



## Fey Asset Management Free Newsletter

*Please call or email us today for a free portfolio review!*

### In This Issue

The Market

Protecting Retirement Assets

### The Market

The market is in an uptrend but inflation is raising its ugly head. MIT developed a real time inflation index, the [Billion Dollar Prince Index \(BPI\)](#) that measures current inflation, rather than looking back like the consumer price Index. The [BPI shows](#) annualized inflation for 12 mo. 3.2%, 1 mo. 5.5% indicating that inflation is accelerating.

[March](#) annualized price increases: Food 9.6%, Gasoline 67.2%, and Medical Care 2.4%. Energy has increased for nine months in a row, rising 23.7% since June 2010. The Fed now has to buy 70% of US Government Bonds, since foreigners decreased their purchases. The dollar is falling. US debt is increasing. The Government so far has failed to put Social Security and Medicare on sound footing. Our health care expenses are twice that of the rest of the developed world with the no better outcome.

#### *April Market Performance*

Currencies: Australia up 7%, Sweden 6%, Switzerland 6%, Brazil 5%, Euro 5%, Britain 4%, Mexico 4%, Canada 3%, China 1%, India 1%, Japan 1%, US\$ down 3.8%.

Asset Classes: Small Growth up 5%, Mid Growth 4%, Large Growth 3%, RAFI 1000 3%, Large Value 3%, Micro Cap 2%, Mid Value 2%, RAFI 1500 2%, Small Value 1%.

Sectors: Silver up 28%, Gasoline 11%, Gbl Carbon 10%, Gold 9%, Biotech 7%, Healthcare 7%, Oil 6%, Priv Equity 6%, Ntrl Gas 5%, US Real Estate 5%, Commodities 4%, Trans 4%, Telecom 3%, Tech 3%, Metals & Mining 2%, Fin 1%, Natural Res 1%, Gbl Solar 0%, Agriculture down 1%, Merger & Arbitr - 1%, Rgnl Bank -3%, Clean Energy -4%.

Foreign Investments: Germany up 11%, Sweden 9%, Europe 8%, S Korea 7%, Australia 6%, Indonesia 6%, World - US 5%, So Africa 5%, Emerg Europe 5%, World 4%, Emerg Asia Pac 4%, China Sm Cap 3%, Emerg Mrkt 3%, US 3%, China 2%, Japan 2%, Malaysia 1%, BRIC 1%, Latin Am 1%, Brazil 0%, Canada 0%, India down 0%, Russia -1%.

Fixed Income: Intl Gvmt Infl Prot up 5%, Intl Tres 4.9%, Natl Munis 2.8%, Invst Grd Corp 2.5%, TIPS 2.4%, Annaly Cap Mgmt 2.2%, Floating Rate 1.8%, US\$ Emerg Mrkt Bnds 1.7%, Emerg Mkts Svgn Debt 1.6%, Hi Yld 1.6%, BuyWrite 1.6%, Mortg Backed 1.2%, Preferred 1.2%, GNMA 1.1%, Absolute 0.6%, CPI Hedge 0.6%.

### Protecting Retirement Assets

We show that investment is risky. We can choose to protect ourselves against some risks but not against all of them at the same time.

#### 1. Introduction

Protecting your retirement assets is concerned with enabling you to achieve your goals. For many of us that means having a cash flow after taxes and investment expenses, despite inflation, that is sufficiently high to maintain our desired life style. Here inflation is the increase in our cash flow requirements, not the [Consumer Price Index \(CPI\)](#). For most retirees this change in cash flow requirements is higher than the Consumer Price Index since, as we age we require more services. Medical expenses and taxes also increase faster than inflation.

What matters for most of us is the cash flow, not the value of our assets. But we are human, not rational machines, and therefore get uncomfortable if our assets fall.

#### 2. Cash Flow Requirement

If you have normal life expectancy and a sufficient cash flow by annually withdrawing 4% or less of your portfolio, you have passed the first hurdle.

If 4% does not give you a sufficient cash flow, you of course can continue with the errors of your ways. More prudently, you increase your income or decrease your expenses or both. It is quite possible to get low paying part-time jobs. It is often possible, but hard psychologically, to downsize or to move to a lower cost area.

It is not rational to expect to be able to withdraw more than 4% of your portfolio per year, or expect that you have a very short life expectancy (unless you are absolutely certain). But life expectancy is a probability distribution with very long tails.

#### 3. Eating Well or Sleeping Well

Returns are related to risk. Risk is the probability that you will not achieve your goal, usually the probability that you will run out of money. High returns generally entail high risk. If you are a billionaire you can keep your money in a money market fund and still have a sufficient cash flow and you don't need to take any nominal price risk. To eat well, most of us need to take the risk of the [Total World Stock Market](#). Putting our assets in a money market fund would be the riskiest strategy we could pursue. It guarantees that we would run out of money.

