectation of those earnings) that drive stock market values. Analysts who were behind the curve as earnings were plummeting now seem to be behind their improvement. Companies beating profit forecasts now outnumber those that trailed by 10-to-1. Sixty-eight percent of S&P 500 companies that released first-quarter results so far have beaten estimates, the most since September, according to data compiled by Bloomberg.

Why do you invest?

If you, like some, threw in the towel and got completely out of the market and now find yourself waiting for some opportune time to get back in, or perhaps you find you have funds that you would have invested without question last year but just can't seem to pull the trigger now; then now's a good time to seriously consider a question – Why do you invest?

There are likely as many answers to the question, why invest as there are investors. Generally, most individuals would say they do so to reach a point where they can claim financial independence; free of the requirements of earning income from a job or business. Businesses invest their free cash in order to fund planned capital outlays as their growth plan requires. Institutions invest their endowments to fund scholarships, professor chairs, and new buildings. And finally, there are those who 'invest' purely for the fun of it. If you fall in this group you may stop reading. If, however, you invest for more serious purposes beyond entertainment, please continue.

Quite simply, we invest to achieve financial goals. We have a pretty good idea of what our goals are and when we want to achieve them, but we still dream how nice it would be to reach them sooner rather than later. But as practical beings we return to reality and generally settle for something less than ideal. With our advisor's help, we develop an investment plan, taking into account our current assets, how much we plan to add during our accumulation years, how much risk we are willing to take to get there, and finally how much and when we expect to spend during our distribution years. If our advisor is good he even weighs our priorities for risk, savings, how long we want to work and how much we would like to leave for our kids as he crafts his recommendations to us.

But what's missing from this plan? Surprisingly it is the very aspect missing from most investment plans, whether one considers individuals, businesses, or college endowments. It is the aspect of *WHEN* risk occurs that is so vitally important to any investment plan, yet it is hardly considered by most and intentionally addressed by even less.

All investors know that risk is certain. To address it they typically focus their attention on past performance to determine how investment choices performed relative to others during market declines – how much less did they lose? By so doing they hope to identify the best future performers for their investment portfolio.

But hear this; even if you could pick the best performing managers with perfect foresight you still bear an ever greater risk. What happens to *YOUR PLAN* if the market drops significantly during a distribution (spending) phase of your life? Will it really matter that you had the best performing mutual fund or managed hedge fund if you still go broke in a downturn? Then why do we give past performance so much consideration in our investment plans while ignoring the impact that certain risk may have if it occurs at the wrong time in our lives?

At Beacon we recognize that market risk is inevitable and unpredictable, so we plan for it. Through our Wealthcare® planning process we model and stress-test, using Monte Carlo analysis, the timing of our clients' cash flows to determine what future portfolio values are needed to provide an appropriate balance between uncertainty and needless lifestyle sacrifice. In other words, we do not ask you to save more or to take more investment risk than is required to confidently meet your goals.

We cannot and would not say that today is that opportune moment to get back into the market, so far it looks like March 9th was that moment. But armed with a thorough understanding of your financial assets, priorities, and goals, we can tell you with confidence what your probability of comfortably meeting them is. Our process is ongoing as conditions and goals change.