All investing is risky and has periods of low cash flow. But we have a choice of what kinds of risks we want to take.

#### 4. Annuities

Annuities provide a fixed monthly payment. They reduce the risk of longevity. There are a variety of annuities. The simplest annuity for you and your spouse would currently pay you about 6%/yr. with 3% annual inflation protection that would yield a 3% real return. For most of us this is not enough.

There are variable annuities where the payment depends on the stock market performance. This does not make sense, since annuities are bought to avoid stock market risk. Variable annuities are very expensive.

You can maximize your annuity by choosing a single life annuity and use the difference between joint and single premiums to buy life insurance for the spouse.

If you take an annuity, take it as late as possible so that you benefit as long as possible from the higher returns of better investments.

#### 5. Treasury Inflation-Protected Securities

[Treasury Inflation-Protected Securities \(TIPS\)](#) are treasury securities with interest and principal payment adjusted for inflation. They reduce the inflation risk. The inflation adjustment to the principal is [taxable each year](#) even though the adjustment is realized only on the sale of the bond. Hence, TIPS should be held in tax deferred accounts.

There are also Exchanged Traded Funds (ETF's) such as [TIP](#). TIP yields about 3%. [Total return increased about 8%](#) in the past 12 mo. The 30 year TIPS themselves yielded 5%, 2% interest plus an inflation adjustment of 3% interest and principal. The 2% real yield is not enough for most individuals.

#### 6. Foreign Government Inflation-Protected Bonds

[WIP](#) is an ETF that invests in foreign government inflation adjusted bonds. It yielded about 3% and for the last 12 mo. It had a [total return of about 17%](#). Again 3% inflation adjusted interested return is not enough for most of us. WIP also protects against a fall in the value of the dollar.

#### 7. Diversified Portfolio

What matters is the value of your portfolio, not the value of any one asset. Ideally a [diversified portfolio](#) consists of assets such that if one asset goes down others go up preventing a portfolio decline. The degree to which portfolios move up and down in lockstep is called correlation. Two assets that move in lockstep have a correlation of one, two assets that move exactly in opposition have a correlation of minus one, and two assets that move independently have a correlation of zero.

Unfortunately [most assets have always been correlated](#). No assets have negative long term correlations. Rarely have assets low correlations. Table 1 shows the 3 year weekly correlation of an example of portfolio assets. The assets are [Bonds \(BND\)](#), [Inflation Protected Bonds \(TIP\)](#), the [All Country World Index \(ACWI\)](#), [Technology Stocks \(XLK\)](#), [Foreign Developed \(EFA\)](#), [Emerging \(EEM\)](#), [Real Estate \(IYR\)](#), [Hedge Funds \(QAI\)](#), [Commodities \(GSG\)](#), [Precious Metals \(DBP\)](#), and [Listed Private Equity \(PSP\)](#).

#### 8. Buy and Hold

Buy and hold is still the best strategy. Market timing requires the correct timing of buying and of selling and there is only one individual who knows and he is not talking to us. Many studies have shown that active funds underperform the buy and hold index funds. They underperform primarily because at market turns after a decline actively managed funds are not fully invested, while index funds always are.

#### 9. Bottom Line

- All investments are risky.
- [Generally high returns have high volatility](#).
- Most individuals' portfolios should accept the volatility of the total stock market to achieve the required cash flow.
- Buying and holding a diversified portfolio is the best strategy.

	BND	TIP	ACWI	XLK	EFA	EEM	IYR	QAI	GSG	DBP	PSP
Bonds (BND)	100%	87%	35%	60%	19%	58%	40%	83%	-50%	87%	-19%
Inflation Protected Bonds (TIP)	87%	100%	69%	85%	56%	84%	73%	83%	-4%	92%	26%
All Country World Index (ACWI)	35%	69%	100%	94%	98%	95%	94%	94%	59%	60%	82%
Technology Stocks (XLK)	60%	85%	94%	100%	86%	98%	91%	90%	32%	79%	61%
Foreign Developed (EFA)	19%	56%	98%	86%	100%	89%	89%	93%	69%	45%	87%
Emerging Markets (EEM)	58%	84%	95%	98%	89%	100%	89%	97%	35%	75%	62%
Real Estate (IYR)	40%	73%	94%	91%	89%	89%	100%	87%	54%	63%	81%
Hedge Funds (QAI)	83%	83%	94%	90%	93%	97%	87%	100%	73%	82%	91%
Commodities (GSG)	-50%	-4%	59%	32%	69%	35%	54%	73%	100%	-15%	91%
Precious Metals (DBP)	87%	92%	60%	79%	45%	75%	63%	82%	-15%	100%	13%
Listed Private Equity (PSP)	-19%	26%	82%	61%	87%	62%	81%	91%	91%	13%	100%

Table 1 Three Year Weekly Correlation